

CHILE
LOCAL DEVELOPMENT PROGRAM
STAGE III

(CH-0004)

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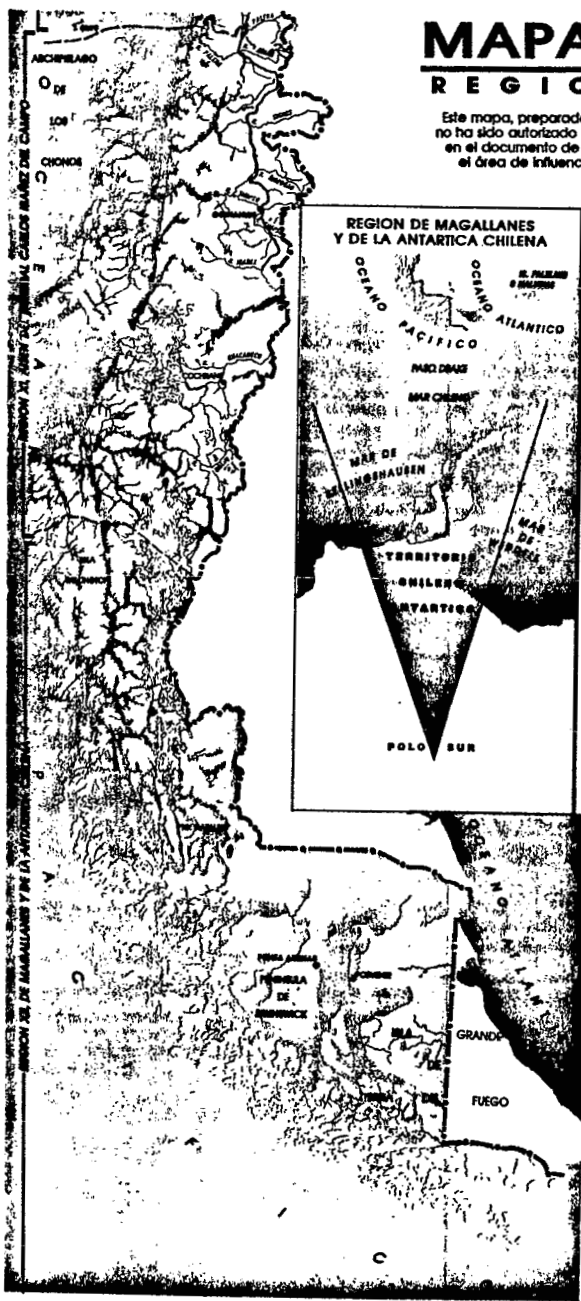
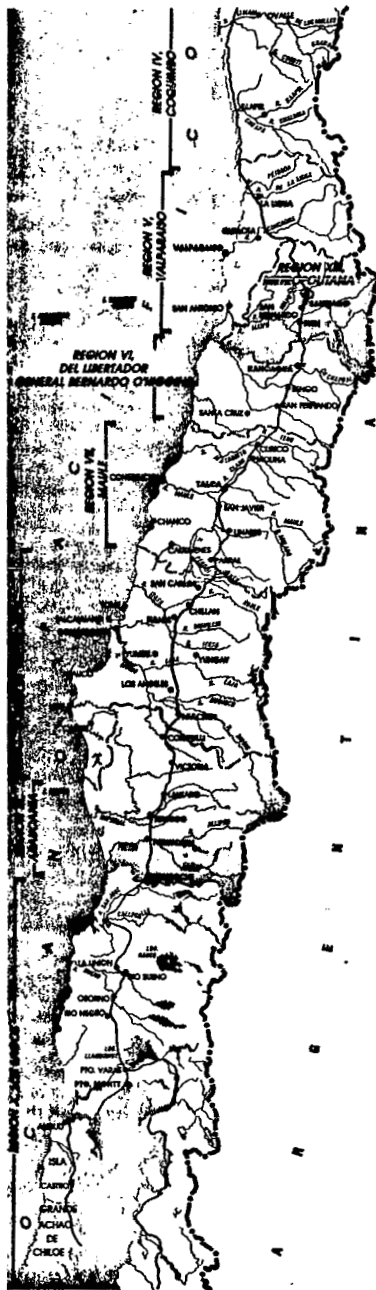
Appendix 1 Proposed Resolutions

DOCUMENTS AVAILABLE IN THE TECHNICAL PROJECT FILE

Reglamento Operativo [Operating Regulations]
Ciclo de Proyectos [Project cycle]
Evaluación Ex-post de una Muestra de Proyectos [Ex post evaluation of a sample of projects]
Programa de Fortalecimiento Institucional [Institutional strengthening program]
Asignación de Fondos Regionales e Incentivos de Eficiencia [Regional funds allocation and efficiency incentives]
Descentralización Fiscal, Problemas y Perspectivas en el Caso de Chile [Fiscal decentralization: Problems and prospects in the case of Chile]
Inversiones de Decisión Regional [Regionally-determined investments]
Análisis del Impacto de las Inversiones Regionales [Analysis of the impact of regional investment]
Diagnóstico de los Sectores de Responsabilidad Regional [Diagnostic study of sectors under regional responsibility]
Control de Calidad Ambiental para los Proyectos de Inversión Pública [Environmental quality control for public investment projects]
Marco Jurídico de la Descentralización Regional y Municipal [Legal framework of regional and municipal decentralization]
Convenios de Programación, Propuesta Operativa [Programming agreements: Operating proposal]

