

### **Chile: Report on Observance of Standards and Codes—Fiscal Transparency**

This Report on the Observance of Standards and Codes on Fiscal Transparency for Chile was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **July 24, 2003**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Chile or the Executive Board of the IMF.

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Price: \$15.00 a copy

**International Monetary Fund  
Washington, D.C.**

INTERNATIONAL MONETARY FUND

CHILE

**Report on the Observance of Standards and Codes (ROSC)  
Fiscal Transparency Module**

Prepared by the Fiscal Affairs Department

Approved by Anoop Singh and Teresa Ter-Minassian

July 24, 2003

**EXECUTIVE SUMMARY**

This report provides an assessment of fiscal transparency practices in Chile in relation to the requirements of the IMF Code of Good Practices on Fiscal Transparency based on discussions with the authorities and other organizations, the authorities' response to the IMF fiscal transparency questionnaire, and other sources of information.

Chile has achieved a high level of fiscal transparency in many areas, and has recently made rapid progress in closing remaining gaps. The authorities' responsiveness to new demands—both from within Chile and from international markets—has been a particular facet of strength.

Chile's main achievements include the government's success in constructing and disseminating an unusually clear view of its objectives and targets, both at the macro level and for individual budget programs. The structural balance rule, despite its relative complexity, gives the public and markets important confidence-enhancing information about future macro-fiscal responses. The budget is clear on government priorities and tools for evaluating budget performance are highly developed. Government accountability to congress and the public is demonstrably being strengthened, with much enhanced reporting, significant and growing input from independent experts, and a rich economic debate in the media. Importantly, the government has begun to clarify and delineate its role in the economy: a recent law permitting fuller reporting on extra-budgetary military spending should help limit uncertainty created by lack of information about the size of the armed forces' economic activity; debt reporting has been greatly expanded and substantive studies published of contingent obligations; and quasi-fiscal activity has either been stopped, covered by budget transfers, or made subject to supervision. The 2003 reforms of public financial management, civil service remuneration, procurement, and campaign financing should contribute substantially to further development of a modern and transparent professional public administration.

A general reform challenge for Chile will be to institutionalize the many recent advances in transparency, and the initiated reforms, so that they become permanent components of fiscal management. The effective implementation of the 2003 reforms will be an important test. Moreover, the transparency of military activity should continue to be enhanced. Other more specific recommendations in the report include the need to clarify: government-central bank relations, e.g., by recapitalizing the central bank; the supervision of CORFO; and the fiscal costs of concessions, including contingent liabilities. More detail on longer-term spending goals would strengthen the medium-term framework, as would more systematic analysis of fiscal risks. While Chile's fiscal accounting has never been problematic, the adoption of a 'unified fiscal presentation,' and eventually of the new GFS, are welcome advances. The introduction of SIGFE, the integrated information system, should facilitate public financial management, address data gaps (e.g., on spending arrears), and facilitate a reconciliation of fiscal and monetary accounts.

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### ABBREVIATIONS AND ACRONYMS

BECH	Banco Estado
BGI	Comprehensive Management Assessment (Balance de Gestion Integral in <a href="http://www.dipres.cl">http://www.dipres.cl</a> )
CGR	Comptroller General of the Republic, the Office of ( <a href="http://www.contraloria.cl">http://www.contraloria.cl</a> )
CODELCO	Copper Corporation ( <a href="http://www.codelco.cl">http://www.codelco.cl</a> )
COFOG	Classification of the Functions of Government (OECD, UN standard)
CONADI	National Corporation for Indigenous Development ( <a href="http://www.conadi.cl">http://www.conadi.cl</a> )
CORFO	Production Development Corporation ( <a href="http://www.corfo.cl">http://www.corfo.cl</a> )
CUF	Unified fiscal account (Cuenta Unica Fiscal)
DIPRES	Directorate of the Budget ( <a href="http://www.dipres.cl">http://www.dipres.cl</a> )
EEES	Autonomous Nonprofit Institutions
EFP	Public Finance Statistics ( <i>Estadisticas de las Finanzas Publicas</i> ; publication, in <a href="http://www.dipres.cl">http://www.dipres.cl</a> )
ENACAR	National Coal Enterprise
ENAMI	National Mining Enterprise ( <a href="http://www.enami.cl">http://www.enami.cl</a> )
FCC	Competitive Common Fund (Fondo Común Concursable)
GFS	Government Finance Statistics (in <a href="http://www.imf.org">http://www.imf.org</a> )
LAFE	Law on Financial Administration of the State
LBGAE	Law of the General Bases for the Administration of the State
PMG	Programs for Improvement in Management (Programas de Mejoramiento de Gestion, in <a href="http://www.dipres.cl">http://www.dipres.cl</a> )
ROSC	Reports on the Observance of Standards and Codes (in <a href="http://www.imf.org">http://www.imf.org</a> )
SAFE	System of Financial Administration of the State
SBIF	Superintendency of Banks and Financial Institutions (Superintendencia de Bancos e Instituciones Financieras, <a href="http://www.sbif.cl">http://www.sbif.cl</a> )
SDDS	Special Data Dissemination Standard (in <a href="http://www.imf.org">http://www.imf.org</a> )
SEP	System of Public Enterprises ( <a href="http://www.comitesep.cl">http://www.comitesep.cl</a> )
SIGFE	Sistema Integrado de la Gestion Financiera del Estado ( <a href="http://www.sigfe.cl">http://www.sigfe.cl</a> )
SII	Internal Revenue Service (Servicio de Impuestos Internos, <a href="http://www.sii.cl">http://www.sii.cl</a> )
SNA	National Customs Service (Servicio Nacional de Aduanas, <a href="http://www.aduana.cl">http://www.aduana.cl</a> )
SVS	Securities and Insurance Supervisor

## I. INTRODUCTION

1. This report provides an assessment of fiscal transparency in Chile relative to the IMF's *Code of Good Practices on Fiscal Transparency*. The assessment has two parts: a description of practice, prepared by IMF staff on the basis of discussions with the authorities and their responses to a fiscal transparency questionnaire, and additional information; and an IMF staff commentary on fiscal transparency in Chile.<sup>1</sup>

## II. DESCRIPTION OF PRACTICE

### A. Clarity of Roles and Responsibilities

#### **Boundaries and roles**

##### *Definition of government*

2. **The general government is defined largely as in the 2001 GFS Manual.** Constitutionally, Chile is a unitary state, with three independent powers.<sup>2</sup> The executive branch and domestic administration are represented by the President and his ministries at the national level, by regional governments—which are semi-autonomous bodies included in central government—and by municipalities.<sup>3</sup> The legislative power includes the senate and the chamber of deputies. The judiciary comprises the Supreme Court, ordinary, special and superior tribunals, and the Court of appeals.

3. **Public entities are categorized under various framework laws.**<sup>4</sup> Budgetary central government is made up of centralized institutions (such as ministries), constitutional state bodies (congress, the judiciary, the comptroller general, and the electoral tribunal), and decentralized agencies (e.g., the national tourism service). Universities and research institutes are part of central government but have their own budgets. Municipalities, public enterprises, the central bank, and Banco Estado comprise the rest of the public sector.

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<sup>1</sup> Discussions on fiscal transparency were held in Santiago during January 8-23, 2003, and the ROSC was finalized during the Article IV consultation, June 2-13, 2003. The staff team, comprising Ms. Cheasty (head), Ms. Albino, Messrs. Donaghue and Phillips, met with officials from the Ministry of Finance, the Budget Directorate, the Internal Revenue Service, Customs, the Treasury, the Comptroller General, the Central Bank, the Ministry of Economy and Energy, the Superintendency of Banks, the Sub-Secretary for Regional Development, the System of State Enterprises, the Commission for Internal Auditing, Banco Estado, Codelco, and representatives of congress and the private sector. Mr. Le Fort, Executive Director for Chile, joined the mission for the final days of discussions.

<sup>2</sup> Article 3 of the Political Constitution of 1980.

<sup>3</sup> Chile has 13 regions, 51 provinces, and 341 municipalities.

<sup>4</sup> Title II of the Framework Law on the General Bases of the State Administration (Law 18575 of 1986), and Article 2 of the Framework Law on the Financial Administration of the State (Law 1263 of 1975).

4. **The budget directorate (DIPRES) presents general government statistics in its public finance statistics yearbook.** These are compatible with the *System of Government Finance Statistics (GFS)*, except that they exclude universities and research institutes, whose budgets are not approved by congress. The coverage of ‘budgetary central government’ is established by the Framework Law on the Financial Administration of the State (LAFE). Budgetary central government is also reported on in the published accounts of the comptroller general (CGR), but referred to as ‘the public sector’ and presented in a form less compatible with GFS. The CGR also reports on public universities, municipalities, and public enterprises under CORFO (see Figure 1).

*Functions of different levels of government*

5. **The distribution of functions among the different levels of government is stably defined, as are intergovernmental fiscal relations with a few exceptions.** The laws for municipalities<sup>5</sup> define their own formula-based responsibilities and identify municipal revenues.<sup>6</sup> The Municipalities’ Common Fund is used to offset any municipal financing gaps; its resources and their permitted distribution are clearly defined by the framework law. The law also identifies the responsibilities shared by municipalities and the central government (mainly education, primary health care, and public cemeteries). These are financed by transfers from central government broadly determined by the number of service users; in practice, municipalities top up the financing of the services in varying degrees. The municipalities do not share revenue from national taxes, and may contract debt only if authorized by law.<sup>7</sup> In principle, municipalities can run deficits only by drawing down deposits, though there are some reports of arrears and ad-hoc financing. Moreover, under Article 10 of the 2003 Budget Law, municipalities in good standing with the Common Fund and up to date with pension contributions may be authorized by the Ministry of Finance to take on financial contracts (leasing, suppliers’ credits, etc.) beyond the fiscal year.

