



OXFORD ANALYTICA

CHILE

FISCAL TRANSPARENCY

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CHILE



COMPLIANCE RATINGS

<i>Fiscal transparency</i>	2006	2005	2004	2003
Clarity of roles	●●●●	●●●●	●●●●	●●●●
Availability of information	●●●●	●●●●	●●●●	●●●●
Budget preparation	●●●●●	●●●●●	●●●●●	●●●●
Accountability	●●●●	●●●●	●●●●	●●●●
Score	4.25	4.25	4.25	4.00

OUTLOOK & COMMENTARY

Even though Chile will continue to make progress in its fiscal transparency practices -- as demonstrated by the recent enactment of the Fiscal Responsibility Law -- one of the most important issues to follow up in the near future will be the country's management of financial assets coming from the current fiscal surplus. The recent release of the *Treasury Financial Assets Report* constitutes an important first step, but continuous disclosure of this information, its reliability, and the allocations of these resources will be key issues to monitor.

Future challenges for the consolidation of the *State Information System of Financial Management* include the establishment of formal coordinating mechanisms with the Office of the Comptroller General to simplify the centralised procedures framework. The proposal to create new independent tax tribunals is likely to be approved in the near future -- although effective implementation could take longer than expected.

EXECUTIVE SUMMARY

4.25 Compliance in progress

Chile enjoys an efficient and transparent fiscal policy framework, in line with international standards, together with a robust financial system. Chile's new administration -- which took office in March this year -- has reaffirmed its support for this framework.

The recently approved Fiscal Responsibility Law (LRF) has incorporated clear provisions regarding the structural balance framework, and every government must now define the fiscal fundamentals of the administration within 90 days of taking office. Even though some commentators believe that the target of the structural balance rule could be gradually reduced, the 2007 budget proposal maintains the rule at 1% of GDP. Fiscal sustainability is monitored on a regular basis. Moreover, the LRF also establishes a legal obligation upon the National Budget Office (DIPRES) to submit annual information on contingent liabilities and fiscal risks.

Chile complies with the IMF Special Data Dissemination Standard (SDDS), and fiscal information is disseminated in compliance with the IMF's Government Finance Statistics Manual 2001 (GFSM 2001). The transition period has not been without difficulty, and the ongoing second stage of implementation of the GFSM 2001 has been postponed until 2007. Information on municipalities and on extra-budgetary transactions continues to increase. Even though progress has occurred in past years, there continues to be an important gap in Chile's fiscal statistics with the omission of some military activity from budget documentation.

The progressive consolidation of the transactional component of the *State Information System of Financial Management* during 2006 has allowed the elimination of differences in methodology, coverage, and periodicity of information among different government dependencies. The *Public Sector Human Resources Statistics* yearbook has been released for the first time, illustrating the work conducted by the DIPRES in the compilation and systematisation of previously dispersed information, increasing fiscal policy efficiency in the allocation of resources.

The consolidation of a performance-based budgetary system (taking into account programme evaluations, public services performance indicators, and assessments of achievement for management goals in more than 176 public services) has reinforced within government departments the importance of compliance with existent objectives.

The Office of the Comptroller General is perceived as an independent institution, but commentators agree on the need to further strengthen its capabilities. The National Institute of Statistics is working towards the improvement of its practices, in line with OECD statistical standards. However, governance of public enterprises continues to be a cause of concern. An initiative to improve the relevant legal framework was rejected by the Senate in March this year, and there is little prospect that this issue will be addressed in the near future.

Chile's overall score is unchanged from last year.

1. CLARITY OF ROLES, RESPONSIBILITIES AND OBJECTIVES

●●●● Compliance in progress

The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.

Structure, functions and responsibilities of government

The 1980 Political Constitution (as amended in 2005), the 1986 Organic Constitutional Law of General Principles for Administration of the State (LOCBGAE) 18,575, Organic Decree Law 1,263 of the Financial Management of the State (LAFE), and the Fiscal Responsibility Law (LRF) 20,128 -- approved in September this year -- set out the structure of Chile's public sector and fiscal management.¹ The distribution of functions among the different levels of government and intergovernmental fiscal relations are clearly defined. Chile is a unitary decentralised republic consisting of 13 regional governments, with clear separation of executive, legislative and judicial powers. Chile also has a number of autonomous and independent public institutions, such as the Central Bank of Chile (BCC), the Office of the Comptroller General (CGR), the Attorney General, and the Superintendence of Banks and Financial Institutions (SBIF).

The Budget Law covers all institutions that are normally included in the IMF's Government Finance Statistics Manual (GFSM) 2001 definition of central government. Fiscal information is disseminated in compliance with GFSM 2001, and the first stage of implementing this methodology is now complete. All the information about capital flows follows an accrual-based system, although it still needs adjustment to some balances. The next stage of implementation is currently under way, with progress in the elaboration of the *Statement of Government Operations* (SGO), the criteria to register and value financial and non-financial assets in order to build the opening and closing balance sheet, and the consumption of fixed capital in the SGO. The second stage of implementation of the GFSM 2001 was scheduled to be completed at the beginning of 2006, but -- even though progress in some areas is noticeable -- its introduction has now been postponed until 2007. The transition period continues and, while there have been some difficulties, commentators agree on the positive results achieved, including the conversion of historic information, and monthly and quarterly information release. Fiscal information for economic flows in 2005 has been submitted following the SGO.

The relationship between regional bodies and the national government is also clearly defined in the constitution. Each regional government is formed by a number of provinces that, in turn, comprise diverse municipalities. The Budget Law also includes the regions' budgets, which are classified as part of the decentralised government in the LOCBGAE. The municipalities -- being managerially and financially autonomous -- are not incorporated into the Budget Law, but their budgetary procedures adhere to the LAFE principles. Municipal governments may not issue debt without authorisation from the Ministry of Finance (MoF).

The Organic Law of the Regional Councils of 1987 (amended in 1992) and the Organic Law of the Municipalities of 1993 determine taxation powers for each level of government. The government has recently redesigned the *Municipal Common Fund* -- which redistributes municipal tax revenues from the wealthiest to those with lower revenue-generating capacity -- to improve the redistributive components and its efficiency overall.

Coordination and management of budgetary activities

The LAFE contains principles and guidelines for budget management in Chile. This Law establishes the principle of unified budgeting, and requires all incomes to be included in institutions' budgets on a gross basis. The MoF sets up the budgetary and financial schedule, and the National Budget Office (DIPRES) is in charge of drafting the Budget Bill and carrying out budget implementation.² Although formally reporting to the MoF, the budget director is appointed directly by the president, who may dismiss him at any time. The DIPRES also presents general government statistics in its *Public Finance Statistics* yearbook, which are compatible with GFSM 2001 except that they exclude universities and research institutes -- only transfers are recorded -- whose budgets are not approved by Congress. The LRF has introduced amendments to the LAFE, increasing its transparency and disclosure standards. The CGR is responsible for the supervision and accounting of the budget execution, in addition to its auditing duties on public funds. Grants and external loans to public institutions have to be approved by the MoF. Credits to central government entities are subject to a debt limit set in the annual budget law.

Law 13,196 of 1958 (as amended in 1985) -- known as the *Reserved Law of Copper* -- authorises the automatic transfer of 10% of sales made by CODELCO (the state's copper holding corporation) to military procurement.³ Law 19,863 of February 2003 authorises the publication of revenues and expenditures related to the earlier law, and these have become publicly available through CODELCO's balance sheets and the MoF. In addition, publicly available fiscal revenues now include the gross revenues of CODELCO.