ABBREVIATIONS

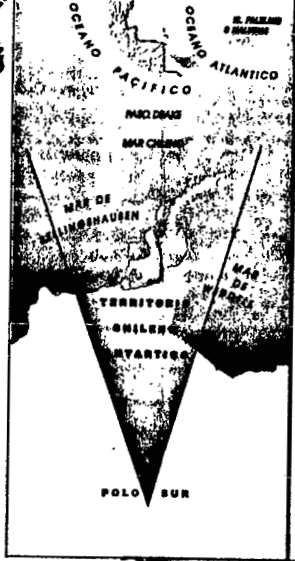
BIP	Integrated project bank
CONAMA	Comisión Nacional del Medio Ambiente [National Environment Commission]
CORE	Regional council
COREMA	Regional environmental council
DIGEDER	Sports and Recreation Directorate
DIPRES	Budget Directorate, Ministry of Finance
EIA	Environmental impact assessment
EIS	Environmental impact statement
FCM	Municipal Common Fund
FNDR	Fondo Nacional de Desarrollo Regional [National Fund for Regional Development]
FOSIS	Fondo de Solidaridad e Inversión Social [Solidarity and Social Investment Fund]
ISAR	Regionally allocated sector investments
MIDEPLAN	Ministry of Planning and Coordination
MINTER	Ministry of the Interior
MINVU	Ministry of Housing and Urban Development
MOP	Ministry of Public Works
PADERE	Regional development support program
PIM	Local development multiple investment program
SEIA	Environmental impact evaluation system
SEREMI	Regional ministerial secretariat
SERPLAC	Regional planning and coordination secretariat
SNI	National investment system
SUBDERE	Administrative and Regional Development Undersecretariat, Ministry of the Interior
UCN	National steering unit
UCR	Regional coordinating unit
UNDP	United Nations Development Programme



MAPA DE C REGIONALIZ

Este mapa, preparado por el Banco Interamericano
no ha sido autorizado por ningún órgano compet
en el documento de préstamo tiene por objeto
el área de influencia del Proyecto que se prop

REGION DE MAGALLANES Y DE LA ANTARTICA CHILENA



CHILE

Basic Socio-Economic Data
Statistics and Quantitative Analysis
Integration and Regional Programs Department

Executive Summary

Social Statistics

Land Area (Km2)	1993	756,629
Population (Thousands)	1993	13,813
Population (Average Annual Growth Rate)	1984-1993	1.7
Rural (Percent)	1993	13.1
Density (Population per Km2)	1993	18.3
Vital Statistics		
Crude Birth (Rate per 1,000 Population)	1992	22.5
Infant Mortality (Rate per 1,000 Live Births)	1992	17.0
Crude Death (Rate per 1,000 Population)	1992	6.5
Life Expectancy at Birth (Years)	1992	72.0
Illiteracy (Percent)	1990	6.6
Primary School Enrollment Ratio	1991	98.0

Economic Statistics

Exchange Rate (Pesos/US\$)	8-1994	419.2
GDP per Capita (Average Annual Growth Rate)	1984-1993	4.5
Labor Force (Thousands)	1992	4,922
Unemployment Rate (Percent)	1993	4.8
Consumer Prices (Twelve Month Variation)	8-1994	11.2
Central Government Deficit or Surplus (% of GDP)	1993	2.1
Domestic Credit (% of GDP)	1993	56.6
Balance of Payments (Millions of US\$)		
Current Account Balance	1993	-2,093
Trade Balance	1993	-979
Capital Account Balance	1993	2,608
Change in Reserves (- Increase)	1993	-420
Total External Debt (Millions of US\$)	1993	20,700
Total Debt Service (Millions of US\$)	1993	2,865
Debt to GDP Ratio (Percent)	1993	41.6
Debt Service Ratio (Percent)	1993	23.2

21 November 1994

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Basic Socio-Economic Data

1. Exchange Rates

Pesos/US\$, End of Period Index 1990=100

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Exchange Rate	128.2	183.9	204.7	238.1	247.2	297.4	337.1	374.5	382.1	428.5
Real Effective Index	58.9	73.0	86.4	93.1	99.6	97.3	100.0	96.9	91.7	91.0

2. Prices

Average Annual Growth Rates in Percent

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Consumer Price Index	19.9	30.7	19.5	19.9	14.7	17.0	26.0	22.0	15.6	12.1
Wholesale Price Index	26.9	42.4	19.1	19.6	6.0	15.5	22.0	22.0	11.5	8.1

3. International Liquidity

Millions of US\$

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Reserves	2843	2968	3019	3262	3840	4221	6710	7638	9742	10252
Reserves minus Gold	2303	2450	2351	2504	3161	3629	6069	7041	9168	9640
Special Drawing Rights (SDRs)	12	0	0	41	44	24	1	1	1	1
Reserve Position in the IMF	0	0	0
Foreign Exchange	2292	2450	2351	2463	3116	3604	6068	7041	9167	9639
Gold (National Valuation)	540	519	668	757	679	592	642	597	574	612

4. National Accounts

Millions of 1988 US\$ 1988 US\$

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Gross Domestic Product	24971	25509	26853	28452	30527	33560	34434	36489	39986	42219
GDP Per Capita	2095	2104	2178	2270	2395	2589	2614	2726	2940	3056