*Functions of different branches of the state*

6. **The functions of the executive, legislative, and judicial branches are clearly defined in the constitution and by law.** Most fiscal powers are vested in the President and the executive. The constitution grants clear authority to the executive to conduct fiscal policy, allocate resources, and administer state finances. The President alone may take fiscal initiatives,<sup>8</sup> and congress only approves or rejects these. The constitution prohibits congress from raising or lowering the revenue estimates in the draft budget; it may only reduce draft expenditures—as long as these are not allocated by a permanent law. If congress does not

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<sup>5</sup> Framework Law on Municipalities, DFL2/19602 of 1999, Law on Municipal Resources, DTO-2385 of 1996.

<sup>6</sup> The own-responsibilities of municipalities include *inter alia* communal development, planning and regulation, public transport, construction, and sanitation. Own-revenues include taxes with rates set at the national level, fines and interest charges, fees for services and concessions, and transfers from the regional government.

<sup>7</sup> In the last 12 years, no law authorizing borrowing has been issued for any municipality.

<sup>8</sup> Article 62 of the constitution.

**Figure 1. Chile's Public Sector**

IMF				Institutions of Chile's Public Sector	Included in LAFE (1)	Included in Budget Law	Supervised by the Comptroller	Direct Executive Dependency
P U B L I C  S E C T O R	N O N  F I N A N C I A L	G E N E R A L	C E N T R A L	1. Centralized institutions	YES	YES	YES	YES
			2. Autonomous agencies	YES	YES	YES	NO	
			3. Decentralized institutions	YES	YES	YES	YES	
			4. Autonomous nonprofit institutions (EEES)	(3)	NO	YES	(5)	
				5. Municipalities	YES	NO	YES	NO
				6. State-owned companies – defined by law (without BECH) – mixed companies (incorporated)	(4) NO	NO NO	YES NO	YES YES
				(Banco Estado) 7. Central Bank	NO NO	NO NO	NO NO	YES NO

Sources:

(1) Law on the Financial Administration of the State.

(2) Public Sector Budget Law.

(3) Article 29 of D.S. No. 3.529/80 excludes these companies from D.L. No. 1.263/75 beginning in 1981.

(4) Article 11 of Law No. 18.196 of 1982 excludes these companies from D.L. No. 1.263/75 beginning in 1983.

(5) D.L. No. 147 to 164 of 1/12/81 approves statutes of the EEES, including relations with the executive.

approve the Annual Budget Law within 60 days after submission by the President, the draft automatically comes into force.<sup>9</sup> Moreover, the executive has the legal right to specify the rules of budget execution each year.<sup>10</sup> Congress discusses the budget in a joint commission, whose report goes to the chamber of deputies and senate for approval.<sup>11</sup> The Judiciary's only fiscal responsibility is to handle a substantial flow of tax and customs appeals cases.

*Coordination of resources within and outside the budget*

7. **Mechanisms for coordination and management of budgetary activities are well-defined.** The LAFE<sup>12</sup> establishes the principle of unified budgeting, and requires all incomes to be included in institutions' budgets on a gross basis. Expenditure financed by grants or external loans is subject to the same rules as other outlays and is fully recorded in the budget. Grants and external loans to public institutions must be approved by the Ministry of Finance. Credits to central government entities are subject to a global debt limit set in the annual budget law and loans that mature beyond the current presidential term must be approved by an absolute majority of senators and deputies.

8. **Earmarking of taxes is prohibited by the constitution,<sup>13</sup> with the main exception being the resources governed by the Reserved Copper Law**—the only major extra-budgetary fund. The Reserved Copper Law assigns 10 percent of the state copper company's sales to military equipment purchases (see Box 1).<sup>14</sup> These purchases are outside the budget, but subject to Ministry of Finance approval.<sup>15</sup> In 2002, revenues transferred via this law were around 0.3 percent of GDP, or 1½ percent of budgeted expenditures. The oil price stabilization fund, which has declined to a negligible operation since a 2000 reform law, also operates outside the budget. Two other funds, the copper stabilization fund and the infrastructure fund, are fully integrated into the budget. The only other exception to the constitutional prohibition of tax earmarking is taxation of local and regional activities—which can be earmarked to municipalities and regional governments.

*Specialized public agencies—the central bank*

9. **The central bank is an independent institution by law, autonomous in the management of monetary policy, with its own capital.**<sup>16</sup> It can act as fiscal agent of the government, but Chile's constitution prohibits it from providing credit or guarantees to the

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<sup>9</sup> The constitution requires the draft Budget Law to be presented to congress at least three months before it begins to apply.

<sup>10</sup> LAFE, article 14.

<sup>11</sup> The commission was made permanent by a 2003 law, with the aim of improving congress's technical capacity to analyze the budget.

<sup>12</sup> LAFE, article 4.

<sup>13</sup> Article 19 of the constitution.

<sup>14</sup> Law 13,196 of 1976. This law is not available to the public.

<sup>15</sup> From 2002 on, the fiscal statistics published by DIPRES began to report information on the amount of the transfer from Codelco to the armed forces (though not the level of any associated off-budget expenditure).

<sup>16</sup> The Constitutional Framework Law of the Central Bank of Chile is Law 18840 of 1989.



government or public enterprises. It cannot engage in transactions with the nonfinancial private sector.<sup>17</sup> Rules for the transfer of central bank profits to the government are clearly defined; although there is no formal procedure for compensating the central bank for losses, the central bank is authorized to request new capital from the government.

10. **The only quasi-fiscal activity of the central bank arises from a commercial bank bail-out in the early 1980s, which left the central bank with an enduring deficit** (see Box 2). The central bank's cash deficit exceeds the accrual deficit by around 0.4 percent of GDP, and the central government's cash deficit is correspondingly understated because the central government is allowed to capitalize part of its interest obligations to the central bank.

*Specialized public agencies—Banco Estado*

11. **Government's participation in commercial banking is limited to Banco Estado**, a large first-tier retail bank which it fully owns. The bank has a market share of around 12 percent, and performs quasi-fiscal activities (see below), though no information is available on their cost. The bank is not covered by the LAFE, nor included in the Budget Law.<sup>18</sup> Its board is appointed by the President, and is formally autonomous in its day-to-day operations—though some decisions (profit distribution and salaries) require Ministry of Finance approval. Banco Estado is subject to all rules applicable to financial institutions and to supervision by the Superintendency of Banks; it is independently audited. Legal safeguards ensure its commercial operations are market-based. It cannot lend to government or public enterprises, though it can engage in leasing operations involving government.

12. **Banco Estado administers the Treasury's unified fiscal account (CUF) without paying interest on the use of Treasury balances, and also pursues social goals from its profits**—though these do not seem to be imposed on it by the government.<sup>19</sup> The 'social' activities include maintaining branches in small communities, providing mortgage loans and loans backed by unemployment insurance, servicing micro-industry, and granting insurance to low-income sectors. These transactions of Banco Estado have caused its 'efficiency gap' (administrative expenses/margin on operations) to be about 65 percent compared with an average of 50 percent for Chilean banks. Banco Estado is developing a program aimed at reducing the efficiency gap by around 5 percentage points, the closest it deems compatible with fulfilling its social functions. Like nonfinancial public enterprises, Banco Estado pays a surcharge on its profit tax of 40 percent (really a dividend tranche).

*Nonfinancial public enterprises*

13. **Nonfinancial public enterprises are important in strategic sectors, notably mining and oil.** Their activities and relations with the government are defined and restricted

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<sup>17</sup> Article 27 of Law 18840 of 1989.

<sup>18</sup> Its legal basis is given in law 2079 of 1978.

<sup>19</sup> Since inflation has dropped, the value of the right to use CUF balances has declined. Moreover, the Ministry of Finance may (since 1979) exempt public agencies from having to keep their finances in the CUF.

by the Law of State Enterprises. A qualified majority of congress is needed to authorize the creation of new public enterprises or expansion of their activity, with the implication that almost any expansion of state shareholding in private enterprises would have to be approved by congress. Public enterprises are joint stock companies or state enterprises-established by-law. All enterprises have a board and prepare financial statements compiled and audited in line with the Law of Joint Stock Companies. From 2002, most public enterprises have come under the supervision of the System of Public Enterprises (SEP).<sup>20 21</sup> By law,<sup>22</sup> their annual budgets are approved via a decree of the Ministry of Finance, and their presentation and execution reports must follow the central government budget classification. The CGR and DIPRES report on and consolidate the execution of these budgets. Enterprises in the defense industry are exempt from most financial regulations applied to other public enterprises.

**14. Borrowing by public enterprises requires the authorization of the Ministry of Finance via a decree; if the borrowing requires a government guarantee, it must be approved by law.** Some enterprises carry out social functions (such as the development of small mines, coal sector restructuring, and public transport), and may not cover their operational costs with their revenues, in which case the government has recently been meeting their financing needs by transfers from the Budget Law.<sup>23</sup> The authorities explained that their policy is to reflect all quasi-fiscal activities of public enterprises in the budget, so that all fiscal activity in Chile is adequately covered by the budget.

*Privatizations, concessions, and post-privatization shareholdings*

**15. Privatizations have been carried out transparently but the focus of the current government has shifted to concessions.** During the last decade, the state transferred a majority share of capital in a number of public enterprises to the private sector, via public and open tender to both Chileans and foreigners. The largest recent privatization or concession was that of six water enterprises, but the state still retains important equity (typically about 35 percent). The state has also transferred concession rights in state ports.

**16. Government equity holdings remain important in some partially privatized companies; these are declared clearly in the financial statement of CORFO,** the public holding company. Majority state-owned companies are regulated, as are private enterprises, by the law of joint stock companies, which requires them to issue financial reports to the public once a year. Also, the Budget Law obliges the Executive to issue semiannual financial

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<sup>20</sup> With the exception of Codelco, Banco Estado, national television, and defense enterprises.