There are a few 'above the line' government operations, including the *Copper Revenue Compensation Fund*, the *Oil Compensation Fund*, and the *Infrastructure Compensation Fund*. The 2006 edition of the *Public Finance Report* has enhanced the availability of information on all three of these funds.⁴ The information is presented following the GFSM 2001 guidelines, both separately and consolidated with the information for the budgetary accounts of the central government. As a result of these changes, fiscal statistics show more clearly the evolution of the flows into and out of the copper and oil funds.⁵ Budgetary reallocations do not represent a concern for the regular functioning of Chilean public finances. In addition, the progressive consolidation of a performance based budgetary system has reinforced within government departments the importance of compliance with existent objectives.

The OECD has praised the country's fiscal management in recent years. The main achievement in this area is the maintenance of a counter-cyclical policy stance. This owes much to the gradual reduction in the public debt overhang, resulting from continued adherence to the structural budget surplus rule and its well-functioning, credible mechanism for smoothing copper-related fluctuations in revenues through the *Copper Revenue Compensation Fund*.⁶

Relations between government and public sector agencies

The Central Bank of Chile (BCC) is independent from the government, as established in the constitution and the BCC's Organic Law. It may not perform lending operations to the government, except in a state of emergency. Moreover, the BCC cannot engage in transactions with the non-financial private sector. Following the mid-1980s banking crisis, the central bank purchased a substantial amount of public debt and banking assets, which have led it to incur losses amounting to approximately 1% of GDP. The combination of substantial prepayments of this liability during 2005 and 2006 -- owing to the large fiscal surplus attained -- and the recapitalisation process contemplated in the LRF will help to meet the government's commitment to cancel the debt by 2014.

The regulatory framework for the financial system is based on internationally accepted criteria. The Superintendence of Banks and Financial Institutions (SBIF) is independent and has administrative autonomy, with the constitution and the General Law of Banks regulating it.⁷ Chile's president appoints the SBIF's executive director. The SBIF authorises the creation of new banks and has wide powers to interpret and enforce regulations. A number of corruption scandals in the financial sector have shown the need to improve coordination and information among different regulatory bodies. A stronger coordination of the supervisors of pension funds, banks and capital

markets would be desirable owing to the size of the Chilean market and the intertwined relations between the largest banks, pension funds, and stock market participants.⁸ Progress towards the improvement of coordination mechanisms among superintendences has been slow in the past year.

Government involvement in the private sector

The government's commercial and non-commercial activities have separate budget processes and are covered by different legal procedures. A qualified majority in Congress is required to create new public enterprises or expand their activity. Commercial activities are often subject to oversight and control like any other private institution, adhering to commercial law and regulations governing private enterprises. The government disseminates the activities, balance sheets and financial statement of its enterprises. A quarterly *Public Enterprises Financial Report* is publicly available. Information on quasi-fiscal operations of public enterprises is publicly available in the budgetary documentation.

There are two types of state-owned enterprises, depending on the level of government ownership. The *Production Development Corporation* (CORFO, established in 1939) is the vehicle through which the government invests and has equity holdings in different industries -- such as health institutions, service providers, the national lottery, and coal industry. These companies, subject to the same supervision guidelines as private firms, are managed by the *System of Public Enterprises* (SEP) -- created in 2001 -- and have to issue financial reports to the public once a year.⁹ The budget law requires the executive to release semi-annual financial reports to Congress for these firms. Quasi-fiscal operations undertaken by CORFO enterprises are funded with government transfers registered in the Budget Law.

Additionally, the government has majority ownership in enterprises like CODELCO and others that are left out of the SEP scheme. These enterprises follow their own budgetary procedures, not necessarily following the LAFE guidelines, but are subject to the MoF's approval. Similarly, budgets for public universities are not governed by the LAFE and are not included in the annual budget law.

The governance of public enterprises -- especially CODELCO -- has been at the forefront of public scrutiny because of the reported shortcomings in management, which demonstrated the broad powers that administrators of these enterprises have.¹⁰ In 2005, the government extracted the corporate governance section from the Capital Markets II draft law, and submitted an autonomous project to Congress.¹¹ However, the initiative was rejected by the Senate in March 2006, and there is little prospect that this issue will be addressed in the near future. Although public-private partnerships have contributed in recent years to a reduction in Chile's infrastructure deficit, governance will need to be enhanced in order to safeguard the budget from undue exposure to contingent liabilities.¹²

In August 2005, CODELCO established a procurement registry in order to disclose a list of companies in a position to work with the copper state enterprise. Procurement contracts will be granted only to companies previously registered. CODELCO's annual reports are publicly available both in Spanish and in English, and the 2005 version has increased the amount of information publicly available.¹³

There are a few public financial institutions, *Banco del Estado* being the most important. These institutions are regulated by the BCC and supervised by the SBIF. *Banco del Estado* -- increasingly operating as a regular commercial bank -- has a market share of around 12% and performs quasi-fiscal activities. The bank is not covered by the LAFE, nor included in the budget law. The bank has a politically driven development role, but this is carried out within reasonable economic parameters.

There should be a clear legal and administrative framework for fiscal management

Legal framework for budgetary activities

The constitution tasks the executive, through the MoF, to present a Budget Bill to Congress, which only has power to reduce or eliminate spending. If Congress has not held a vote on the budget within 60 days after submission by the president, the bill automatically becomes law. Congress discusses the budget in a special joint commission, whose report goes to the Chamber of Deputies and Senate for approval. The LAFE centralises the fiscal process in the MoF, which gathers budgets of other ministries, agencies, and regional governments to assemble the bill. Moreover, the LAFE also regulates accounting, the management of funds, financial control and public credit.

The approved Budget Law therefore includes all government revenues and expenses other than the exceptions described above. The law is introduced together with a financial statement that considers the previous year's budgetary execution, and also the new financial requirements necessary to meet both the annual fiscal targets and the medium-term financial plans. The MoF has broad powers to meet fiscal targets, including the authority to review and authorise any actions that would require future disbursements. It also has capacities to reduce budgeted government spending, and propose extra-budgetary increases that require congressional approval (except for economic emergency situations).

In September 2003, Congress passed Law 19,896 giving permanent legal status to different regulations that were previously included in each year's budget law. This law also establishes the obligation to publish annually a *Public Finance Report* (PFR).¹⁴ The law includes a number of legal contents that the PFR must have, unifying in one core document previously fragmented information.

The Fiscal Responsibility Law (LRF) that was approved in September 2006 is intended to improve the fiscal transparency regulations, increase management procedures, and provide a clear framework for the use of fiscal surpluses. The new legislation incorporates clear provisions regarding the structural balance framework of the country and introduces the *Unemployment Contingency Programme* as a permanent budget item to tackle the potential for high unemployment problems at a national, regional, provincial and municipal level.

The Fiscal Responsibility Law creates a *Pension Reserve Fund* to cover future expenditures arising from the current legal framework on minimum pensions, establishing a minimum annual contribution of 0.2% of GDP to this fund, an amount which can be increased to 0.5%. Minimum established transfers to the *Pension Reserve Fund* will be made, even in a budget deficit scenario. The sustainability of this fund -- whose resources cannot be used until 2016 -- will be assessed by the MoF every three years. The LRF also authorises the central government to transfer to the BCC up to 0.5% of GDP for a period of five years, starting in 2006. This recapitalisation scheme will operate after the transfer to the *Pension Reserve Fund* has occurred, and only in a budget surplus scenario. Even though there is no mandatory obligation to make this transfer, there is widespread consensus that it will effectively take place while the fiscal surplus continues.¹⁵

The LRF also establishes a new *Economic and Social Stabilisation Fund* designed to compensate for drops in revenue in periods of slower growth and/or lower copper prices, and to finance any future deficits as an alternative to borrowing. Resources will come from fiscal surpluses (after the deductions to the *Pension Reserve Fund* and the transfers the BCC have been done), and assets accumulated in the *Copper Revenue Compensation Fund* will be transferred into the stabilisation fund, unifying both instruments. Resources from this fund can be used to make the transfers to the *Pension Reserve Fund* when there is a budget deficit. Specific regulations for the operation of the *Economic and Social Stabilisation Fund* will be enacted by presidential decree in the near future.