Annual Growth Rates in Percent - Constant Prices

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
GDP Per Capita	4.1	0.3	3.8	4.8	5.5	8.3	1.3	4.4	8.5	4.4
GDP by Type of Expenditure (MP)	5.9	2.0	5.6	6.6	7.3	10.2	3.0	6.1	10.3	6.0
Consumption	-1.6	-0.2	4.4	5.6	6.5	9.3	2.2	7.1	9.4	6.9
Gross Domestic Investment	72.5	-17.1	6.9	26.8	11.6	24.2	-3.3	-2.1	23.3	13.8
Exports of Goods and Services	2.2	12.3	10.1	6.7	11.6	15.9	8.8	10.0	16.7	4.4
Imports of Goods and Services	13.1	-10.3	7.9	18.6	12.8	24.5	2.0	6.3	23.7	11.5
GDP by Sector of Origin (FC)										
Agriculture, Forestry and Fishing	8.9	7.3	7.6	9.5	11.5	3.8	6.6	3.2	4.8	1.1
Mining and Quarrying	5.5	3.2	0.9	-0.3	7.8	9.6	-1.9	5.3	1.5	0.6
Manufacturing	8.9	2.7	7.6	5.3	8.8	10.9	0.5	5.7	11.0	3.6
Electricity, Gas and Water	7.3	4.5	6.1	5.5	5.6	-2.8	-1.7	24.1	22.6	5.2
Construction	1.9	17.8	9.7	9.1	8.6	17.2	4.5	3.8	12.8	14.0
Wholesale and Retail Trade	3.1	-5.9	5.1	10.9	5.3	12.6	5.1	6.2	14.0	8.7
Transport and Communications	4.5	5.4	6.6	9.6	8.8	13.5	6.4	9.6	14.2	7.9
Financial Services	7.6	-2.7	4.4	5.3	5.1	8.4	4.2	6.4	7.6	6.0
Government
Other Services	3.9	3.3	3.9	1.2	2.8	2.3	2.5	2.9	3.5	3.3

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Basic Socio-Economic Data

4. National Accounts (cont.)

Composition in Percent - Current Prices

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
GDP by Type of Expenditure (MP)										
Consumption	...	80.4	78.1	74.9	70.3	70.0	72.1	73.2	74.3	...
Gross Domestic Investment	...	17.2	18.9	22.2	22.8	25.5	24.7	22.2	23.7	...
Exports of Goods and Services	...	28.1	29.1	30.3	34.6	35.1	34.3	33.3	30.9	...
Imports of Goods and Services	...	25.7	26.0	27.4	27.6	30.7	31.1	28.7	28.9	...
GDP by Sector of Origin (FC)										
Agriculture, Forestry and Fishing	...	7.4	8.6	8.8	8.5
Mining and Quarrying	...	13.2	10.0	11.4	15.5
Manufacturing	...	15.7	17.9	17.5	18.1
Electricity, Gas and Water	...	2.6	2.7	2.5	2.5
Construction	...	4.9	4.8	4.8	5.1
Wholesale and Retail Trade	...	13.4	14.1	15.4	13.4
Transport and Communications	...	6.0	6.3	6.1	6.0
Financial Services	...	11.2	11.1	10.0	9.8
Government
Other Services	...	13.8	13.2	12.2	11.8

5. Central Government

As a Percent of GDP

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Current Revenues	32.5	30.3	30.9	30.6	31.4	29.7	25.9	27.1	27.2	26.7
Tax Revenue	21.0	19.5	19.2	19.0	18.1	17.4	16.4	17.8	18.4	18.6
Current Expenditures	31.0	27.6	26.1	22.9	21.0	20.8	19.5	20.6	19.8	20.0
Current Savings	1.5	2.7	4.8	7.6	10.4	8.9	6.5	6.5	7.4	6.7
Capital Expenditure	4.7	4.8	5.5	5.5	7.1	4.2	5.3	5.1	4.9	4.7
Deficit or Surplus	-3.0	-1.9	-0.5	2.3	3.6	5.0	1.4	1.6	2.6	2.1
Domestic Financing	2.4	0.9	-1.5	-2.4	-5.8	-5.8	-1.3	-0.9	-0.4	-0.3

6. Monetary Survey

As a Percent of GDP

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Domestic Credit	80.9	84.9	96.2	90.1	76.4	69.0	65.8	55.2	52.4	56.6
Public Sector	12.2	22.3	38.2	37.2	28.3	23.8	23.5	17.3	13.0	11.3
Private Sector	68.7	62.6	57.9	52.9	48.1	45.2	42.2	37.9	39.4	45.3
Money (M1)	6.6	5.1	4.9	4.2	4.3	3.9	4.5	4.5	4.8	3.9

7. External Trade

Direction in Percent - Customs Basis Index 1980=100

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Exports of Goods (fob)										
Developed Countries	70.3	69.3	68.5	68.5	71.8	70.5	72.9	69.8	...	61.2
Developing Countries	29.7	30.7	31.5	31.5	28.2	29.5	27.1	30.2	...	38.8
Latin America	15.0	14.3	16.5	16.7	12.7	12.0	12.2	14.1	...	19.4
Imports of Goods (cif)										
Developed Countries	52.3	51.3	56.4	55.8	53.4	55.4	57.6	53.7
Developing Countries	47.7	48.7	43.6	44.2	46.6	44.6	42.4	46.3
Latin America	25.9	25.5	23.5	23.7	26.7	25.0	23.8	26.4
Terms of Trade Index	78.0	72.6	76.9	81.5	98.6	92.1	84.6	86.6	78.4	71.0