<sup>21</sup> The SEP, which operates temporarily as a committee of CORFO, has a president, executive secretary, and a council of nine members nominated by the President and the Ministers of Economy, Finance, and Public Works. The SEP is responsible for designating enterprise directors, approving strategic plans and draft budgets, setting transparency rules and performance norms, and monitoring management.

<sup>22</sup> Law 1350 of 1976.

<sup>23</sup> ENAMI, ENACAR, the Santiago Mass Transport System, and the National Railway.

reports to congress for these firms. CORFO is regulated by a framework law, and supervised by DIPRES, but subject to fewer accounting requirements than public enterprises.

### *Regulation of the private sector*

17. **The nonfinancial private sector is regulated mainly via sector-specific laws defining the regulatory process.** There is a general antitrust law oriented toward safeguarding competition and free markets, and specific regulation in sectors of natural monopoly.<sup>24</sup> Decisions of the regulatory and supervisory agencies are subject to the constitutional principle that citizens have the right to seek review of administrative acts. However, only the recently revised laws incorporate ex ante consultation provisions. Laws establish detailed appeal and review procedures for environmental issues and tariff-setting in natural monopolies. Environmental impact studies must be published and discussed in the affected communities. Tariff fixing is done on the basis of microeconomic analyses of cost and demand, and subject to arbitration of differences between regulator and regulatees.

18. **The regulatory framework for the financial system is based on internationally accepted criteria.** The banking system is supervised and controlled by the Superintendency of Banks and Financial Institutions (SBIF).<sup>25</sup> This independent public institution authorizes the creation of new banks and has wide powers to interpret and enforce regulations. The SBIF also approves any change in statutes or capital increase proposed by banks. Banks must submit monthly financial reports to the SBIF, publish quarterly financial reports in the national media, have their financial statements audited annually by independent auditors and get two risk classifications (ratings). Further, banks must report to the SBIF any person or entity who controls 5 percent or more of bank property directly or indirectly; anyone who wishes to acquire 10 percent or more of bank property must first get SBIF authorization.

### **Legal and administrative framework**

#### *The legal framework for the budget*

19. **Fiscal management is defined by a clear legal and administrative framework.**<sup>26</sup> That said, an important part of the legal framework is not permanent but set by annual laws.

20. **The main permanent law, the LAFE, applies to all central government institutions except the resources governed by the Reserved Copper Law.** It regulates budgetary processes, accounting, the management of funds, financial control, and public credit. It assigns clear responsibilities for financial administration, concentrating in the Ministry of Finance and DIPRES all responsibilities for the formulation and execution of the

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<sup>24</sup> For instance, electricity, gas and water, and telecommunications; the General Law of Electric Power Services (DFL 1, 1982), Decree D.L. 211 of 1973, and General Law of Telecommunications (Law 18168, 1982).

<sup>25</sup> Including Banco Estado.

<sup>26</sup> The legal institutional framework of the budget is determined by articles 32, 60, 62, and 64 of the Constitution, by the LBGAE and, principally, by the LAFE.

budget, in the CGR all the functions of financial control and accounting, and in the Treasury all management of public cash and credit. The LAFE requires all fiscal revenues to be included in the budget, deposited in the unified fiscal account held by Banco Estado, and allocated in line with budget priorities. The LAFE allows some outlays to exceed the budget allocation, financing the overruns with reallocations or higher revenues.<sup>27 28</sup>

21. **Some provisions which regulate modifications to the budget (such as the size and use of the Executive's contingency fund) are not included in permanent legislation** but are part of each Annual Budget Law. A significant 2003 amendment to the LAFE has, however, importantly reduced the number of such provisions.<sup>29</sup> Also, in recent years congress has accompanied its approval of the budget with agreements with the Executive (protocols) which specify reports to be presented to congress on topics of potential budgetary concern. These protocols are public commitments which do not have the force of law.

*The legal framework for the tax and customs administration*

22. **The revenue agencies, namely Internal Revenue (SII), Customs, and the Treasury (the collection agency), are each governed by a framework law.**<sup>30</sup> A permanent commission has been established to coordinate their activities, chaired by the head of the SII.

23. **Tax laws are relatively simple,**<sup>31</sup> and the President has the sole right to initiate them. Self-assessment is the norm.<sup>32</sup> The SII and Customs have web-sites which explain tax dispute procedures.<sup>33</sup> Tax payments may be made by internet: 70 percent of income tax returns are made via the internet as are 15 percent of VAT returns (representing nearly 60 percent of VAT payments). Also, customs agents can complete clearance procedures via the internet. Customs is developing a project to permit full internet tracking of imports through to clearance, and a 'single window' project is under discussion.

24. **Taxpayers have clear legal rights and arbitration procedures,** described in the Tax Code. The first level of appeal is to a tribunal within the SII or Customs; this decision may then be appealed in the general courts. The fact that first-round tax appeals are internal to the tax services has been seen as leaving scope for bias. Hence the authorities have sent to congress a proposal to make first-round tribunals independent of the tax agencies and to

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<sup>27</sup> These expenditures correspond to compliance with legal rulings, repayments of taxes and other refunds required of the state, debt service, and pension payments determined by law.

<sup>28</sup> The authorities explained that overruns have never caused total expenditure to exceed the budget envelope, since they are, in practice, offset by underexecution elsewhere in the budget.

<sup>29</sup> Moreover, the Budget Law is accompanied by an Annual Compendium of Regulations on Public Sector Financial Management—meaning that all applicable rules are available for reference in published form.

<sup>30</sup> The framework law of the SII is the DFL 7 of 1980; for the National Customs Service the law is Ministry of Finance Decree 329 of 1979; and for the Treasury Service it is in DFL 1 of 1994.

<sup>31</sup> The Tax Code is DL 830 of 1980.

<sup>32</sup> Constitution, article 62.

<sup>33</sup> <http://www.sii.cl> and <http://www.aduana.cl>.

create chambers with independent tax expertise within the Court of Appeals; these are expected to be in place by end-2004.

*A code of conduct for civil service behavior*

25. **Public officials are subject to a code of conduct, though there is no independent ethics commission.** The principal rules governing ethical conduct are the Administrative Statute and the Law of Administrative Probity.<sup>34</sup> The Administrative Statute establishes principles of probity, confidentiality in legally restricted affairs, and prompt reporting of knowledge of irregularities in one's area of responsibility. The Statute of Municipal Employees, which governs municipal workers, has similar principles. The Administrative Probity law requires state authorities and officials to have blameless official conduct, and to subordinate individual interest to the common good. It also requires the President, Ministers, Subsecretaries, intendants, and governors to submit a declaration of interests within 30 days after taking office; this declaration must cover their professional and economic activities.

26. **Agencies with regulatory or enforcement powers have personnel rules which set stricter limitations than on the personnel of other public institutions** (and a pay regime superior to that of other state workers). For instance, in the CGR, all civil servants have traditionally been '*personas de confianza*,' meaning that they can be fired at the discretion of the Comptroller.

## **B. Public Availability of Information**

### **Information on fiscal activity**

*Budget documentation*

27. **The budget documents cover most central government activity, but not all of general government.** In accordance with LAFE, the annual budget covers all 'budgetary central government,' including autonomous agencies such as Congress, the Comptroller General of the Republic, and the Public Prosecutor, but not universities, research institutions, and the resources under the Reserved Copper Law.<sup>35</sup> The *Draft Budget Law of the Public Sector* is accompanied by the *Report on the State of the Public Finances* presented by the Minister of Finance, and the *Report on the Public Finances*<sup>36</sup> presented by the Budget Director.

28. **The public has access to comprehensive and timely fiscal reports.** DIPRES sends to congress and publishes on its website ([www.dipres.cl](http://www.dipres.cl)) monthly, quarterly, biannual, and

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<sup>34</sup> Law 18834 of 1989; and LBGAE complemented by Law 19653 of 1999.

<sup>35</sup> A legal amendment will allow the Ministry of Finance to publish Reserved Copper Law transactions starting in 2004.

<sup>36</sup> Prior to 2001, this document was called *Macroeconomic Aspects of the Draft Budget Law*; in its new form, it has been legally established.

annual reports on budget execution, and audited annual balances and quarterly financial statements of public companies (Figure 2). DIPRES also publishes a monthly list of decrees on transfers from the contingency fund, Comprehensive Management Assessments (BGI),<sup>37</sup> reports on the state's external debt, and evaluations of programs agreed by congress.<sup>38</sup>

29. **Budget documents provide comprehensive information on all items except resources under the Reserved Copper Law and *gastos reservados*.** The latter are a 'reserved spending' line in some ministries (the Presidency, security-related ministries), and are reported globally but not itemized; they amount to less than 0.1 percent of total spending. A law approved by congress in January 2003 establishes the obligation to limit the amount of reserved expenditures, restrains the ability to supplement them, limits the purposes they can be used for and the institutions that can use them, and makes them accountable to the CGR.

30. **The budget documentation shows information for the main fiscal aggregates for four years previous to the budget and projections for three years following the budget.** The draft Budget Law includes final execution figures for the four previous years for Ministries and programs, with as much disaggregation as in the budget. The CGR's annual statements include a comparison with the relevant budget. The *Public Finance Statistics* yearbook includes consolidated figures for central government, general government, and the nonfinancial public sector for the previous nine years. Since 2000, as required by LAFE, the documents accompanying the budget have included a financial projection of the fiscal macro aggregates of budgetary central government for three years following the budget.<sup>39</sup>

*Contingent liabilities, tax expenditures, and quasi-fiscal activity*

31. **The annual budget documentation is not required to explicitly address contingent liabilities, tax expenditures, or quasi-fiscal activities but the government has moved forward in analyzing and presenting information in each of these areas.** In 2001, congress was provided with a note identifying and giving basic quantitative information on contingent liabilities (including the minimum pension guarantee, guarantees on infrastructural concessions, and the state guarantee on bank deposits), and a first study of tax expenditures was recently completed by the SII. The enhanced *Public Sector Financial Report* to be attached to the budget beginning in 2003 is intended to regularly include estimates of tax expenditures and the main contingent liabilities.