Information on the newly created funds will be publicly available on a quarterly basis. It has yet to be announced whether their administration will be conducted by the BCC or by external portfolio investment managers.

Legal framework for taxation

Taxes are determined by law and provide no discretionary powers to the government. The Internal Tax Service (SII) is responsible for the general management of taxes, while the National Customs Service (SNA) is responsible for tariffs and other foreign trade duties. The treasury is responsible for managing the tax revenue process. A permanent commission has been established to coordinate these activities, chaired by the head of the SII. Both the SII and the SNA have procedures to challenge tax decisions, and are legally protected from political influence. Tax laws are relatively simple, the SII and the SNA websites provide information about the tax code and tax dispute procedures, and analysis of tax expenditures prepared by the SII are publicly available. Commentators have praised the SII's technical capabilities, and it is considered one of the most efficient public services. The new management of the SII -- which took office in March 2006 -- has released a *Taxpayer Rights* resolution aiming at simplifying the current tax framework, improving compliance and increasing efficiency. Moreover, tax payments can be made via the Internet, and coverage of electronic filing for income taxes reached 96% during 2005. The customs service is developing a project to permit full Internet tracking of imports through to clearance.

Chile's tax code contains clear provisions regarding taxpayers' legal rights and arbitration procedures. After almost four years since first being introduced, the proposal to make first-round tribunals independent of the tax agencies, and to create chambers with independent tax expertise within the Court of Appeals, has been revamped. An updated version that would guarantee the independent selection of tax judges was submitted to Congress in September 2006. The allocation of resources to finance the functioning of the proposed 16 new tribunals is among the key obstacles for its implementation in the near future.

Ethical standards for public servants

The 1989 Administrative Statute of Law 18,834 sets supervisory controls and conduct conventions for all public sector employees. The Administrative Statute also establishes principles of probity and confidentiality in legally restricted affairs, and prompts reporting of any knowledge of irregularities. Complementary legislation for the code of conduct for government staff is set by the *Administrative Probity Statute* established in Law 18,575 (of 1986) and Law 19,653 (of 1999).

Following the amendment of Law 18,575 in early 2006 -- introduced by Law 20,088 -- higher public officials, members of parliament, members of the electoral courts and members of the Constitutional Court must submit, under oath, a detailed written statement of their assets. The statements, which are made public, are presented to the CGR or regional comptrollers, and must be updated every four years or each time the official moves to another office.

2. PUBLIC AVAILABILITY OF INFORMATION

●●●● Compliance in progress

The public should be provided with full information on the past, current and projected fiscal activity of government.

Chile has efficient budgeting procedures, and the public has access to comprehensive and timely fiscal reports. The annual *Public Finance Report* (PFR) is considered a significant instrument for public availability of information, including data on fiscal policy, government statistics, projections of the structural balance, and performance criteria for budgetary programmes.¹⁶ Information on tax expenditures is also reported in the publication. The PFR -- first published in 2002 -- constitutes a relevant tool to present fiscal information, together with explanations for the legal framework and methodological changes, and increases the transparency of the budgetary process.

The *Report on the State of the Public Finances* and the PFR are included in the Budget Bill, and provide detailed disclosure of the previous four years' fiscal activity, a three-year forward financial plan, the structural surplus targets, and the assumptions and guidelines used to make the projections. The Budget Bill itself includes an analysis of general macroeconomic conditions to explain the assumptions and guidelines used to estimate government revenues and expenses. The *Public Finance Statistics* yearbook includes consolidated figures for central government, general government, public enterprises, public debt, and the non-financial public sector for the previous ten years. Starting in 2005, the amount and quality of information provided in this report have been substantially improved, and it is now considered a useful tool for reviewing and assessing financial statistics.¹⁷ The DIPRES website has an online system that analyses the budgetary impact of legislative government projects within a four-year framework.

The 2005 amendment to the Political Constitution has incorporated the right of access to public information -- Article 8 states that the acts of every public institution are deemed public knowledge and their underlying principles should be made publicly available. However, legislation regarding clear procedures for granting access to information and specific restrictions for the general principle is still pending.

Central government operations

The DIPRES submits to Congress -- and publishes on its website -- monthly, quarterly, biannual and annual reports on budget execution, and audited annual balances and quarterly financial statements of public companies. The DIPRES reports central government operations on a quarterly and annual basis. The results of quarterly budget-execution reports are compared with the relevant Budget Law and with previous years' performance. Annual reporting not only includes the year's budget accounts, but also the functional execution of the budget. Execution of central government agencies (at a programme level) is published quarterly, and monthly information is also available.

Despite Chile's progress in enhancing fiscal transparency, there is still a need to clarify and disseminate information on some other areas. Budget documentation does not provide detailed information on resources under the *Reserved Law of Copper* and the 'reserved spending'. The latter is a reserved expenditure line limited to the Office of the Presidency, the Ministry of Home Affairs, the Ministry of Defence and the Ministry of Foreign Affairs, and is reported but not itemised. Law 19,863, passed in 2003 and the first law in seventy years to regulate the government's use of discretionary funds, has increased the transparency of this spending, decreasing the amount while limiting the purposes such funds can be used for and making them accountable to the CGR. Reserved

expenditure has been decreasing in the past years, and currently represents 0.02% of total expenditure -- down from 8.1% in 1980.

Under the *Reserved Law of Copper*, CODELCO must transfer 10% of its export returns directly to the armed forces. The Law guarantees a minimum level for this transfer (approximately 75 million US dollars for each of the three branches of the military), and if copper prices are at a low level, the government has to make up the difference out of the fiscal budget. In 2005, due to high international copper prices, the government introduced a *de facto* limit on spending of these transfers, which coincides with the minimum guaranteed by law. Spending above this amount requires authorisation from the MoF, with part of the additional amount used to form a stabilisation fund for future military acquisitions.¹⁸ This procedure will be used for as long as copper prices remain within historical trends.¹⁹

An important gap in Chile's fiscal statistics is the omission of some military activity from budget documentation. Since 2002, however, the government reports the transfer of 10% of CODELCO's sales to the armed forces. The availability of records of consolidated spending information is considered an important step towards full disclosure of military accounts. Information on military spending aggregate is released every three months and is also included in the *Public Finance Statistics* yearbook. Following Article 19 of LRF, information on military revenues, expenditures and debt must be submitted on a quarterly basis to the DIPRES. In addition, the new legislation establishes that military investment projects -- excluding those involving national defence -- will have to be evaluated by the Ministry of Defence following a pre-established mechanism.

Public sector operations

The DIPRES reports on the general government, including municipalities and decentralised public institutions, on a regular basis. Municipalities are subject to the same standards of fiscal accounting as the central government. Even though there is room for improvement, the quality and periodicity of information from municipalities has been increasing during the past years. Sub-national levels of government report yearly to the central government, but information is usually less comprehensive than at the national level.²⁰ Financial information for the municipalities is available for the same year as that of the central government and included in the annual *Public Finance Statistics* yearbook.²¹ Spending information at this level has also been improved both in its quality and timeliness. The financial activities of municipalities are overseen by the CGR, which prepares quarterly consolidated statements on their budgets, finances and assets on the basis of monthly reports that the municipalities produce.

The CGR releases information on public financial institutions, as does the BCC in its *Financial Management Report of the Public Sector*. The government discloses a consolidated balance of state-owned enterprises on a quarterly basis and information on budget execution, quasi-fiscal operations and contingent liabilities. Reports on the non-financial public sector are published annually. These reports include information on net debt. Following analyst concerns about the lack of information regarding contingent debt taken to countenance public works, the government includes detailed information on concessions of public works in the annual PFR.

A commitment should be made to the timely publication of fiscal information.