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Basic Socio-Economic Data

7. External Trade (cont.)

Millions of US\$ - Customs Basis Composition in Percent

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Exports of Goods (fob)	3567.1	3674.1	3954.6	4845.2	6794.2	8006.3	8292.1	8552.0	9646.4	9068.7
All Food	22.5	24.4	27.4	26.8	23.6	22.7	24.0	27.6	28.9	28.6
Agricultural Raw Materials	10.2	8.5	9.9	11.0	9.7	8.1	8.7	8.2	9.3	10.5
Fuels	1.3	0.5	0.1	0.1	0.2	0.3	0.5	0.5	0.4	0.2
Ores and Metals	59.7	60.6	55.0	53.6	58.0	59.0	56.2	51.0	48.3	44.5
Manufactured Goods	6.3	6.0	7.7	8.4	8.5	9.9	10.5	12.7	13.1	16.3
Chemicals	2.2	2.6	2.6	2.6	3.1	3.8	3.5	3.8	3.5	4.0
Machinery and Transport Equipment	1.5	0.7	1.7	1.0	0.8	0.7	1.1	1.3	1.9	2.8
Other Manufactured Goods	2.6	2.7	3.4	4.8	4.7	5.5	5.9	7.6	7.7	9.4
Imports of Goods (cif)	3190.0	2742.5	2914.3	3793.2	4730.8	6495.7	7022.3	7452.6	9455.5	10541.9
Capital Goods	15.7	19.9	21.4	25.0	25.9	...	30.2	25.2
Consumption Goods	27.8	23.0	21.9	20.5	20.6	...	13.6	17.2
Intermediate Goods	56.5	57.1	56.7	54.5	53.5	...	56.2	57.6
Fuels	16.3	17.3	12.4	10.8	11.9	...	11.6	9.9
Other

8. Balance of Payments

Millions of US\$

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Current Account Balance	-2111	-1413	-1192	-808	-167	-704	-648	12	-748	-2093
Trade Balance	362	884	1092	1230	2219	1578	1273	1574	747	-979
Exports of Goods (fob)	3650	3804	4191	5224	7052	8080	8310	8928	9985	9202
Imports of Goods (fob)	3288	2920	3099	3994	4833	6502	7037	7354	9238	10181
Service Balance	-2580	-2444	-2368	-2164	-2563	-2497	-2121	-1901	-1926	-1500
Freight and Insurance	-13	53	25	31	31	-45	124	41	75	48
Travel	-167	-146	-151	-168	-221	12	105	241	174	279
Investment Income	-2024	-2044	-1892	-1700	-1919	-1925	-1811	-1808	-1860	-1503
Other Services	-130	-48	-94	-65	-91	-207	-200	-110	13	24
Unrequited Transfers	107	147	84	126	177	215	200	339	431	386
Private	47	127	38	65	63	58	54	40	74	61
Official	60	20	46	61	114	157	146	299	357	325
Capital Account Balance	2014	1380	716	1021	1102	1394	3011	836	2931	2608
Non-Monetary Sector	1850	1371	999	1517	1512	1955	3462	1457	1380	2545
Private Sector	321	255	716	803	1195	2531	3581	1468	1165	2871
Direct Investment	78	114	116	230	141	1279	582	400	321	410
Portfolio Investment	-11	28	197	693	870	87	359	225	452	747
Other Long-Term	423	-272	-204	158	510	322	1215	79	3	645
Other Short-Term	-169	385	607	-278	-326	843	1425	764	389	1069
Government Sector	1529	1116	283	714	317	-576	-119	-11	215	-326
Long-Term	1488	1268	640	412	449	-711	-87	-9	168	-169
Short-Term	41	-152	-357	302	-132	135	-32	-2	47	-157
Monetary Sector	164	9	-283	-496	-410	-561	-451	-621	1551	63
Long-Term	1538	-34	-410	-644	-660	-916	-436	-355	-2	40
Short-Term	-1374	43	127	148	250	355	-15	-266	1553	23
Change in Reserves (- Increase)	-93	102	252	-135	-826	-570	-2331	-1248	-2548	-420
Errors and Omissions	190	-69	224	-78	-109	-120	-32	400	365	-95

CHILE

Basic Socio-Economic Data

9. External Debt

Millions of US\$
Ratios in Percent

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Total Debt	19737	20384	21145	21489	19582	18032	19227	17947	19360	20700
Long-Term Debt	17044	17628	18124	18008	16058	13789	14689	14790	14924	15881
Public and Publicly Guaranteed	10617	12897	14689	15542	13696	10866	10426	10071	9578	9772
Bilateral	568	574	636	686	1076	1042	1039	964	855	875
Multilateral	917	1532	2294	3218	3391	3550	4143	4315	4333	4517
Bond Holders	73	92	58	66	57	43	39	200	320	215
Banks	8375	10012	11008	10775	8417	5679	4748	4230	3799	3887
Suppliers	401	349	378	513	497	352	324	280	217	226
Other Creditors	284	339	316	284	258	200	133	81	54	52
Private Non-Guaranteed	6427	4731	3435	2466	2361	2924	4263	4720	5347	6109
Use of IMF Credit	779	1088	1331	1465	1322	1270	1157	958	722	482
Short-Term Debt	1914	1668	1689	2017	2202	2973	3382	2199	3714	4337
Interest Arrears on Debt	0	0	0	0	0	0	0	0	0	0
Total Debt Service	2776	2271	2220	2367	2148	2668	2772	2700	2705	2865
Public and Publicly Guaranteed	1172	1232	1526	1366	1265	1642	1612	1578	1438	1305
Bilateral	76	52	49	42	39	157	164	180	196	190
Multilateral	93	128	224	314	366	495	576	641	695	315
Private Non-Guaranteed	1255	735	239	365	359	477	523	619	847	1125
IMF Repurchases and Charges	46	64	265	457	360	303	327	294	273	290
Short-Term Debt (Interest only)	303	240	190	180	163	246	310	209	148	145
Debt to GDP Ratio	94	93	87	78	64	51	52	44	42	42
Debt Service Ratio	60	48	41	36	25	27	26	23	21	23