32. **In the mid-1990s, the central government budget began to include transfers to pay for quasi-fiscal activities**—those of two small public enterprises (ENAMI and ENACAR). Since 2002, the budget has partially covered the financing needs of the Santiago Metro and the State Railway Company, which their tariff revenue cannot fully cover.

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<sup>37</sup> The assessments include budgetary execution and the results of the previous year's operations, and report on compliance with objectives and tasks set during the budget approval process.

<sup>38</sup> Programs to be evaluated are determined by a Ministry of Finance decree, as are the procedures and terms of reference, and the participating agencies (see Box 5); the list of evaluations must be sent to congress by June.

<sup>39</sup> Though LAFE does not require that these be published.

**Figure 2. The Public Sector's Financial Information System in Chile, 2003**

<b>REPORT</b>	<b>CONTENT</b>	<b>RELEASE CALENDAR</b>	<b>APPROXIMATE PUBLICATION DATE</b>	<b>OFFICE RESPONSIBLE</b>
The central government's budget execution	<ul style="list-style-type: none"> <li>- Central government's income and expenses, by subtitle</li> <li>- Outturn (balance)</li> </ul>	Monthly	Forty-five days after the end of the month	Budget Directorate, Ministry of Finance
Central government's budget report	<ul style="list-style-type: none"> <li>- Central government's income and expenses, by subtitle</li> <li>- Outturn (balance)</li> <li>- <i>Balance ajustado</i></li> <li>- Income from taxes</li> <li>- Financing items</li> <li>- Central government's gross debt</li> </ul>	Quarterly	Forty-five days after the end of the quarter	Budget Directorate, Ministry of Finance
State-owned companies' financial report	<ul style="list-style-type: none"> <li>- Financial statement both by company and consolidated</li> <li>- Status of results, both by company and consolidated</li> </ul>	Quarterly	Sixty days after the end of the quarter	Budget Directorate, Ministry of Finance/State-Enterprise System
Public finance statistics	<ul style="list-style-type: none"> <li>- Central government: execution of income and expenses, by subtitle, operative classification of the expense, outturn, <i>balance ajustado</i>, income from taxes, financing items, gross debt, main financial assets, the Reserved Copper Law.</li> <li>- Municipalities: execution of income and expenses, by subtitle, outturn (balance)</li> <li>- General government: execution of income and expenses, by subtitle, outturn (balance).</li> <li>- State-owned companies: financial statement, state of consolidated results, execution of income and expenses by subtitle, cash balance.</li> </ul>	Annually	March	Budget Directorate, Ministry of Finance
Public finance report	<ul style="list-style-type: none"> <li>- Central government's financial statement</li> <li>- Contingent liabilities</li> <li>- Tax expenditures</li> <li>- Others, to be determined</li> </ul>	Annually	September	Ministry of Finance
Public debt report	<ul style="list-style-type: none"> <li>- Central government's gross and net debt</li> <li>- Central Bank's gross and net debt</li> <li>- Explanatory notes and complementary information</li> </ul>	Biannually	March, September	Ministry of Finance with collaboration from the Central Bank

33. **Before 2000, the oil price stabilization scheme represented a not insignificant quasi-fiscal activity**, either a tax or a subsidy depending on world oil prices. However, a 2000 law in 2000 reformed the scheme, making the setting of the regulated oil price transparent and greatly limiting the scale of future quasi-fiscal activity. The impact of the oil price stabilization has been incorporated into the government's fiscal policy target measure, and the authorities plan to modify budget submissions and official statistics to reflect it.

#### *Debt and assets*

34. **Statistics on public debt and financial assets are now compiled and reported by the Ministry of Finance, for the central government and nearly all of the public sector** (see Box 3). Quarterly reporting of central government (gross) debt follows SDDS requirements, including for various classifications of the debt stock; however, it does not include any debt associated with off-budget military expenditure. In 2002, twice-annual reporting of a broader report began, which also includes statistics on central bank and nonfinancial public enterprise debt, and data on liquid financial assets of the same entities (including reserves), as well as other information.

#### *Consolidation of relevant parts of government*

35. **The consolidated fiscal position for municipalities and the central government is published regularly.** Municipalities are subject to the same standards of fiscal accounting as the central government. Since their budget is approved independently and subsequent to the annual Budget Law, their information is provided only upon execution, i.e., ex post. Their financial activities are overseen by the CGR, which prepares quarterly consolidated statements on their budgets, finances, and assets on the basis of monthly reports from them. Their consolidated budget balance is also included in DIPRES's annual fiscal statistics.

#### **Timely publication**

36. **Delivery dates are set in the annual Budget Law for specified fiscal information** that the Executive should present to congress. The information requirements are listed in paragraph 28 and the detailed release calendar is in Figure 2.

### **C. Open Budget Preparation, Execution, and Reporting**

#### **Fiscal objectives, macro-framework, policies, and risks**

37. **Main fiscal policy objectives are presented each year in the President's speech on May 21 and in the Minister of Finance's budget presentation and report to congress.** Beginning with the 2001 budget, the central government budget has been prepared and presented in a medium-term framework, with two main elements: a target for the *structural* balance (see Box 4) and a medium-term financial projection. The government that took office in early 2000 committed itself to holding the underlying fiscal stance steady, aiming to maintain each year a constant 1 percent of GDP surplus in the structural balance.



This approach was designed to avoid any tendency toward sustained debt accumulation, while allowing the overall balance to fluctuate temporarily.<sup>40</sup>

38. **The structural balance framework does not apply to the general government, on the argument that the legal prohibition against municipalities contracting debt has kept the local government cash balance very close to zero**, and thus sustainability should not be an issue. For the public enterprise sector, sustainability is considered one company at a time, including when the Minister of Finance approves each company's annual budget.

#### *Fiscal rules*

39. **The structural balance rule is not based in legislation, but is a policy commitment of the administration**—which has been accorded a high profile. The rationale, nature, and technical design of this quasi-rule are laid out in a policy paper published by the Budget Directorate in 2001.<sup>41</sup> The estimation methodology has been published. The government has delegated to independent expert panels the determination of critical inputs to the estimation: medium-term forecasts of real copper prices, the labor force, capital accumulation, and total factor productivity. Statements identifying the members and documenting the panels' results have been published.

#### *Medium-term projections*

40. **Within the context of the structural balance target, the annual budget is prepared and presented on the basis of medium-term projections** for potential output and copper export prices, and internally consistent assumptions for a broader set of variables, using a model kept by the Ministry of Finance. Assumptions for a core group of relevant macro variables, but not details of the estimation procedures used, are provided in documents accompanying the budget submission, including on the web. Congress and the public may assess the reasonableness of the budget proposal's macro projections, for example, on the basis of independent projections released by the central bank in mid-September, as well as the survey of private forecasts conducted and published each month by the central bank.

41. **The question of fiscal sustainability is revisited on an ongoing basis.** The structural balance estimate is updated and published twice a year. The expert panel is to be convened each August, so that its update will provide the basis for the budget proposal finalized in September. This analysis is complemented with medium-term financial projections published each October, with the aim of determining how much room fulfillment of the structural balance target will leave for increasing expenditure, or how much policy tightening will be needed. For this purpose, four years of projections are presented for expenditure and revenue (for the latter, both before and after cyclical adjustment)—though the exercise does not show details of spending programs or financing projections.

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<sup>40</sup> Since the target is defined with respect to a balance including interest, any deterioration in financing conditions that prompted a higher interest bill would require the government to raise its primary surplus.

<sup>41</sup> *Balance Estructural del Gobierno Central*, DIPRES, September 2001. A comprehensive discussion is contained in IMF, *Chile, Selected Issues*, 2001.

### *Identification of new policies*

42. **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 (the Fondo Común Concursable (FCC)). Proposals must include a clear presentation of objectives, expected results, coverage, resource requirements, and evaluation indicators.

### *Risks*

43. **A general analysis of fiscal risks is included in the Budget Director’s report** to congress at the time of the budget submission. Its scope varies with the uncertainties being faced. For example, the late-2001 report explicitly considered an alternative macro scenario for the coming year. Risks which need to be considered are limited by the policy of targeting the structural balance, since short-term fluctuations in output and copper export prices are not considered to represent risks—as the intention is to execute the budget irrespective of such shocks. Analyses of risks to specific expenditure commitments are not presented, though the government has presented studies on main contingent liabilities, and on more specific concerns such as the deficit of the military pension system and costs of the penal reform.

### **Policy analysis of budget information**

44. **Budget data are, by rule, reported on a gross basis.** The budget is developed according to administrative categories, but also reported broadly on a program basis. A summary table showing an economic classification is presented but with little detail. Information by functional classification is only available ex post,<sup>42</sup> and, since Chile’s methodology is broadly based on institution-level statistics with some adjustments (rather than being compiled by program), it is not clear whether the classification fully follows COFOG. As noted earlier, budget reporting does not include the state universities nor extra-budgetary activities of the armed forces associated with the Reserved Copper Law.

### *Program objectives*

45. **Objectives are outlined for all budget programs.** The specification of these objectives at the level of each ministry and program, and their link to performance indicators and evaluation procedures is a highly developed feature of the Chilean budget (see Box 5). Specifically, the budgets of all institutions include a description of the institution’s mission, its main outputs, beneficiaries, objectives, performance indicators, and quantitative targets

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<sup>42</sup> The problem is that the central contingency fund cannot be distributed ex ante. Since it includes funding for pay increases, and since personnel outlays are not evenly distributed across agencies, ex ante and ex post functional classifications would differ significantly. This issue is to be resolved when SIGFE is implemented.

for those indicators.<sup>43</sup> LAFE contains a series of provisions for evaluating the goals of budget programs. From the mid 1990s, a management control system established bases for budgeting through results. The management control system is coordinated by DIPRES and implemented by means of Management Improvement Programs (PMG). The outturns for each year, as measured by budget execution, and achievement of targets, indicators, and institutional commitments, must be reported after the close of the year in Comprehensive Management Assessments (BGIs). Programs that receive resources from the FCC must likewise specify their objectives, expected results, and quantitative targets in order to access these resources.