Chile subscribes to the IMF Special Data Dissemination Standard (SDDS).²² Data on general government operations are disseminated in millions of Chilean pesos. The data cover the budgetary units of central government (which include the Social Security Funds managed by the public sector) and the local government entities. Chilean data are generally perceived to be of good quality, and timely and adequate for surveillance purposes -- in line with international standards. Even though the DIPRES already fulfils the legal requirements for publishing fiscal information, it continues to improve the timely disclosure of information, enhancing its frequency and amount.

Starting in 2004, the methodology to report data on government operations has changed in order to observe more closely the guidelines prescribed by GFSM 2001. Explanations of these changes are publicly available at the DIPRES website. Monthly data -- compiled only for central government -- do not consider extra-budgetary components, although these are included in quarterly and annual data. Official data adapted to the new methodology are publicly available for the central and the general government operations and the consolidated public enterprises, and include monthly and quarterly breakdowns for central government data. Moreover, assessments are conducted following an impact evaluation process of government operations. Budgetary classifications have been adapted to the new methodological framework, and a functional classification of expenditures (both budgetary and extra-budgetary) for 1987-2005 has been released in the past year. Treatment of interest payments on inflation-indexed bonds and on debt owed to the central bank differs from the GFSM 2001. The ongoing second stage of migrating fiscal statistics to the new system includes the development of estimates of consumption of fixed capital and fully consistent opening and closing balances.²³ The construction of comprehensive balances with information on assets and liabilities of the central government is also part of the migration process.²⁴

Information on financial aspects of public investment has increased with the release of a new *Treasury Financial Assets Report*. First released in May 2006, this is available on a quarterly basis and includes capital markets' participation with detailed information on the allocation of resources both in the country and abroad. The move was fostered by the fiscal surplus generated by high copper prices and the need to keep the market informed about the allocations of public resources. Detailed quarterly data on revenue and expenditure are published within 60 days of the reference quarter, and annual financing data are released within three months of the end of the year. The Budget Law requires the release of quarterly information within 45 days of the end of the period, but in practice the time lag has been reduced to 30 days.

Debt reporting

Chile releases a comprehensive amount of debt information. Statistics on public debt and financial assets are compiled and reported by the MoF on a quarterly basis. Reporting of central government debt follows SDDS requirements, including for various classifications of the debt stock. The frequency of the *Public Debt Report* -- providing consistent debt information on the central government, the central bank and public enterprises -- has been increased in the past year, and this report is now released on a quarterly basis. Reports on central government debt include information on payment schedules, maturities and lenders. In addition, both the *Public Finance Statistics* yearbook and the *Financial Evaluation of the Public Sector* report include a detailed section on debt and financial assets of the public sector, including data on net and gross debt and on public assets. Information publicly available includes a classification of central government debt, together with a progression of debt stock since 1990. The recently approved LRF has increased public availability of information on the armed forces, including periodic data on capital flows and debt from the *Reserved Law of Copper*.

Advance release calendars

An advance release calendar that provides one-quarter-ahead notice of the precise release dates is disseminated on the DIPRES website.²⁵

3. OPEN BUDGET PREPARATION, EXECUTION AND REPORTING

●●●●● Full compliance

Fiscal policy objectives, macroeconomic framework and risks

Fiscal policy objectives

A statement of fiscal policy objectives is included in the *Public Finance Report*. This publication also includes the government's medium-term fiscal policy objectives and priorities for the following three years, explanation of changes in fiscal rules, and budgetary reallocations for the preceding three years. The budget preparation process makes a distinction between existing commitments and new policies. Since 2001, a new methodology has distinguished between inertial and 'incremental' outlays. The gap between inertial expenditure and the total expenditure permitted by the structural balance target determines a pool of available funds for which competing proposals can be considered. Proposals have to include a clear presentation of objectives, expected results, coverage, resource requirements and evaluation indicators.²⁶

Macroeconomic framework

Chile prepares medium-term financial plans that include the relevant fiscal year and three years ahead. Income and expenditure forecasts are based on publicly disclosed assumptions on economic growth, inflation, interest and exchange rates, and copper prices. This framework includes a rolling medium-term expenditure exercise based on forecasts by budget item and programme. The projected outcomes are then compared to the structural surplus rule of 1% of GDP to identify any sources of fiscal imbalance.

Each year, the MoF presents the budget proposal for the following period before the Special Budget Commission in Congress. This presentation includes some general remarks regarding macroeconomic forecasts, which are also publicly available through the PFR.²⁷ One month before this presentation, the BCC has to submit a report of advances and changes in inflation targets to Congress. The BCC's report also includes a section on macroeconomic forecasts. Forecasts prepared by both institutions are generally homogeneous.

Fiscal risks

In the past, analyses of fiscal risks were included in the Budget Bill when identified, but they were not presented within a systematic methodology. However, the recently approved LRF establishes a legal obligation upon DIPRES to submit annual information on contingent liabilities and fiscal risks. The 2006 PFR presents a special section on these issues, assessing the impact of pensions and ongoing fiscal projects, including infrastructure projects.²⁸ A more methodological and comprehensive information system is expected to be published in the 2007 version of the PFR.

Fiscal sustainability

The budget is prepared and presented in a medium-term framework, with two main elements, namely a target for the structural balance and a medium-term financial projection. Fiscal sustainability is monitored on a regular basis. Since 2001, Chile has followed a budgetary process aimed at achieving an annual structural fiscal surplus of 1% of GDP.²⁹ The methodology follows IMF and OECD guidelines to determine revenues and expenses should the economy reach its potential output and copper prices remain within historical trends.³⁰ The 1% structural fiscal

surplus methodology, however, lacks a debt ceiling to ensure fiscal sustainability. Moreover, the balances of the central bank and public enterprises are excluded from this methodology. Chile has met structural fiscal targets, and the high price of copper helped in the accumulation of recent fiscal surpluses. The fiscal surplus in 2005 was 4.7% of GDP, and estimates put this figure at 7.6% for 2006.

The structural fiscal surplus methodology has increased transparency and accountability by defining a specific medium-term fiscal policy path, that removes policy discretion while not suppressing automatic stabilisers. The use of expert panels to determine cyclical adjustments to meet the rule has enhanced transparency and credibility. There is a widespread perception about the positive impact of the rule with regard to the sustainability of public finances, and it has also proven to be an effective counter-cyclical tool to the economy since its adoption.³¹ However, according to the 2005 OECD Economic Survey on Chile, while the principle of the structural budget rule should be maintained, the actual level of the structural budget balance will need to be set for the near term.³² In doing so, it will be important to consider the pressures on the budget that could arise in the coming years in connection with the pension system, in addition to the financing needs of the central bank.

The LRF has incorporated clear provisions regarding the structural balance framework of the country, improving transparency and predictability. According to the new provisions, every government has to define the fiscal fundamentals of the administration within 90 days of taking office, and has to publish the methodology used to calculate the structural balance -- although it can be modified during the four year period, providing that Congress is informed of the changes. The current administration was granted 60 days from LRF's publication to publicly disclose its fiscal policy framework. It is worth noting that the LRF does not mandate the government to set up a structural surplus rule of 1% -- like the one applied since 2001 -- but establishes clear rules about the structural balance framework. The provision leaves room for manoeuvre regarding the establishment of the surplus figure in case the macroeconomic fundamentals change, and this is perceived as an important advance from previous unwritten practices.

The government works in close collaboration with independent expert panels to determine the critical inputs to the estimation of medium-term forecasts: the prices of copper and molybdenum, the labour force, capital accumulation and total factor productivity. Statements identifying panel members and documenting results are publicly available. The use of expert panels in measuring the structural balance is a key component in ensuring the transparency and credibility of the fiscal policy rule. Information regarding the methodology used to calculate the rule has been enhanced since first applied in 2001. The government includes the transfer from CODELCO to the military -- resulting from the *Reserved Law of Copper* -- to calculate the structural balance rule.