... Not Available

0.0 Indicates that the amount is nil or negligible

CHILE

Basic Socio-Economic Data

Sources and Notes

Executive Summary

Social Statistics:

Land Area: Organization of American States (OAS), América en Cifras 1974.

Population: IDB estimates based on data from Latin America Demographic Center (CELADE) and United Nations Population Division.

Vital Statistics:

World Bank, Social Indicators of Development - 1994 Edition and Economic Commission for Latin America and the Caribbean (ECLAC), Statistical Yearbook - 1994 Edition.

Economic Statistics:

Labor Force: World Bank, Social Indicators of Development - 1994 Edition.

Unemployment: Programa Regional del Empleo para América Latina y El Caribe (PREALC).

1. Exchange Rates:

International Monetary Fund (IMF), International Financial Statistics (IFS). Official rate.

Real Effective Index: IDB estimates based on data from the IMF, IFS.

2. Prices:

IMF, IFS. Annual figures are expressed as average annual growth rates; monthly figures as a twelve month variation.

3. International Liquidity:

IMF, IFS.

4. National Accounts:

GDP in 1988 US Dollars: IDB estimates.

GDP by Type of Expenditure and Sector of Origin: Banco Central de Chile. Financial Services and Government included in Other Services from 1989.

5. Central Government:

Contraloría General de la República, División de Contabilidad. Refers to General Government which includes central government, decentralized entities and municipalities.

6. Monetary Survey:

IMF, IFS (mid-year observations).

7. External Trade:

Trade by Direction: IMF, Direction of Trade Statistics (magnetic tapes).

Terms of Trade: ECLAC, Balance Preliminar de la Economía de América Latina y el Caribe, 1993.

Export Composition: United Nations Statistical Division (UNSTAT) Commodity Trade (COMTRADE) Data Base; Exports include Re-Exports.

Import Composition: Banco Central de Chile, Boletín Mensual. Fuels include Crude Petroleum.

8. Balance of Payments:

Banco Central de Chile and IMF, Balance of Payments Statistics (magnetic tapes).

9. External Debt:

World Bank, World Debt Tables (magnetic tapes) and estimates.

CHILE

REGIONAL SUPPORT SERVICES ITC/IRO

TENTATIVE LENDING PROGRAM

1995		US\$ Millions
CH0004	MULTIPLE LOCAL DEVEL. INV. PROGRAM III	75.0
CH0036	WATERSHED MANAGEMENT PROGRAM	25.0
CH0029	URBAN TRANSPORT AND IMPROVEMENT PROGRAM	50.0
CH0121	PREINVESTMENT PROGRAM II	10.0
CH0037	POTABLE WATER AND SEWERAGE PROGRAM	50.0
CH0123	SUPPOR MODER.IMPROV.INST.JUSTICE EFFORT	15.0
CH0120	SOIL RECUPERATION & HABILITATION PROGRAM	50.0
CH0040	MULTISECTOR CREDIT PROGRAM IV	100.0
CH0119	WORK TRAINING PROGRAM	60.0
CH0058	URBAN AREAS SOLID WASTE	30.0
CH0122	RURAL SANITATION PROGRAM	25.0
TOTAL		490.0
1996		
CH0039	PROG.TO INCREASE EFFIC.OF HEALTH SERV.	120.0
CH0031	MINING DECONT.& DIVERSIFICATION	40.0
TOTAL		160.0
TOTAL PROGRAMMED		650.0
OTHER POSSIBLE PROJECTS		
CH0035 96	PROGRAM AGAINST POLLUTION IN SANTIAGO	90.0

CHILE
REGIONAL SUPPORT SERVICES
RSS/ITC/IRO

IDB LOANS

APPROVED AS OF OCTOBER 31, 1994

	US\$Thousand	Percentage
TOTAL APPROVED *	4,571,011	100.0%
DISBURSED	4,186,642	91.6%
CANCELLATIONS	663,304	14.5%
UNDISBURSED BALANCE	384,369	8.4%
PRINCIPAL COLLECTED	1,600,795	35.0%
APPROVED BY FUND		
ORDINARY CAPITAL	4,324,765	94.6%
FUND FOR SPECIAL OPERATIONS	203,334	4.4%
SOCIAL PROGRESS TRUST FUND	34,351	0.8%
VENEZUELAN TRUST FUND	1,791	0.0%
OTHER FUNDS	6,770	0.1%
APPROVED BY SECTOR		
AGRICULTURE AND FISHERY	798,903	17.5%
INDUSTRY AND MINING	724,658	15.9%
TOURISM AND MICROENTERPRISE	51,895	1.1%
ENERGY	1,119,265	24.5%
TRANSPORTATION AND COMMUNICATIONS	728,760	15.9%
EDUCATION SCIENCE AND TECHNOLOGY	166,384	3.6%
PUBLIC AND ENVIRONMENTAL HEALTH	272,356	6.0%
URBAN DEVELOPMENT	658,175	14.4%
PLANNING AND REFORM	33,561	0.7%
EXPORT FINANCING	3,857	0.1%
PREINVESTMENT AND OTHER	13,197	0.3%

* Net of cancellations with monetary adjustments and export financing loan collections.