### *Fiscal indicators*

46. **The overall balance of the central government (which in Chile is unlikely to differ significantly from that of the general government) is considered as an indicator of the government's fiscal position, along with the current account balance.** The published accounts readily allow the calculation of other standard balance indicators. In addition, since 2001, the main indicator and target of fiscal policy is the structural balance of the central government, which is published annually, along with the estimated cyclical components from which it is derived. The *balance ajustado*, which shows the overall balance after adjustments made to enable the calculation of the structural balance (but does not incorporate the cyclical adjustments), is published quarterly.<sup>44</sup> Analytical tables clearly show the relation between budget estimates and the overall balance.

47. **A consolidated nonfinancial public sector balance has previously been published annually, but is being reconsidered.** Quarterly accrual data for public enterprises are available on the website of the SVS. However, the authorities consider that, since quasi-fiscal activities of public enterprises are limited and reflected transparently in government transfers, their consolidation with the central government balance is unnecessary, and that the conversion of the data to a cash basis (necessary to make the consolidation) risks inappropriately biasing investment and financing decisions. Nevertheless, the authorities consider it important to continue to present information regularly on the public enterprise sector. In 2003, they are beginning to present data based on the aggregation of the companies' individually prepared (and externally audited) financial reports, and are establishing the procedures needed to publish accrual basis data in line with the 2001 GFS.

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<sup>43</sup> During 2002, about 150 public service agencies submitted information on quantitative targets, based on more than 500 performance indicators.

<sup>44</sup> After the shift to a unified fiscal presentation (targeted for mid-2003), the overall balance will be completely aligned with the *balance ajustado* (and hence only one number will be reported). The adjustments made to go from the overall balance to the *balance ajustado* were mainly aimed at deriving an overall balance measure in line with the 2001 GFS (e.g., by incorporating important accrual elements); with the government's phased introduction of the 2001 GFS, they will no longer be necessary.

## Execution and monitoring

### *Accounting*

48. **The rules of the public sector accounting system are comprehensive and consistent with international standards.**<sup>45</sup> They are set by the CGR and entities are responsible for developing and maintaining their own accounts within the rules. The CGR centralizes and aggregates the accounting information, and prepares reports of government accounts on an accrual basis. DIPRES receives information from the same sources but keeps records only for the payment stage of expenditure. This allows DIPRES to produce reports more quickly than the CGR but effectively means that, despite having accrual-based accounts, Chile has no systematic centralized recording of commitments or payments arrears. As noted, there are also some differences in methodology, coverage, and periodicity of DIPRES and CGR information which make cross-checking and reconciliation difficult. These problems are to be addressed by SIGFE, an integrated financial management system, which began development in 2001 and is to be fully operational by end-2005.

### *Procurement*

49. **Almost all state procurement is subject to tender.** The LBGAE establishes general transparency and competitiveness principles for the contracting process, and the CGR sets monetary thresholds above which agencies must solicit bids by open and public tender. Mismanagement in procurement contracts is reportedly uncommon, with the current Ministry of Public Works presumed corruption case (under judicial investigation) being an exception. Transparency International concluded that Chile's procurement procedures are transparent except for small purchases.<sup>46</sup>

50. **A new procurement law was passed in 2003.** Until then, regulations were agency-specific, implying that they could differ from sector to sector and were not fully defined for all areas (e.g., municipalities were not covered). Procurement by the armed forces was governed by self-regulation arrangements and exempted from technical evaluations—though evaluations were recently made of nonmilitary investments such as hospitals and buildings at the request of the Ministry of Finance. The new law generalizes and homogenizes procurement procedures (including for defense and for municipalities—though not for professional services), ensures they are published on the web with records of procurement decisions, and establishes an independent tribunal to handle appeals by suppliers. The Ministry of Finance has created a register of state suppliers and an official website ([www.chilecompras.cl](http://www.chilecompras.cl)) for public contracts.<sup>47</sup>

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<sup>45</sup> The legal framework for the government's accounting system is in articles 63-69 of the LAFE and in CGR Rule 3754 of 1998. Public enterprises follow the same international accounting rules as the private sector.

<sup>46</sup> Prior to the 2003 law, Transparency International found that, in terms of value, 82 percent of goods and services acquisitions were made through open and public tenders (for construction services, 99 percent).

<sup>47</sup> CGR, Decree 826, November 2002; also, the 2003 Budget Law, article 6.

*Terms of employment*

51. **Entry to the civil service is based on competition and merit, except for political appointments** (mainly to high levels of the administration). Civil service careers cover most of the central government, but co-exist with other special personnel regimes.<sup>48</sup> By law, promotions should also be decided by competition, or by climbing the relevant career ladder. A series of laws was passed in 2003 to formalize and expand the scope of civil service human resource policy—with a new salary structure (see below), a new career development ladder, and a new National Civil Service Directorate. Moreover, the number of political appointments to line jobs in government (*personas de confianza*) has been reduced from around 3,500 to 400, including ministers, under-secretaries, and ambassadors.

52. **Salary scales of all civil servants are established by law.** They are grade-based and include performance incentives (since 1994). Different scales exist for civil servants, the armed forces and police, municipal employees, teachers, and doctors. Allowances are granted for experience, location, and training. To compensate for the fact that remuneration in the senior ranks of the civil service is still constrained below market levels, some officials have been allowed to receive supplementary pay from teaching, consultancy, and honoraria. This created doubts about the transparency of civil service pay which the government addressed by passing a law that improved pay levels, enforced full-time work, and severely limited the scope for topping up salaries through honoraria or reserved spending (see Box 6).

*Internal control*

53. **The internal control system is more or less voluntary within each agency—based on incentives, particularly under the umbrella of management improvement programs (PMGs).**<sup>49</sup> Various institutions play a role in the system: DIPRES exercises budgetary control, the National Council for Internal Audit sets policies,<sup>50</sup> and the CGR (which also establishes guidelines for internal control) exercises legal control of the budget and performs the evaluation of agencies' internal control. Internal control is performed by the internal audit units within each agency.<sup>51</sup> Annual audit plans are approved and monitored within the institutions by the highest authority. Currently, there are no mechanisms in place that ensure independence of the officials of these units. The PMGs, which are voluntary, have played an increasingly important role in strengthening internal audit. They are connected to a merit pay system linked to compliance with management goals, internal audit being one component.

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<sup>48</sup> Civil service careers are defined and regulated by article 38 of the Constitution, Chapter II of the LBGAE, and the Administrative Statute. The rules do not apply to officials in specialized areas subject to free hiring and mobility, e.g., doctors and other primary health-care workers, and teachers. CGR officials, the central bank, the armed forces, security, and municipalities are each governed by their framework law. Public enterprises and the national television board are subject to the Labor Code (the regulations applied to the private sector).

<sup>49</sup> The regulatory internal control framework is in several laws and guidelines, including LAFE and LBGAE.

<sup>50</sup> The Council for Internal Audit is dependent to the Ministry of Finance (previously to the General Secretariat of the President). It is responsible for proposing annual internal audit plans and control measures for strengthening public management.

<sup>51</sup> Currently, 87 percent of the central government's public services have internal audit units.

### *Revenue collection*

54. **The tax and customs administrations are legally protected from political influence** in that they report to the Ministry of Finance, and not to congress. Moreover, the Director of the SII has by law<sup>52</sup> the exclusive right to interpret tax laws. Court rulings and administrative interpretation of tax laws are accessible to the public on the website of the SII. All revenue agencies are subject to the Law of Probity, and the other laws governing civil servants' behavior. Their framework laws forbid other remuneration. Except at the highest levels, entry to the tax services is by public competition. The requirement that imports must be made through customs agents is not seen as a restrictive practice, since there are around 250 agents, and professional affiliation is by public competition.

55. **Reporting on tax activities is regular, and compliance with tax laws is relatively high.** Customs issues a monthly internal report of its receipts, which is not published but is widely distributed. Both agencies are required to provide congress with any information it requests. Tax evasion has been low compared with other countries in the region, an estimated 24 percent in 2001, before the Law on Fighting Tax Evasion<sup>53</sup> came into effect in June 2001. This law aims, inter alia, at strengthening the tax administration, amending the functions of Internal Revenue and the Treasury, and providing for the fair treatment of taxpayers. Collection results for 2001 and 2002 show further declines in evasion under the new law.

### **Fiscal reporting**

56. **The government delivers to congress quarterly reports on budget execution** (at the "subtitle" level) and posts execution reports (in economic classification) on the DIPRES website within 45 days. Also, since 2001, DIPRES has in mid-year given congressional committees a report evaluating the financial conduct of the central government over the previous year, and updating the expenditure and revenue projections for the current year.<sup>54</sup>

57. **DIPRES publishes its public financial statistics yearbook in April or May**, covering the central government (though the armed forces incompletely), municipalities, and nonfinancial public enterprises.<sup>55</sup> The audited final accounts compiled by the CGR are published in March or April, with somewhat reduced coverage (e.g., excluding Codelco).

58. **Different types of evaluations are presented to congress.** In April of the year after the budget, a report is sent to congress on the Comprehensive Management Balances of the public agencies with PMGs. The targets and compliance rate with the management indicators of PMG entities are presented in September as part of the draft Budget Law. Also, program and impact evaluations are carried out, as well as comprehensive expenditure evaluations for a selected ministry. The programs and ministry to be evaluated are discussed and agreed by

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<sup>52</sup> Tax Code, article 6.

<sup>53</sup> Law 19738.

<sup>54</sup> "Evaluacion de la Gestion Financiera del Sector Publico en 2001 y Proyecciones para 2002:" at <http://www.dipres.cl/publicaciones/presentacionCongreso-imprental.html>.