According to some commentators, the target of the structural balance rule could be gradually reduced -- without diluting prudent fiscal management -- due to the solid fiscal position of the country and the continuous reduction of the public debt. However, any move in this direction should include keeping the resources accumulated in past years.³³ The 2007 budget proposal maintains the structural surplus rule at 1% of GDP, and there is little indication that the target will be changed in the near future.

Even when the fiscal surplus rule has strong merit per se, there is still some room for improvement. At present, the structural budget target is measured against actual rather than potential GDP, which would tend to introduce noise into the interpretation of fiscal developments when there are unexpected changes in the business cycle.

Budget presentation

Data reporting

The Budget Bill is available in early October of the preceding fiscal year. The document includes a detailed presentation of fiscal targets and policies to be implemented in the following fiscal year. The approved Budget Law is published with a description of appropriations and the cash plan. Previous years' budgets and execution reports are also publicly available. A Budgetary Report on central government operations is published on a quarterly basis.

The 2007 budget proposal -- the first presented by the current administration -- has been submitted with an unusual display of communications by the government, although information on the budget figures had been kept secret until its submission before Congress.

In order to provide greater consistency to budgetary information, the DIPRES provides clear guidelines on submitting budget initiatives for public institutions. The budget is developed according to administrative categories, but also reported broadly on a programme basis. The specification of programme objectives and their link to performance indicators and evaluation procedures is highly developed in the budget presentation. In December 2003, DIPRES published detailed guidelines for conducting the evaluation of government programmes, which were enhanced a year later by a *Technical Notes Report*. One of the main objectives in developing these guidelines -- currently being applied -- was the need to unify criteria and define previously unwritten conventions.

Budget execution and monitoring

Chile continues to make progress in monitoring budget execution and improving its budget-performance methodology. The DIPRES and the CGR are implementing a *State Information System of Financial Management* (SIGFE) that includes a complete overhaul of the methodology followed by government agencies and municipalities. The core objective of this programme is to establish an integrated system of checks and balances within government departments designed to monitor spending according to budgetary allocations, together with addressing some deficiencies in the quality and reliability of budgetary information. The transactional component of the system has become almost fully operational in the past year, with 90% of central government departments using SIGFE.³⁴ The system enables daily electronic recording of fiscal disbursements and budget execution, increasing transparency and timeliness in fiscal management and reporting.³⁵ The CGR has recently performed an overall evaluation of SIGFE in order to facilitate the identification of its problems and to gather suggestions from users. Future challenges for the consolidation of SIGFE include the establishment of formal coordinating mechanisms with the CGR to simplify the centralised procedures framework.³⁶

The DIPRES regulates budget execution following a monthly programme, with results regularly posted on its website. In addition, consolidated budget execution information is also publicly available at the DIPRES website. Government propositions to distribute public funds take place from an increasingly consolidated budget-performance mechanism, which takes into account programme evaluations, public services performance indicators, and assessments of achievement for management goals in more than 176 public services. Budget documentation also includes *Strategic Definitions* for public institutions covered by the annual budget. These are usually the result of conversations between each specific institution and the DIPRES.

Evaluation of budgetary programmes includes the involvement of expert panels, the periodic revision of their recommendations, and the strengthening of human resources expertise within the public sector. The recommendations from the 138 programmes evaluated in the 2000-2006 period have resulted in 24% of these programmes introducing major redesign or institutional changes, while 38% underwent substantial design

modifications, and 25% have had to improve their information systems and make minor changes to management processes. About 8% of the programmes evaluated were eliminated in the light of their results, or because their objectives no longer responded to new requirements, and 5% have been institutionally reallocated.³⁷ Assessments of budgetary programmes are sent to Congress and made publicly available.

The DIPRES is committed to scrutiny and evaluation of government programmes in order to maximise budgetary allocations. Assessments of 14 government programmes were completed and sent to Congress in 2005, and 13 programmes have recently finished the evaluation process for 2006. In addition, the DIPRES works with public institutions in charge of the programmes assessed in order to address the shortcomings detected. Availability and systematisation of these assessments at the DIPRES website have been improved in the past year.³⁸ However, concerns have recently emerged regarding the real follow-up and implementation of recommendations and the overlapping of some budget execution instruments.³⁹

The development of performance indicators -- mainly focused on social and economic impact -- is an important element in the country's fiscal framework. Performance indicators, goals and targets are prepared between the MoF and government agencies, and discussed with DIPRES to ensure their consistency with budget appropriations. Their presentation follows pre-established guidelines and a calendar, both of which are publicly available at DIPRES website. The number of government agencies working with performance indicators continues to increase.⁴⁰ The 2007 budget includes 1,445 performance indicators for 139 public services (an average of 10.4 indicators per service), up from 275 performance indicators for 72 public services in 2001. Detailed information for performance indicators used since 2002 within government ministries is publicly available.

An assessment of the 2005 performance indicators has been included in the 2006 PFR. A total of 1,552 indicators (representing 98% of indicators used during 2005) have been evaluated, with 88% of indicators achieving between 95% and 100% of fulfilment. Only 7% of the performance indicators for the 2005 fiscal year achieved a rate of fulfilment below 80%. The annual PFR provides comprehensive information on the budget-performance system in place, including an evaluation of performance indicators, budget programmes, impact evaluations, and management improvement programmes. The system has been continuously improving since its introduction in 2001, and a comprehensive performance culture is perceived among public institutions.

The *System of Management Control and Results-based Budgeting* (SCG) -- an ambitious programme being developed by the DIPRES to build a logical framework for all public programmes -- seeks to orient public management towards results and to improve the efficiency of public spending. Starting in 2005, the introduction of interactive electronic resources has helped to increase the coherence of the database. The *Evaluation Programme* (including Programme Evaluation, Impact Evaluation and Comprehensive Spending Reviews) is one of the six instruments used by SCG.⁴¹ The programme has received praise from the World Bank, which noted that positive external conditions -- in particular the power of the budget office, good financial management and an increasingly higher degree of professionalism in the country's public officials -- constitute a key element of the SCG's continuing success. Recommendations made to strengthen the current framework include development of indicators that link the results with superior objectives, the reinforcement of their use by all institutional actors -- especially all ministries -- and the consolidation of instruments to measure the impact of programmes.⁴² The public availability of information from the SCG has increased appreciation of its results by independent analysts.

The past year has witnessed a progressive consolidation of the *Management Improvement Programmes* (PMGs), including the implementation of workshops aimed at expanding their use within the public administration. PMGs are used as instruments to improve public services and are based on common strategic areas within the public sector. Fulfillment of pre-established goals grants remunerative incentives for public officials. Publicly available information regarding PMGs has been expanded.⁴³

The DIPRES -- following a protocol signed with the congressional Special Budget Commission -- continues to work on the standardisation of the procedures and rules used in the PMGs in order to achieve certification under the International Standard Organization (ISO) 9001:2000 regulation.⁴⁴ Explanation of the goals and procedures that are being used to achieve ISO certification for PMGs -- currently formulated by public institutions in collaboration with independent experts -- is publicly available at the DIPRES website.⁴⁵ A list of PMGs in the process of ISO certification is publicly available.

Accounting basis

The general principles of government accounting are established in the LAFE, which also gives the Comptroller General responsibility for assessing the public sector accounts. Rules of the public sector accounting system are consistent with international standards. Chile has implemented a financial accounting system that requires all government levels and agencies to report their budget execution (including public investment) as well as meeting specific monitoring criteria. The system includes management incentives that allocate an additional 2% (of their corresponding budget) to the best performing units.