LOCAL DEVELOPMENT PROGRAM
STAGE III

(CH-0004)

EXECUTIVE SUMMARY

BORROWER: The Republic of Chile

EXECUTING AGENCY: The Administrative and Regional Development Undersecretariat (SUBDERE) of the Ministry of the Interior (MINTER) with the participation of the Ministry of Planning and Coordination (MIDEPLAN) and the National Environment Commission (CONAMA)

AMOUNT AND SOURCE:

IDB:	US\$ 75,000,000 (OC)
Local contribution:	US\$425,000,000
Total:	US\$500,000,000

FINANCIAL TERMS AND CONDITIONS:

Amortization period:	25 years
Disbursement period:	5 years
Interest rate:	variable
Inspection and supervision:	1% of the loan amount
Credit fee:	0.75% of undisbursed balances

OBJECTIVES: Under this program - the third stage of the program of support being provided by the Bank for the decentralization process in Chile - the institutional development of the regional governments will be fostered, in particular their ability to manage investments, and projects proposed by regional and municipal governments will be financed, in order to promote socioeconomic development and, above all, improve the living conditions of low-income groups.

DESCRIPTION: The program, which will be executed in the form of a multiyear (time slice) investment project, will be divided into two components: an investment component and an institutional development component. The investment component (US\$437.6 million) will provide the Fondo Nacional de Desarrollo Regional [National Fund for Regional Development] (FNDR) with resources to finance projects featuring primary health care infrastructure, municipally-administered education, sanitation facilities, rural electrification, secondary roads, and urban streets. These projects are to be cleared by the national investment system (SNI) and the environmental impact evaluation system

(SEIA), and assigned the required regional priority rating by the regional councils. During the execution period and subject to the Bank's approval, other sectors under regional responsibility may be added. The institutional development component (US\$5.7 million) will be used to finance training activities and advisory assistance services to strengthen the capacity of regional governments and of the SNI to allocate FNDR resources efficiently.

**PROCUREMENT
PROCEDURES:**

As a result of the analysis conducted by the project team, and in conjunction with the Procurement Policy and Coordination Office, the following threshold amounts have been established for international public bidding: goods procurement, US\$350,000 equivalent; and works contracts, US\$3 million equivalent. The bidding process will take place with no prequalification of bidders.

**ENVIRONMENTAL
CLASSIFICATION:**

The Environment Committee classified this as a Category III operation at its November 16, 1993, meeting and approved the environmental brief at its October 18, 1994, meeting.

BENEFITS:

The program will help to further the decentralization process in Chile by improving the regions' ability to efficiently allocate investment resources over which they have discretionary decision-making authority. The Bank's contribution goes beyond financing investments, since it will help to upgrade institutional mechanisms for execution and, in particular, for socioeconomic and environmental project evaluation, with active participation in supervision.

Financing is to be provided under the program for investments that will have a positive impact on living conditions for low-income population groups or support economic development in the various regions. In designing the operation, special emphasis was placed on ways to allocate funds more efficiently. They include: (i) implementing a revised version of the formula for interregional allocation, which will make for more equitable and effective distribution of FNDR resources; (ii) rationalizing the allocation of investment among sectors, by promoting the use of multiyear programming methodologies; (iii) introducing rules to govern cofinancing (by FNDR and sector ministries) that will minimize the adverse impact of duplicating financing windows and foster the use of FNDR funding by the regional governments as a way to attract sector investments; (iv) strengthening the regional structure of the SNI, which will assume full responsibility for evaluating the investments; and

(v) implementing procedures for assessing the environmental impact of projects.

TARGETING:

It is estimated that 65 percent of the program's beneficiaries would be members of low-income groups. That figure compares favorably with the 33 percent estimated percentage of the country's poor. Pursuant to the guidelines set forth in the report on the Eighth Replenishment (document AB-1704), it has been determined that the proposed program complies with the mandate of targeting low-income groups, in accordance with conditions prevailing in Chile.

RISKS:

The program entails no significant risks. The operating mechanisms are already functioning, and the borrower has given assurances that counterpart resources will be made available. The main risk would arise if the SNI and SEIA were unable to evaluate the projects efficiently, in which case there would be no guarantee that the projects were competently prepared and accurately evaluated. The institutional development component calls for resources to strengthen the entities involved, and the project team considers these activities sufficient to mitigate that risk.

**BANK'S COUNTRY AND
SECTOR STRATEGY:**

The Bank's strategy for Chile calls for backing programs to modernize the state and decentralize services to the regional and communal levels. The investments financed under the program will strengthen the regions' administrative, technical and financial ability to provide services and achieve more balanced development in their territories. The proposed program is fully consistent with that strategy.

**SPECIAL
CONTRACTUAL
CONDITIONS:**

Conditions precedent to the first disbursement:

(i) Application of the Operating Regulations; (ii) entry into force of the legal mechanism governing participation by MIDEPLAN and CONAMA; and (iii) agreement with the Bank on environmental control procedures.