<sup>55</sup> The accounts of Banco Estado are not included, but are reported in the externally audited annual report.

congress and included in the budget protocol. The evaluations are based on a framework used by multilateral agencies and are prepared over four to five months by panels of three private sector experts (competitively chosen). The reports are sent to congress in June, before submission of the draft budget. The impact evaluations are carried out by universities or private consultants on the basis of first-hand information, and also presented to congress. The comprehensive expenditure evaluation aims at evaluating the whole set of procedures, programs and policies administered by a Ministry.

#### **D. Assurances of Integrity**

##### **Data quality**

59. **In general, overall budget results have not differed significantly from the original estimates** (e.g., total expenditure execution in the last five years has varied between 97 and 99.8 percent of approved expenditure). Supplementary budgets have not been used since the adoption of the LAFE in 1975.

60. **The accounting basis of budget data and the final accounts is clearly identified.** The annual budget data published by DIPRES are on a cash basis. The final accounts (*Informe sobre la Gestion Financiera del Estado*) published by the CGR are on an accrual basis. Both reports include methodological commentaries which address accounting issues.

61. **DIPRES reconciles the official fiscal statistics it publishes with data horizontally consolidated, published, and audited by the CGR.** In principle, given double-entry accounting, no statistical discrepancy needs to be reported. To date, the published below-the-line flows have not provided enough detail to allow a reconciliation with banking data and the balance of payments. Moreover, the budget balance has not been reconciled with the change in government debt or other financial instruments. The planned introduction of the new GFS (and the more detailed debt statistics since 2002) will facilitate a reconciliation.

##### **Independent scrutiny of fiscal information**

62. **The Comptroller General of the Republic (CGR) is the autonomous agency charged with carrying out external audit of the fiscal accounts.** By the constitution, the Comptroller is designated by the President via a Senate majority agreement, and may not be removed until age 75.<sup>56</sup> The CGR verifies the legality of the administration's transactions, inspects the income and investment of treasury and municipality resources, and develops auditing and internal control. It is also—somewhat unusually—the entity which sets the accounting standards of the nation. Employees of the CGR are hired, promoted, and removed at the sole discretion of the Comptroller. The Comptroller determines his annual budget and wage scale of his personnel with the approval of the President. The CGR must, by law,

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<sup>56</sup> The CGR law specifies that he may be removed only by the President, upon judicial resolution.

present by the 30th of April every year, to the President and congress, a *Report on the Financial Administration of the State* for the previous year.<sup>57</sup>

63. **The Budget Directorate makes its own fiscal forecasts and outside scrutiny is piecemeal but growing.** The main macro assumptions for the budget are made public, in line with the Transparency Code. A further improvement would be to actively encourage independent analysis of the detailed fiscal forecasts. Already, for two of the most important variables affecting revenue, the medium-term copper price and rate of growth of potential output, panels are convened to provide their own forecasts. In 2002, this was done in August, one month ahead of the budget presentation, and the results were put on the DIPRES website.

64. **The national statistics institute does not publish fiscal statistics;** the official Chilean statistics are those published by the Budget Directorate. These statistics are not subject to external verification, but they are based on the same information used by the CGR in the preparation of audited final accounts (with a slightly different coverage and nomenclature). Chile meets the Special Data Dissemination Standards (SDDS) of the IMF.<sup>58</sup>

### III. IMF STAFF COMMENTARY

65. The analysis in the previous sections shows many facets of strength in Chile's fiscal transparency and a number of areas for improvement. Particularly impressive are the rapid progress made recently toward enhancing transparency, and the authorities' responsiveness to new demands—both from within Chile and from international markets. The main achievements may be summarized as follows:

- **First, the government has succeeded in constructing and disseminating an unusually clear view of its objectives and targets,** both at the macro level and for individual budget programs. The structural balance rule, despite its relative complexity, gives the public and markets important confidence-enhancing information about future macro-fiscal responses into the medium term. At the level of the budget, a clear vision of government priorities is transmitted to the sectoral level by the inclusion of objectives in individual ministry budget documents, the shift to a quasi-program budget presentation, and the establishment of a sophisticated array of indicators and evaluation procedures for judging performance.
- **Second, government accountability to congress and the public is demonstrably being strengthened.** Regular reporting has increased in frequency, timeliness, and breadth of topics covered. Performance evaluations are unusually multi-faceted—and go to congress. Recent use of protocol agreements to elicit information on topical issues of concern, and the establishment of a permanent congressional committee, suggest that congress is playing a deepening role in economic oversight and that the government is responding constructively. Calls on independent consultants to provide

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<sup>57</sup> The findings usually go to the public through the *Annual Report*; see ([www.contraloria.cl](http://www.contraloria.cl)).

<sup>58</sup> Chile has made use of the SDDS flexibility option for timeliness and periodicity of fiscal data. As of July 2003, the IMF's website showed these options still being used (<http://dsbb.imf.org>).



projections and carry out evaluations have become more frequent, and the economic debate in the press is rich and heated.

- **Third, the government has begun to clarify and delineate its role in the economy.** Most concerns about transparency in Chile have been related to uncertainty about the extent of quasi-fiscal activity, the size of actual and contingent liabilities, and the importance of the armed forces. As regards quasi-fiscal activity: the activities which generated the central bank deficit have long stopped; the social role of Banco Estado is limited by its need to comply with the same prudential requirements as the rest of the banking system; and most identified public enterprise quasi-fiscal costs are covered by explicit transfers from the budget. As regards its liabilities, the government has recently greatly expanded its debt reporting and has produced substantive publicly-available studies of its contingent obligations. The recent passage of the law permitting fuller reporting on extra-budgetary military spending should help limit uncertainty created by lack of information about the size of the armed forces' economic activity.

66. **These achievements, together with the compliance with more specific standards noted in the text, and a number of on-going initiatives (see Box 7), suggest that Chile has achieved a high level of fiscal transparency in many areas,** though with some remaining items on the reform agenda. The reform recommendations below should be seen in the context of the fact that, by international standards, Chile already has a well-designed fiscal system, and prudently managed public finances.

67. **A general reform challenge for Chile will be to institutionalize the many recent advances in transparency, and the initiated reforms, so that they become permanent components of fiscal management** rather than being hostage to the goodwill of future governments. In a number of areas, Chile has complied with the transparency standards via recent specific initiatives rather than because the legal framework includes permanent procedures. For instance, reports on tax expenditures and contingent liabilities were prepared in line with the recent budget protocols, but there is no legal provision for them to be updated annually. Likewise, many provisions usually included in permanent laws are included in the annual budget law in Chile (e.g., conditions for modifying the budget and rules governing the contingency fund). Further, most internal control appears to be motivated by voluntary incentives, mainly programs for improving management. Finally, the structural balance target does not have a legal basis, but is purely a policy commitment of the current government.

68. **The authorities rightly note that the flexibility inherent in such instruments as protocols and time-bound laws may contribute importantly to speedy and effective policy responses.** They have, however, indicated their willingness to move some transparency measures to permanent legislation, and have taken a substantial first step by amending LAFE to cover a number of key annual budget provisions (notably limits on the expenditure envelope and transfers).

69. **A second challenge will be to continue to improve the transparency of military activity.** The authorization to disclose details on Reserved Copper Law resources is an

important step forward, as is the increase in accountability for reserved expenditures, and the inclusion of defense under the new procurement law. Further tasks remain, however. First, extra-budgetary military activity should be effectively disclosed, not only the expenditures covered by the authorization but movements in debt. Second, military spending should be subjected to general budget discipline, in particular to normal borrowing and reporting procedures, and via the elimination of earmarking or spending floors. And third, military deficit and debt information should be incorporated into the budget and fiscal statistics.

70. **Other specific areas where further progress would help consolidate Chile's gains in transparency are listed below.** It should be underlined that many are already being studied by the government or have reached the stage of draft laws submitted to congress.

#### **Clarity of roles and responsibilities in the public sector**

- While the **definitions and functions of government** are generally clearly defined, there are a few outstanding issues. Besides the importance of clarifying extra-budgetary military activity, fiscal statistics need to show clearly the transactions of the copper and oil stabilization funds, if these are maintained. It would be useful to clarify the coverage and effectiveness of the municipal budget constraint, and eliminate the minor coverage differences in sources of general government statistics.
- The alignment of **central bank** and government accounting bases planned by government will help clarify the flows between them and the size of the central bank's quasi-fiscal balance. If only for transparency purposes, the government should consider recapitalizing the central bank, so that the bank would be more likely to transfer profits back to government than to show uncompensated losses.
- Transparency would be enhanced by making the government's relations with **Banco Estado** explicit: notably by remuneration for the use of balances in the unified fiscal account on the one hand, and of the offsetting costs of providing fiscal services and pursuing the bank's social support agenda on the other.
- Since **public enterprises** are important in the economy, concerns about whether they are truly arms-length from government could create uncertainty. Hence, it would be essential to continue to provide information on them—while noting that Chile already provides more detail than elsewhere, exceeding international standards. The planned shift in the fiscal presentation to accrual accounting should give a more accurate picture of their operations, as will the intended development of a general government balance sheet incorporating the equity value of the enterprises. The supervision of **CORFO**, and its reporting requirements, should be examined.<sup>59</sup>
- While the **tax system** (SII, Customs, and Treasury) seems open, the reform of tax tribunals now in congress (which will make first-round tribunals independent of the

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<sup>59</sup> The investigating commission found a series of gaps in CORFO's internal control and accounting procedures.

tax agencies and create expert tax chambers in the courts) is an appropriate response to questions about their independence.

- The recent laws passed to clarify **government remuneration** and limit **political appointments** should put to rest important transparency concerns as they are implemented—as will the general civil service reform law.
- **Procurement** has not been seen as a serious problem area in Chile, despite the lack of a general legal framework and recent investigations of irregularities in contracts. Nonetheless, the introduction of Chilecompras and the new law, implying the alignment of procurement rules across agencies, will be useful in clarifying and completing the rules (including for small purchases), eliminating differences of treatment in the regimes of different agencies, and making contracts more transparent.