Fiscal policy information is mostly submitted following the accrual-based methodology established in GFSM 2001. Since 2005, public-services transactions are recorded under an accrual-based accounting system. In addition, progress has been made in preparing the *Statement of Government Operations* (SGO), and the gross operating balance is now calculated as indicated in GFSM 2001. Following a government decision, tax revenues will continue to be registered according to a cash-based system. Authorities are currently working on the criteria to register and value financial and non-financial assets in order to build the opening and closing balance sheet, and the consumption of fixed capital in the SGO. This stage will require coordinating efforts with the CGR -- legally in charge of the accounting standards in the public sector -- and during the past year, progress has occurred at a slower pace than expected. The latest *Public Finance Statistics* yearbook includes detailed information on the progress of the conversion process, together with a concise summary on the changes operated in the accounting systems since the introduction of GFSM 2001.

Procurement and employment

The constitution and diverse laws regulate procurement as well as appointments and wages of public sector staff. Law No. 18,575 on the General Principles for the Administration of the State establishes general transparency and competitiveness principles for the contracting process. Allegations over obscure government employment and payment practices are not common, and corruption allegations are usually judicially investigated. Procurement Law 19,886 was passed in July 2003, providing homogeneity to procurement procedures and establishing an independent tribunal to handle appeals by suppliers. In late 2005, the Public Procurement Tribunal started operations, in order to guarantee the appropriate enforcement of legislation, reinforcing transparency overall. The MoF has a special website where it publishes tenders and public contracts, together with all relevant legislation and recent news in the public procurement area.⁴⁶ The system of public procurement provides a reliable tool that gives access to state-related business opportunities for both nationals and foreigners. A proposal regarding the possibility of modifying procurement contracts from the original tenders is currently being discussed.

Entry to the civil service is based on competition and merit, with some exceptions made for political appointments. As well as creating a National Civil Service Directorate, the Civil Service Statute approved in 2003 seeks to modernise public administration and to lay the foundations of a professional civil service.⁴⁷ As part of the redesigning of selection and pay policies, the Statute emphasises promotions on a competitive, merit-determined basis, increases performance-based incentives, introduces new incentives for retirement, and establishes a new system for monitoring the performance of top-level officials. As a result of these changes, the number of political appointees in the public administration is expected to drop from approximately 3,500 to around 740, although the reduction is taking place at a slower pace than expected.⁴⁸

According to some commentators, the immobility of the civil service tends to reduce productivity.⁴⁹ Law 19,882 introducing new measures on work and salaries for high public officials -- intended to improve the selection of higher public officials on a merit basis and to strengthen human resources management -- was not unanimously regarded as a useful tool to address Chilean deficits in this area.

Drafting of a Public Administration Personnel Information System (SIAPER), intended to improve human resources allocation within government departments, began in 2004. Some delays have emerged in its design, and the pilot stage has been rescheduled for early 2007. The design phase of the system should be completed by the end of 2006 and could be fully operational by the end of 2007 or early 2008.⁵⁰ In December 2005, the *Public Sector Human Resources Statistics* yearbook was released for the first time, with detailed disaggregated information on central government personnel between 1995 and 2004. The report -- publicly available online -- illustrates the work conducted by the DIPRES in the compilation and systematisation of previously dispersed information, increasing fiscal policy efficiency in the allocation of resources.

Fiscal reporting

The DIPRES reports fiscal activity on an annual and quarterly basis, and publishes its public financial statistics during the first quarter. The *Public Finance Report* contains information on DIPRES reports to Congress, including type and periodicity of data submitted. Information on budgetary execution is publicly available on a monthly basis. Information on revenues and expenditures is updated every three months. In line with GFSM 2001, the budgetary classification includes a functional classification of expenditures. The DIPRES website is updated on a regular basis with all the latest reports released by the government. The DIPRES website is considered highly reliable by users, and benefits from a specific government commitment through its Digital Agenda programme to expand the information that is publicly available through the internet.⁵¹ The launching in the past year of the DIPRES virtual library has further enhanced fiscal reporting.

Law 19,875 of May 2003 gives permanent status to the Special Budget Commission, made up of members from both chambers of Congress. In the past, this commission only met on an ad hoc basis to discuss the budget submitted each year. A Budgetary Advisory Unit that reports directly to the Commission was also established in 2003. The core objective of the changes introduced is to give Congress more powers to oversee and control budgetary execution during the fiscal year.⁵² Even though the expertise of the Special Budget Commission and its permanent staff has increased the role of Congress in budgetary monitoring, its capabilities are still underdeveloped.⁵³

The government provides Congress with mid-year reports evaluating the financial conduct of central government. In June each year, the DIPRES submits to the Special Budget Commission a *Financial Evaluation of the Public Sector*. This report -- widely acknowledged as a relevant analytical tool -- includes not only a comprehensive analysis of the previous year's financial management of the public sector, but also a detailed update for projections of the year in progress. If necessary, the government might include in these reports amendments to the original projections included in the budget documentation. In addition, the report incorporates operations conducted under the previous year's budgetary framework, and extra-budgetary operations conducted by central government bodies. Central government data are provided in accordance with GFSM 2001 -- which has helped to improve the quality of information, and consequently distinguishes between transactions affecting the availability of economic resources and those of a financial nature. Information on public enterprises is also submitted to Congress on a regularly basis in the quarterly financial statements and annual reports.

Results of major budget programmes and impact evaluations are submitted to Congress annually, and there is an increasing perception that it has started to make use of the evaluations conducted. The Special Budget Commission

also hires private consultants to assess the performance of budget programmes, with the results publicly available and widely recorded in the press.

Public institutions have to submit annually to Congress an *Integrated Management Balance Report* (BGI). The purpose of the BGI is to provide information on goals and achievements of public management. Additionally, the BGIs constitute a tool that helps institutional analysis and evaluation, allowing end-users to have a clear picture of the functioning of public services. In particular, the DIPRES uses these reports to prepare its medium-term and long-term assessments. In the past year, the DIPRES website has increased the availability and timeliness of BGIs. Additionally, the work conducted by the MoF has provided a high degree of homogeneity in the presentation of information, and this enables the comparison of information among different public services.

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●●● Compliance in progress

Chile continues upgrading its fiscal reporting system for government agencies. The progressive consolidation of SIGFE during 2006 has allowed the elimination of differences in methodology, coverage, and periodicity of information among different government dependencies. Additionally, SIGFE has introduced aggregate and consolidated functions, providing more accurate financial information when adopting efficiency decisions for public resources.

Data quality standards

In general, overall budget results do not differ significantly from the original estimates. Supplementary budgets have not been used since the adoption of the LAFE in 1975. In addition to budgetary data provided by the DIPRES, the CGR prepares a *Financial Management Report of the Public Sector* and an audit report of the Treasury Account. Reports include methodological commentaries that address accounting standards. The DIPRES reconciles the official fiscal statistics it publishes with data horizontally consolidated, published, and audited by the CGR.⁵⁴ A comprehensive series of fiscal statistics -- following GFSM 2001 -- is publicly available. In addition, the government regularly submits a progress report to Congress on the change of fiscal statistics towards an accrual-based system.

Independent scrutiny of fiscal information

Independent Audit

The Office of the Comptroller General carries out an independent audit on the public sector's fiscal management and budget execution, including sub-national levels of government. The CGR has institutional and administrative autonomy, but it is financially dependent on the Budget Law and subject to the budgeting procedures for the central government. Once appointed by the President with approval of the Senate, the Comptroller may only be removed through congressional action on an accusation relating to a constitutional infringement.⁵⁵ The CGR also verifies the legality of the administration's transactions, inspects the income and investment of treasury and municipality resources, and develops auditing and internal control. Before 30 April each year, the Comptroller has to submit both to Congress and to the President the *Financial Management Report of the Public Sector* for the previous year. Annual reports prepared by the CGR are publicly available on its website.⁵⁶

The CGR is perceived as an independent institution with full institutional and operative capacity, although impact evaluation of fiscal expenditure is limited.⁵⁷ Commentators agree on the need to further strengthen its capabilities.⁵⁸ The CGR has the power to pursue the recovery of funds if fiscal mismanagements are found following an audit. In a 2004 OECD report, the case for modernising this office and re-launching it as a modern auditor-general body has been made.⁵⁹ Moreover, according to a joint report from the World Bank and the Inter-American Development Bank, the CGR should improve its annual financial statements, moving to closer adherence with internationally accounting standards in its reporting and complying with the International Organization of Supreme Audit Institutions principles.⁶⁰

In July 2005, the government sent to Congress a bill to improve the internal audit process within government departments and strengthen management procedures. The bill also addresses officials' responsibility over government contracts and establishes conflict of interest regulations for procurement deals. If approved, the network of public offices in charge of the auditing (*Sistema de Auditoría Interna de Gobierno*) would have permanent staff and autonomy. The auditing task would differ from that conducted by the CGR (*ex-post*), and would be aimed at undertaking preventive measures based on risk matrices and on the mitigation of risk. The proposal also includes granting more financial flexibility to the CGR. Recently, the government has announced that it will give legislative priority to this project, and parliamentary debate on this proposal is expected in the near future.