Other contract conditions: The loan contract with the Bank will set forth conditions relating to: (i) presentation and implementation of a definitive methodology for allocating FNDR resources (paragraphs 2.7 and 4.4); (ii) program followup by means of yearly meetings (paragraph 4.34); (iii) cost recovery (paragraphs 4.20 and 4.21); (iv) reports and financial statements (paragraphs 4.33 and 4.38); (v) information for ex post evaluation (paragraph 4.37); (vi) the hiring of consulting services to strengthen the SNI; and (vii) implementation of environmental control procedures (paragraph 2.7).

I. FRAME OF REFERENCE

A. Background

- 1.1 Over the past two decades, marked changes have taken place in the internal administration of the Chilean State. Among them are the privatization of many activities, the deconcentration (execution by regional units of policies and programs decided on by central units) of most government programs and, recently, the decentralization in part of decisionmaking for investments of local interest.
- 1.2 The first stage of this process, undertaken in the second half of the 1970s, centered around defining a territorial framework for deconcentrated state administration with the establishment of 13 regions, 51 provinces and 325 communes. At the same time, progress was made on the privatization of many activities, and the state's role was reduced to that of a regulator, intervening in a subsidiary manner to offset shortcomings of the privatized system. At this initial stage, the state's concern was focused on solving the problems spawned by extreme poverty through welfare programs which it administered in a deconcentrated manner through the regions and communes. The decentralization program was launched in the second half of the 1980s, when responsibility for decisionmaking on the use of investment funds allocated to the Fondo Nacional de Desarrollo Regional [National Fund for Regional Development] (FNDR) was turned over to the regions. That process has been supported by the Bank through loans 141/IC-CH and 578/OC-CH, approved respectively in 1985 and 1989. They were used to finance in part two stages of the local development multiple investment program (PIM I and II). The investment management framework was upgraded in 1994 when the institutional structure was created for environmental impact evaluation, which has yet to be consolidated.
- 1.3 In the context of a unitary and highly centralized state, decentralization in Chile gives the regions and communes greater freedom in the allocation of resources to satisfy community needs and promote economic development within their respective territory. The Chilean process does not go so far as initiatives that advocate fiscal federalism and full local autonomy, but seeks to benefit from: (a) the more efficient allocation of local development funds that results when beneficiary communities take an active part in the process; and (b) the ability of a decentralized administration to take full advantage of synchrony between public investments in economic infrastructure and private investments.

B. The decentralization process

1. Legal framework

- 1.4 The 1991 constitutional reforms (Law 19,097); the Constitutional Organic Laws on Municipalities (Law 18,695 of 1992); and the Government and Regional Administration Statute (Law 19,175 of 1993)

have accelerated the decentralization process by altering significant aspects of the 1980 Constitution.

- 1.5 The reforms confirm the existence of a unitary state with an administration that is functionally deconcentrated and territorially decentralized, retaining the structure of three territorial levels of government: the regional governments, the provincial governments and the municipalities charged with administering the communes. The regional governments were granted legal status and their own assets; participatory bodies - the regional councils (COREs) - were made more democratic; and provision was made for direct election of communal councillors. These reforms modified the previous administrative structure, which emphasized the vertical hierarchy of the territorial entities and indirect participation by the community in decisions made by authorities appointed by the central government.
- 1.6 Changes are also taking place in the allocation of funds to the territorial entities. Two laws are currently under discussion in the Parliament: the Regional Government Employees Law, which will define the size and composition of permanent staff and grant the resources the regional governments need in order to function; and the Municipal Revenue Law (see section B.4 below on regional finances), which will increase municipal revenues. The government expects to approve these laws during the 1994 legislative session.
- 1.7 Although it is not directly tied to the decentralization process, the recently approved Framework Law on Environmental Standards (Law 19,300 of 1994) makes it compulsory for all government agencies and private investors - including regional and municipal governments - to undertake evaluations of the environmental impact of investments.

2. Institutional structure

a. Regional and provincial government

- 1.8 Administration of each region is entrusted to a regional government which enjoys legal status under public law and has its own assets. The regional government consists of an intendant and a CORE whose members are elected by the communal councillors in the region. The intendant, who reports directly to the President of the Republic, is responsible for coordinating, supervising and auditing all public services operating in the region. The CORE performs regulatory, decision-making and audit activities. One of its duties is to approve the annual investment budget proposed by the intendant.
- 1.9 Within the deconcentrated administrative structure, the sector ministries are represented in the regions by the ministerial regional secretariats (SEREMIs). While these offices belong functionally to the respective ministries, their activities in the regions are coordinated by the intendants. The regional planning

and coordination secretariat (SERPLAC) assists the intendant in coordinating sector activities, prepares regional development plans and strategies, and - when such duties are delegated by the central level - analyzes and issues recommendations on public investment projects.

- 1.10 Each province has: (a) a provincial governor, appointed by the President of the Republic, who performs such duties as the intendant may assign to him; and (b) a consultative political assembly for participation by the social organizations of the provincial community, called a provincial economic and social council.

b. Communal government

- 1.11 The affairs of the communes are administered by the municipalities, which are autonomous public-law corporations that enjoy legal status and have their own assets. The municipalities are managed by a mayor and a council.