### **Public availability of information**

- As discussed, great strides have been made in publishing information. The most obvious remaining issue is the incorporation of information on **defense transactions and debt under the Reserved Copper Law** into the budget and fiscal statistics.
- The increase in importance of **concessions** has raised questions about future contingent liabilities from concession contracts. Recent studies of contingent liabilities have helped to identify potential costs. This should be regularly updated in the documentation accompanying the budget, and the flows associated with concessions should be accounted for transparently in fiscal statistics.
- More generally, a regular updating schedule should be established for estimates of **tax expenditures and contingent liabilities**.

### **Open budget preparation, execution, and reporting**

#### *Macro objectives and framework*

- Uncertainty would be further reduced by converting **the structural balance target** into a legally-based fiscal rule. However, obviously other policy considerations would have to be taken into account in deciding whether it would be appropriate to make the structural balance rule permanent. Public understanding of the target is high despite its complexity, but the authorities could enhance perceptions of transparency by providing more detail about the potential output methodology and their longer-term spending goals.
- While **the macro-framework and medium-term projections** in the documentation accompanying the budget meet the standards of the code, further detail, and in particular more disaggregation of expenditure to show the impact of future obligations (for instance, for investment, concessions, or pensions), would strengthen the value of the projections. Likewise, while **fiscal risks** are analyzed in this

documentation when perceived to be important, the inclusion of a more systematic discussion (sensitivity analysis or alternative scenarios) would reassure.

- The **copper stabilization fund** co-exists somewhat uneasily with the structural balance rule, which also relates to copper price fluctuations. If the changes in fiscal accounting currently under discussion go through, the copper fund would become redundant and could be terminated without cost to fiscal management.
- The adoption of **the unified presentation of fiscal accounts** should dispel questions about whether Chile's fiscal targets accurately show the fiscal stance. It must be stressed, however, that differences between the various presentations have never been large enough to be problematic.

#### *Data for budget preparation and execution*

- While Chile provides rich **budget data** broadly in line with GFS classification, it would be helpful if a consolidated national currency budget could be provided in the Budget Law as well as the separate dollar and peso budgets, and if more disaggregation of the economic classification of the budget numbers could be shown. Some attention could usefully be paid to the functional classification of expenditure, ideally making it available with the budget documentation rather than only ex post, and ensuring that it is compiled from program-level data. The introduction of SIGFE, the integrated financial management system currently being tested by the Ministry of Finance on a pilot basis, will substantively facilitate data provision—and should be introduced as soon as possible.
- The lack of timely and systematic accounting and reporting of **expenditure arrears** is a weakness of the current cash-based budget management system (though the CGR has commitments data which allow arrears to be tracked, and these are small). The implementation of the new GFS will provide a comprehensive framework for accounting, and the introduction of SIGFE should permit timely reporting. As a short-term measure, consideration should be given to issuing periodic reports on arrears in problem areas (notably health and public works).

#### **Assurances of integrity**

- **Reconciliation of fiscal with monetary data** is done by individual institutions and seemingly not systematically at the macro level. Reconciliation of the macro-accounts can be a useful independent check on the accuracy of budget execution figures and a regular exercise is recommended. In this connection, the authorities' intention to move rapidly to full implementation of **the new (2001) GFS standard** is welcome—both because it will facilitate reconciliation, and will more generally enhance fiscal reporting by providing an integrated view of all government flows and stocks.

### Box 1. Military Activity—Transparency Issues

A well-known gap in Chile's fiscal statistics is the omission of some military activity from budget and debt statistics, and inclusion of only general information on some budget items. The armed forces are also exempt from some other transparency requirements and regulations. Issues include:

- **The Reserved Copper Law provides for 10 percent of Codelco's gross revenues from copper to be transferred in equal parts to the three branches of the armed forces for equipment purchase.** The law sets a floor on the revenues transferred—which, in case of very low copper prices, is topped up by government. The use of the resources is subject to control in that the Ministry of Finance authorizes any spending financed by resources allocated under the Reserved law (though the CGR does not receive information on the transactions). There are, however, transparency problems with the arrangement because (1) the public and the markets do not know how military funds are being allocated, and (2) since the funds need not be spent in the year they are transferred from Codelco, a surplus or deficit might arise in the military sector which is not factored in to the overall macro-assessment of fiscal policy. A law was passed on January 21, 2003, which will authorize the authorities to publish details on Reserved Law resources. The data available since then suggest that the balance on military activity is small enough and stable enough not to change overall fiscal policy conclusions.
- **The armed forces may borrow** to finance purchases of equipment. Since their debt is not reported (for instance, it is not included in the new *Statistics on Public Debt*), the lack of information on their borrowing creates uncertainty about Chile's total debt stock and debt service. The Ministry of Finance, by virtue of its powers to authorize military spending, pursues the goal of limiting military borrowing to amounts compatible with future earnings expected from the Reserved Copper Law—with a view to maintaining the sustainability of Chile's overall debt stock in line with the nonmilitary debt measured in published reports.
- **The armed forces, like a few other ministries,** hold expenditure reserves (*gastos reservados*) whose use is not specified in the budget. They are however included in the budget, and are reported on (without details of their use) to the Ministry of Finance and the CGR. The transparency issue arises because their use is not identified. However, they are very small, around 0.1 percent of the armed forces' total budget allocation. The January 21, 2003 law is intended to limit these and require details of their use to begin to be reported.
- **The armed forces are exempt from various general regulations.** For instance, military procurement is subject only to internal procedures, equipment purchases are not subject to technical evaluation, and until recently no evaluation was made of nonmilitary investments. Likewise, defense industry enterprises are exempt from most public enterprise financial regulations. The 2003 procurement law will begin to address some of these shortcomings.
- **Several provisions covering spending by the armed forces complicate budget management.** Defense spending is subject to a constitutional floor, and some specific components also have legal floors. The armed forces are not required to provide the same disaggregation of spending items as are other public institutions, nor to record or get clearance for the use of proceeds from the sale of fixed assets.

### **Box 2. The Legacy of Past Quasi-Fiscal Activity in the Central Bank**

The Central Bank of Chile registers a quasi-fiscal deficit on account of past operations, despite the fact that these have long ceased. Moreover, the impact of the measured deficit is difficult to assess in isolation, for various Chile-specific reasons.

- The central bank's balance sheet continues to reflect **the impact of commercial bank rescue operations conducted in the 1980s**. Broadly put, the income on the bonds received by the bank from the government did not fully compensate for the costs of the bank rescue. Moreover, the government bonds that were issued to the central bank provided for some interest to be capitalized; since traditionally the central government accounts have been on a cash basis while the central bank's financial statements are on an accrual basis, the flows between the two were reported differently. This difference will be resolved by the government's plan to report its interest payments on an accrual basis, as part of the transition to the new GFS.
- **Past episodes of sterilized intervention in the foreign exchange market** also acted to reduce the central bank's capital. Before a floating exchange rate regime was adopted in 1999, the central bank at times purchased significant amounts of foreign currency, sterilizing the monetary impact by issuing domestic obligations that pay a higher interest rate than could be earned on international reserves.
- **Interpretations of the implications of the quasi-fiscal deficit are difficult**, since part of the interest bill moves up and down more or less automatically with capital gains or losses. Thus, movements in the Bank's profit-and-loss account which are not taken into account in the calculation of the quasi-fiscal position tend to offset/compensate for the deficit.

**Today, the scope for quasi-fiscal activity by the central bank is quite limited.** The central bank is prohibited, by Chile's constitution, from providing credit or guarantees to the government or public enterprises. The bank's transactions with the government are limited to acting as a fiscal agent, and the practice is to conduct these operations on market-related terms, such as in the interest rate paid on government deposits. Similarly, if the bank sells foreign exchange to the government, such as that needed for debt service, this is done using the average market exchange rate of the previous day. The bank cannot engage in transactions with the nonfinancial private sector. Rules for the transfer of any central bank profits to the government are clearly defined, though there is no rule requiring the government to compensate or recapitalize the bank should losses emerge. The bank is however authorized to request new capital from the government.

### Box 3. Chile's Public Debt Statistics

**The quality of Chile's public debt data was previously assessed by the IMF in mid-2001, for the Data Module of the ROSC. At that time it was found that Chile's fiscal data met the Special Data Dissemination Standards,** though with flexibility options exercised on timeliness and periodicity.<sup>60</sup> Notably, the Ministry of Finance compiled quarterly central government debt data with a one-month lag but did not disseminate them. Annual central government debt data were compiled and disseminated with a ten-month lag, although the data were available earlier.<sup>61</sup> The coverage of Chile's debt statistics was effectively general government—except for the omission of military debt—since municipalities have not been permitted to contract debt.

**Since then, important innovations have significantly improved Chile's debt reporting,** in terms of timeliness and provision of specific information useful for analyzing Chile's macro-situation, exceeding SDDS requirements.

- The Ministry of Finance began to release **quarterly data on central government debt with one quarter's lag**, starting in September 2001. These data include classifications by currency, maturity, creditors, and instruments.
- The Ministry issued a **comprehensive report on public sector debt** in October 2002, with broader scope, more detail, international comparisons, and methodological commentary. In particular, the new report includes central bank debt and nonfinancial public enterprise debt, and it shows net and gross debt of the central government consolidated with the central bank. Though pension liabilities are not classified as debt in the GFS, and indeed are not reported by most countries, the report also includes supplementary information on the amount of pension "recognition bonds."

**Taking all of Chile's sources of debt statistics into consideration, Chile now more than fully complies with the best-practice criteria in the Fiscal Transparency Manual** (paragraph 79), with some remaining exceptions.