Some variables used to prepare macroeconomic projections are discussed with representatives of the private sector and civil society. Independent critiquing of fiscal data constitutes a regular exercise, mainly in such areas as macroeconomic forecasting and evaluation of public programmes. The involvement of independent expert panels in the estimation of trend-output growth and the reference price for copper has enhanced transparency and confidence in the policy framework, preventing political interference.⁶¹ Following the enactment of the LRF, there is now a legal obligation for the government to collect opinions from independent analysts on public revenues and expenditures. In addition, the LRF has incorporated recommendations made by external evaluations from international organisations on fiscal transparency practices in the country.

National Statistics Agency

The National Institute of Statistics (INE) -- an institution now incorporated in the system of *High Public Management*, with a director and other staff members selected by an open and public process -- is the central government authority in charge of statistics and enjoys prestige and political independence. Quality, technical independence and transparency are among INE's central pillars in the conduct of its work.⁶² Fiscal information reporting is performed by the DIPRES and controlled by the CGR. The dependence of the DIPRES on the executive does not undermine the reliability of its fiscal information.

The INE is currently engaged in its *2005-2008 Programme*, which includes the revision and improvement of several statistical tools and surveys.⁶³ Social and economic indicators are publicly available on its website. In the past year, the INE has invited public and private organisations to set up a *Committee of Researchers-Users* of statistics, in order to review current practices and propose improvements in the access of information at a microdata level.⁶⁴ The INE is preparing for the alignment of its practices with OECD statistical standards. At present, the institute participates as statistical observer in the OECD, attending workshops and staff training courses, and the current goal is to achieve OECD standards by 2010.

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Chile between 16 and 18 October 2006:

Central Bank of Chile

16 October 2006

Rodrigo Valdes Pulido	General Manager	Department of Economic Research
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Ministry of Finance

18 October 2006

Jorge Rodríguez Cabello	Head, Research Division	National Budget Office
Matías Bernier Bórquez	Head, Financial Planning	National Budget Office
Leticia Celador Izquierdo	Legal Advisor	Capital Markets & International Finance Department
William Mullins	Advisor	Capital Markets & International Finance Department

ADDITIONAL INTERVIEWS

17 October 2006

Christian Howard	Studies Division	Superintendence of Securities and Insurance
Felipe Morandé	Dean	University of Chile – Faculty of Economics
Mariana Schkolnik	Director	National Institute of Statistics (INE)
José Inostroza Lara	Advisor	National Institute of Statistics (INE)
Gustavo Arriagada	Superintendent	Superintendence of Banks & Financial Institutions
Fernando Valdes Ossa	Correspondent	Superintendence of Banks & Financial Institutions
Axel Buchheister Rosas	Legislative Programme Director	Freedom and Development Institute
Rosanna Costa	Economic Programme Director	Freedom and Development Institute

18 October 2006

Leonardo Suarez	Chief Economist	Larrain Vial Consulting
Diego Figueroa Martinez	Economist	Larrain Vial Consulting

NOTES

¹ In August 2005, Congress reformed the constitution left in place by the late General Augusto Pinochet. In particular, the reform abolished the reservation of Senate seats for the military and now enables the president to dismiss military commanders. The reform is widely perceived as a final stage in the transition from dictatorship to democracy. Constitution of Chile at www.bcn.cl/pags/legislacion/leyes/constitucion_politica.htm Organic Constitutional Law 18,575 of the General Principles for the Administration of the State (LOCBGAE) of 1986, Organic Decree Law 1,263 of the Financial Management of the State (LAFE), and Fiscal Responsibility Law (LRF) 20,128 of 2006 are all available at: www.bcn.cl/portada.html

² The National Budget Office (DIPRES), legally established within the Ministry of Finance, has its own website at: www.dipres.cl

³ *Corporación Nacional del Cobre* (CODELCO) was established by Law Decree 1,350 of 1976 available at: www.bcn.cl/portada.html. See CODELCO at: www.codelco.cl

⁴ Additional information on central government's extra-budgetary incomes and expenditures is available at: www.dipres.cl/estadisticas/anuales.asp

⁵ 'Chile: Reports on the Observance of Standards and Codes – Fiscal Transparency Module – Update', IMF, July 2005, available at: www.imf.org

⁶ 'Economic Survey – Chile 2005', OECD, November 2005, available at: www.oecd.org

⁷ General Law of Banks available at Superintendence of Banks and Financial Institutions (SBIF) www.sbif.cl

⁸ 'Economic Survey – Chile 2003', OECD, December 2003, and interviews in Chile, 16-18 October 2006.

⁹ Chile Enterprise System (SEP) at: www.comitesep.cl

¹⁰ The *Copper Chilean Commission* (COCHILCO) is legally empowered to control all mining enterprises, including CODELCO. However, its auditing and research reports are not publicly available.

¹¹ The Capital Markets II (MK2) Project was originally prepared to improve the bankruptcy proceedings and corporate governance environment, together with securities and capital markets regulations. The introduction of public enterprises governance in the MK2 draft law was directly influenced by the allegations of mismanagement at CODELCO during a politically sensitive time, with presidential elections scheduled for December 2005. Due to pressures to address this issue specifically, the public enterprises governance section was taken out of MK2 and discussed separately.

¹² 'Economic Survey – Chile 2005', OECD, November 2005.

¹³ *CODELCO 2005 Annual Report*, available at:

www.codelco.cl/english/la_corporacion/memorias/annualreport2005.pdf

¹⁴ '2006 Public Finance Report' (*Informe de Finanzas Públicas*), October 2006, available at: www.dipres.cl

¹⁵ Interviews in Chile, 16-18 October 2006.

¹⁶ '2006 Public Finance Report' (*Informe de Finanzas Públicas*), October 2006, available at: www.dipres.cl

¹⁷ *Public Finance Statistics* yearbooks are available at www.dipres.cl/fr_estadisticas.html

¹⁸ In 2005, a fourth account was created for joint Army-Navy-Air Force initiatives. Under an agreement with the armed forces, the funds in this account are to be spent only up to the amount corresponding to the ten-year average copper price used in formulating the budget (which is determined by a committee of independent experts) and the rest is to be saved. This account is administered by the armed forces, but spending has to be authorised by the Ministry of Finance, which aims keep total defence spending at its present level of 1.4% of GDP.

¹⁹ The armed forces will be able to use resources from this stabilisation fund for future acquisitions when low copper prices reduce the transfer. Additionally, the government and the armed forces have agreed that part of this amount will be used to repay debt on past acquisitions, rather than for new purchases. According to the government, this would reduce annual interest payments by 50 million dollars.

²⁰ As part of a broader initiative, the government works closely with municipalities in order to strengthen their technological resources and capabilities.

²¹ However, information on some local corporations (*corporaciones*) -- through which some municipalities channel education and health spending -- is not disclosed in a timely fashion. Where they exist, these corporations are an important part of a municipality's spending, but not all municipalities have them.

²² IMF Special Dissemination Standard (SDDS) - Chile, at: <http://dsbb.imf.org/Applications/web/sddsnsdppage/>

²³ In the latest edition of the *Public Finance Statistics* yearbook (see www.dipres.cl/estadisticas/anuales.asp) some progress has been made regarding this issue, and an estimation of the consumption of fixed capital for central government, municipalities and general government has been incorporated.

²⁴ 'Chile: Reports on the Observance of Standards and Codes – Fiscal Transparency Module – Update', IMF, July 2005, available at: www.imf.org

²⁵ Available at: www.dipres.cl/fr_estadisticas.html

²⁶ 'Chile: Reports on the Observance of Standards and Codes – Fiscal Transparency Module', IMF, August 2003.

²⁷ In addition, the annual *Financial Evaluation of the Public Sector* includes mid-year adjustments to the macroeconomic assumptions which help to correct estimates provided in the annual budget.

²⁸ At present, there are concerns about the future budgetary impact of the guarantee of a minimum pension to those workers who paid contributions but at a level that is insufficient to ensure a retirement income at or above the lowest pension. Dealing with these contingent liabilities represents an important challenge to maintain the current fiscal policy framework.

²⁹ The decision to target a 1% of GDP surplus was taken in order to offset the perennial 1% of GDP deficit at the Central Bank. When the two are consolidated, the public sector has an approximately zero balance.

³⁰ Under the structural surplus rule, the government spends its 'structural' income minus 1% of GDP, where 'structural income' is defined as the income it would receive if the economy were growing at its medium-term potential rate (as defined annually by a committee of independent experts) and copper prices were running at their estimated average for the next ten years (also defined annually by a committee of independent experts).

³¹ 'IMF Executive Board Concludes 2005 Article IV Consultation with Chile', IMF Public Information Notice 05/104, August 2005, available at: www.imf.org

³² 'Economic Survey – Chile 2005', OECD, November 2005, available at: www.oecd.org

³³ Interviews in Chile, 16-18 October 2006.

³⁴ The remaining 10% includes institutions with more complex financial operations, whose alignment with SIGFE will be done at a different speed. The process of implementing SIGFE has been slower than expected because training public officials took more time and money than initially anticipated.

³⁵ During the January-August 2006 period, an average of 750,000 transactions, distributed among 1313 SIGFE operational units, have been completed. Chapter VI of the '2006 Public Finance Report' (*Informe de Finanzas Públicas*), October 2006, available at: www.dipres.cl, provides a detailed progress report on SIGFE, including the operational management of the system.

³⁶ Interviews in Chile, 16-18 October 2006.

³⁷ '2006 Public Finance Report' available at: www.dipres.cl

³⁸ Evaluation of government programmes since 1997, available at: www.dipres.cl/control_gestion/listado_programas.asp

³⁹ Interviews in Chile, 16-18 October 2006.

⁴⁰ For a comprehensive list of institutions that submitted performance indicators for the elaboration of the 2007 budget see: www.dipres.cl/control_gestion/indicadores/Listado_instituciones_formulan_Indicadores.html

⁴¹ The remaining five instruments are: Strategic Definitions; Management Improvement Programmes; Performance Indicators; Comprehensive Management Reports; and Competitive Fund.

⁴² *Chile. Estudio de Evaluación de Impacto del Programa de Evaluación de Programas*, Report No. 34589-CL, World Bank, December 2005, available at: www.worldbank.org

⁴³ A detailed 2007 *Management Improvement Programmes Technical Report* is available at: www.dipres.cl/control_gestion/PMG/documento_tecnico_pmg_2007.html

⁴⁴ The ISO 9001:2000 is an internationally accepted regulation that includes minimum legal provisions for public and private management systems to be certified.

⁴⁵ For a comprehensive explanation of the ongoing procedures, see '*Mecanismo de Certificación Externa de Sistemas de Gestión de los PMG*', DIPRES, August 2005. This report, together with supplementary information on PMGs and reference guidelines to achieve ISO certification are available at: www.dipres.cl/fr_control.html

⁴⁶ Public Procurement Law and System of Public Procurement (ChileCompras), available at: www.chilecompras.cl. Since the new law on public procurement came into force in 2003, ChileCompras has expanded rapidly. Its transactions of just 1 billion US dollars in 2003 almost doubled in 2004 and reached 2.9 billion by the end of 2005, when 164,000 suppliers, including 64,000 small and mid-sized enterprises, had registered with the system, up from 48,000 in 2003.

⁴⁷ An advisory four-member board has been appointed within the Directorate, charged with seeking and selecting personnel and suggesting remuneration. It is, in principle, a guarantee of transparency in hiring and appointing on merit (rather than political loyalty), and it is slowly setting new standards for selecting public officials.

⁴⁸ The new government which took office in March 2006 could have used the opportunity to ask for the resignation of political appointees whose posts are included in the *High Public Management* (HPM) system and replaced them

with merit-based selected officials, but only isolated resignations have been requested and the replacements have occurred slower than expected. However, after irregularities found by the CGR in programmes financed by Chiledeportes (the government agency for the promotion of sports) in November, the government has announced that it will bring forward from 2010 to 2007 the schedule to include more than 40 services in the HPM system. It has already been announced that Chiledeportes will be included, and several other government agencies that allocate funds directly are also expected to be on the list.

⁴⁹ Interviews in Chile, 16-18 October 2006.

⁵⁰ '2005 Financial Evaluation of the Public Sector and 2006 Projections Update' (*Evaluación de la Gestión Financiera del Sector Público en 2005 y Actualización de Proyecciones para 2006*), June 2006.

⁵¹ The Digital Agenda (AD) is the outcome of an endeavour that began in April 2003 when the Digital Action Group was established. It is presided over by the Governmental Coordinator of Information and Communications Technologies and comprises government institutions, business organisations, academia, and other government agencies. This effort generated a wide-ranging public/private agreement regarding a countrywide strategy that will be implemented in the run-up to the Bicentennial celebration in 2010. The AD objective is to contribute to Chile's development by using information and communications technologies to increase competitiveness and improve equal opportunities, individual liberties, and public sector efficiency and transparency. Information on the AD initiative is publicly available at: www.agendadigital.cl

⁵² The Special Budget Commission also has the power to require budgetary documentation from the government at any given moment during the fiscal year.

⁵³ Interviews in Chile, 16-18 October 2006.

⁵⁴ Interviews in Chile, 16-18 October 2006.

⁵⁵ Further to the 2005 amendment to the Political Constitution, a three-fifths Senate majority is required to approve the proposal to appoint the Comptroller General. This qualified proportion implies that consensus between ruling and opposition parties is required, reducing discretionary appointments by the government.

⁵⁶ Office of the Comptroller General (CGR), available at: www.contraloria.cl

⁵⁷ The Comptroller's Organic Law authorises the CGR to evaluate the internal auditing systems of state agencies and their monitoring capacities over budget execution.

⁵⁸ Interviews in Chile, 16-18 October 2006.

⁵⁹ 'Budgeting in Chile', OECD, May 14, 2004.

⁶⁰ 'Republic of Chile. Country Financial Accountability Assessment', World Bank & Inter-American Development Bank, 2004, p. xiv.

⁶¹ Interviews in Chile, 16-18 October 2006.

⁶² The INE releases an extensive list of publications. An annual catalogue summarises both the content and the periodicity of its publications. National Institute of Statistics, available at: www.ine.cl

⁶³ A progress report on this programme was released in June 2006 ('*Avances en Proyectos Estratégicos. Plan de Desarrollo de las Estadísticas Públicas 2005-2008*')

⁶⁴ Microdata are collections of unit records (i.e. individual respondent data) vital to the production of statistics. The final document of this committee -- currently under analysis by the National Statistical Board -- was released in April 2006 and is publicly available online ('*Informe Final. Política para el Acceso a Microdatos para Fines de Investigación*', INE, 2006).