**The outstanding reform agenda includes,** most importantly, the need to report on military debt. Also, for the new report covering the broader public sector, it would be advisable to (1) break down debt by maturity; (2) separately identify debt indexed to the exchange rate or inflation (and comment on its revaluation); (3) if the state universities have debt, include this; (4) verify whether information provided by residence and by currency composition is comprehensive (for instance, data are shown only in dollars and pesos); and finally, (5) include debt service projections (interest as well as amortization) in the reports.

<sup>60</sup> The Manual on Fiscal Transparency (IMF, 2001, paragraph 79) states that "Best-practice in debt reporting is represented by the SDDS."

<sup>61</sup> Other institutions also publish debt data: the central bank (external debt only—monthly and annually); the CGR, and the Treasury (both annually).

#### **Box 4. The Structural Balance Target**

The government that took office in 2000 committed itself to achieving in 2001, and then maintaining in subsequent years, a targeted level of the structural balance. Although pursuing such a target is not a legal requirement, it is a flagship/emblematic policy commitment of President Lagos' administration, and has been the explicit basis for the budgets prepared for 2001, 2002, and 2003.

The nature, rationale, and methodology of the policy of targeting the structural balance were set out comprehensively in a policy paper issued by the Budget Directorate in 2001. Essentially, the structural balance is defined as the overall balance adjusted for estimated temporary effects on government revenue of cyclical fluctuations in output and real copper export prices.

This new, innovative practice has a number of positive implications for transparency:

- **It allows the government to commit to a precise target for the fiscal balance**, to be achieved in every year, without having to suppress automatic stabilizers (as would a simple balanced budget rule, for example). The rule is based on an ex ante measure which allows the legislature, analysts, and the public to assess fiscal policy at the time the budget is discussed.
- **It provides a clear indication of how the government intends to conduct fiscal policy over the medium term.** In particular, it makes clear that the government intends to forsake active countercyclical policies (i.e., beyond allowing automatic stabilizers to operate), and provides additional information about the fiscal stance. Similarly, it makes clear that the government intends to adjust policies to fully offset the effect of permanent shocks on the fiscal balance, but to make no adjustment in response to temporary shocks.
- **The policy horizon is unambiguous:** the targeted structural balance is to be achieved in each budget year (not "over the cycle," or on average over a certain number of years, which would give more discretion and leave open the possibility of delayed or last-minute adjustments).
- **The question of fiscal sustainability is addressed on an ongoing basis**, since the target seeks to achieve a small surplus as a long-run average, and thus to avoid any tendency toward ongoing debt accumulation. Updated estimation of the structural balance is conducted and published twice each year, once a year with direct input from expert panels. Since the target refers to the overall balance, any deterioration in financing conditions that prompted a higher interest bill would automatically require the government to raise its primary surplus.

**The new fiscal policy approach has not, of course, resolved all possible uncertainties about future fiscal policy.** Distinguishing temporary from permanent shocks as they occur is notoriously difficult, and as for any country, the structural balance can only be estimated with some uncertainty. Structural balances require a complex estimation process, requiring a substantial effort to avoid perceptions of nontransparency (hence, for instance, Chile's use of independent expert panels).



### **Box 5. Recent Innovations in Evaluating the Effectiveness of the Budget**

**The process of incorporating tools for improving budget procedures and directing them toward results has speeded up in Chile in the past three years.** Tools include (1) performance indicators; (2) program and impact assessments; (3) comprehensive evaluations of expenditure; (4) a competitive common fund; and (5) comprehensive management assessments. Evaluations are carried out by external consultants, who are selected by public competition to ensure independence in the process,

- **Performance indicators are used to provide quantitative information on the institution's results in providing outputs (goods and/or services).** The budget bill for 2003 incorporates 1,039 indicators for 111 government services, which virtually doubles the number of indicators used in previous years.
- **Evaluation of government programs and impact assessments provides information to support analysis in resource allocation.** The evaluation of government programs is based on the analytical framework for evaluation used by multilateral development agencies and contains conclusions about the capacity of the program to achieve the planned goals. Impact assessments—introduced in 2001—require on-site research and the application of more complex analytic models. In six years, 134 public programs have been evaluated, two of them under the new impact assessment.
- **The Comprehensive Expenditure Evaluations focus on evaluating the set of procedures, programs and policies administered by a Ministry.** The comprehensive evaluation of the expenditure of the Ministry of Agriculture was carried out during 2002 by a panel of six external consultants with the World Bank's support.
- **The Competitive Common Fund (FCC) was created in 2000 to finance new, reformulated or expanded programs.** Programs for competitive fund financing are presented by line ministries in a standard format to the Ministry of Planning and are selected on merit (defined by a number of comparable criteria). For the 2003 budget bill, a total of 298 proposals were presented by various ministries. Initiatives worth a total 148 billion pesos were approved. Sixty-three percent of the FCC was assigned to 114 programs.
- **Management Improvement Programs link compliance with performance targets to a monetary incentive for employees.**<sup>62</sup> Employees who met the targets have the right to a 3 percent bonus in the following year, provided the institution achieved 90 percent of its annual agreed objectives. Since 2000, the PMG relate to the development of strategic areas of public management.

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<sup>62</sup> Management improvement programs (PMGs) were introduced in 1998 and re-formulated in 2000.

### **Box 6. Policy Response to Irregularities in the Public Sector**

**Since November 2002, several allegations have led to judicial investigations of public sector financial irregularity.** These focus on the Ministry of Public Works and Transportation, and on the public holding company (CORFO) and relate to the authorization of motor inspection centers, payments to high officials (reportedly from reserved spending) and external contractors, relationships with concessionaires, and the diversion of public investible funds. The investigations sparked a broader discussion of public sector performance, oversight, and transparency. The government, wanting to avoid jeopardizing its high Transparency International ranking (17 out of 102 countries), took several measures to ensure that the recent cases remain isolated and to address some of the issues that emerged in the discussion.

**The cases were viewed as highlighting shortcomings in public remuneration, budget transparency, political funding, and oversight of public financial holdings.** (1) Officials have been allowed to receive honoraria for services such as lectures, consulting; this was seen as allowing them to supplement their salaries to closer to market levels. (2) The reserved spending category (available to some ministries only) was not reported in detail or controlled. (3) The number of political appointees was relatively high. (4) No public funding of political parties has been permitted and regulations on private campaign financing have been lacking. And (5) few controls limited the placement of public funds in capital markets.

**The 2003 budget law contained the following provisions,** later turned into permanent legislation:

- That any services contract with a government entity must include a **disclosure** of any other contracts that might imply a conflict of interest; likewise, it would need to be established that no conflict existed with the probity principles in the Administrative Statute.
- **Provisions prohibiting conflict of interest** were extended to temporary as well as permanent staff.
- All investment contracts must be subject to **open competitive bidding**.

**Measures were passed by congress in two laws on January 21, 2003:**

- **Allowances were created for high-level officials,** to raise their salaries toward market levels. It was clarified that such officials could not receive honoraria or work for anyone other than government.
- Further requirements were imposed as regards disclosure of transfers from government.
- A uniform definition of **reserved spending** was set, with a list of institutions eligible for such spending (only security-related agencies); procedures were introduced for more detailed reporting of the spending to the CGR; and military reserved expenditure will be subject to regular authorization rather than decree.

**A Transparency Commission was set up by the President,** to elaborate on commitments already discussed by the government and congress, notably a **reduction in political appointments** from around 3500 to around 400, **competitive hiring** of other officials, and **changes in funding processes** for political parties.

**All major political parties signed an agreement covering 49 areas for reform,** to be implemented in the next three years. The first twelve (the “short-term agenda”) were implemented by May 21, 2003. Some of these new laws made permanent the commitments described above, and, as discussed in the text of the ROSC, resolved important fiscal transparency shortcomings—on civil service personnel policy, procurement, and establishment of a permanent congressional budget commission. Others cover campaign financing, parliamentary and administrative procedures, and anti-trust tribunals.

**DIPRES issued guidelines limiting public institutions’ investment outside banks.** Also, a law is being prepared to require all public financial placements to be recorded in the central securities depository.

### **Box 7. Recent Progress and Pending Reforms in Fiscal Transparency**

#### **Recent progress includes:**

- Reform of the budget system
  - Creation of the Competitive Common Fund (FCC) to finance new programs (2000)
  - Establishment of Management Improvement Programs (2000)
  - Introduction of impact assessments of budget programs, with on-site research (2001)
  - Adoption of comprehensive evaluations of ministry spending and management (2002)
  - Establishment of panels for evaluations and to provide independent forecasts for key macro assumptions (2001-02)
- Timely disclosure of fiscal information mandated by law (2003; see Figure 2)
  - Monthly central government budget execution
  - Quarterly central government budget report
  - Quarterly state-owned companies financial report
  - Yearly *Public Finance Statistics* and yearly *Public Finance Report*
  - Biannual public sector debt report
- Administrative reform
  - Laws simplifying administrative procedures and consolidating financial management legislation (amending LAFE): including 'positive administrative silence,' restrictions on honoraria and reserved spending, prohibition of deferred payments, switch of some annual budget provisions to permanent legislation (2003)
  - Civil service reform law: including new salary scale, performance incentives and promotion provisions, and reduction in political appointments
  - "Fighting Tax Evasion" Law to encourage fairer treatment of taxpayers
- Strengthened control of the procurement system
  - Introduction of a register of state suppliers and an official website (Chilecompras) for public contracts (2002); new procurement law (2003)
- Clarification of political-fiscal relations (2003)
  - Permanency of the congressional budget commission
  - Reform of campaign financing laws and restrictions on publicity spending
  - Constitutional reform defining parliamentarians' obligations

#### **Pending reforms:**

- Bill sent to congress to make first-round tribunals independent of tax agencies and to create chambers with independent tax expertise within the Court of Appeals.
- Introduction of an integrated system of financial management on a pilot basis in 2002 and full operation scheduled by end-2004.
- The rest of the 'Agenda for the Modernization of the State,' including: review of state enterprise management; review of subnational government laws; review of probity legislation; modernization of the CGR; and further measures to improve procurement and evaluation.