3. Sectors under the responsibility of decentralized government

- 1.12 The regional governments perform a wide array of functions to promote socioeconomic development in their respective territories, such as executing FNDR-financed investments, coordinating sector public investment in their jurisdictions, providing guidance for private investment, and setting priorities for programs to eliminate extreme poverty. The principal instrument used by the regional governments is the allocation of regional investment resources.
- 1.13 The municipalities are responsible for land use management, local roads, traffic regulation, and the execution of social welfare measures designed to combat poverty, which have been decentralized to this territorial level. The provision of elementary and secondary education and primary health care services and the distribution of welfare subsidies to families are now municipal functions financed by special transfers from the central government. Given the inadequacy of such transfers, however, investment in infrastructure in those sectors has become a problem which must be addressed by the regions. The regions assist those municipalities that receive less revenue in financing outlays for urban roads within their purviews. The regional governments have also assumed responsibility for financing sanitation projects (water supply and sewer systems); secondary roads, especially those serving production systems; and, in isolated communities, rural electrification subsidies. The regions have also expressed interest in helping the municipalities with investments in projects for garbage collection and disposal, subsidies for rural telephone projects, and

investments in flood protection projects and small-scale fishing facilities. 1/

4. Resources of decentralized government

a. Evolution of the financial framework for the decentralization process

- 1.14 The basic mechanism for financing the decentralization process has been transfers between different levels of government. In line with the concern about developing the country's furthest-flung regions, in the early 1970s transfers from the national treasury to the regions were limited to financing for regional development corporations, while transfers to the municipalities consisted mainly of general budget contributions. In 1970, the national government was responsible for funding and executing more than 93 percent of public expenditures.
- 1.15 By the early 1990s, that situation had changed somewhat as a result of the decentralization measures. Transfers from the national treasury to the municipalities finance the redistributive functions for which execution has been decentralized to the local level, while transfers from the national treasury to the regions are used to fund investments of regional interest. In 1992, the national level of government was responsible for the execution of only 63 percent of public spending, although it continued to finance more than 80 percent. 2/
- 1.16 In recent years, transfers to the municipalities have not sufficed to finance all of the services delegated to them. The municipalities have thus been forced to use funds from their current budgets to underwrite such operations. The resulting deficits have rendered them unable to provide adequate maintenance for infrastructure, much less make investments to meet the demand for new services. To comply with their subsidiary role, the regions have allotted a significant share of the transfers they receive for investment purposes to financing for capital investments in health care and education which the municipalities have been unable to cover. Between 1985 and 1993, the FNDR financed 97 percent of the outlays in infrastructure for education now under municipal jurisdiction, 63.5 percent of primary health care spending, and

1/ A detailed study of the status of all investment sectors covered in the proposed program is available for consultation in the project files.

2/ Yáñez, José, "Descentralización fiscal en América Latina: Problemas y perspectivas del caso de Chile" [Fiscal decentralization in Latin America: Problems and prospects in the case of Chile], Santiago, May 1994, Economics Department, University of Chile (mimeographed document).

20.38 percent of investment in sanitation, having earmarked more than 70 percent of FNDR resources to fulfilling those needs.

b. Regional finances

- 1.17 As explained earlier, the major source of financing for the regions are central government transfers. There are three main mechanisms for effecting such transfers: (a) the FNDR; (b) resources earmarked by sector ministries for allocation to the regions for sector projects with regional priority, known as regionally allocated sector investments (ISARs); and (c) agreements reached by the regions with the sector ministries on specific projects or multi-year investment programs, known as programming agreements.

(i) The National Regional Development Fund

- 1.18 The FNDR's goal of territorial compensation is geared to the financing of activities relating to social and economic infrastructure in the regions, with a view to achieving more harmonious and equitable territorial development. The FNDR is the financial instrument most freely available to the country's 13 regions to carry out projects, programs and studies of a regional and municipal nature. The projects financed by the FNDR are directly identified by local authorities and then selected and approved pursuant to the rules and procedures of the national investment system (SNI) administered by the Ministry of Planning and Coordination (MIDEPLAN) and the Finance Ministry's Budget Directorate (DIPRES).
- 1.19 Pursuant to Law 19,175, which sets forth the corresponding regulations, the FNDR must distribute 90 percent of its resources in accordance with the region's socioeconomic variables, reflecting the needs and the specific territorial status of each region. Efficiency in spending accounts for another 5 percent, and the remaining 5 percent is set aside as a contingency fund. The variables currently used to measure differences between the regions' socioeconomic levels are, *inter alia*, the infant mortality rate, the percentage of population living in poverty, the unemployment rate, and the region's per capita output. The efficiency of regional administration is measured by the percentage of execution of the budget allocated to the region the previous year. Territorial variables such as distance to the capital, rurality and population density are also included.
- 1.20 Although the relative importance of the FNDR as a proportion of central government spending is small, its recent performance has been solid. Over the period from 1986 to 1994, FNDR outlays amounted to about 6 percent of GDP and grew at a real annual rate of 5.1 percent - more slowly than GDP, which posted a real growth rate of 7.4 percent per annum. Although FNDR-financed investments rose at a real rate of 19 percent over the same period, they account for less than 0.5 percent of GDP in 1994 as a result of the low initial level (0.2 percent of GDP in 1986). Central government

investments financed through the FNDR climbed from 2.4 percent of aggregate public spending in 1985 to 12.2 percent in 1988. That trend slowed in 1989 and 1990 owing to depletion of the proceeds of IDB loan 141/IC-CH, which financed PIM I. Subsequently, growth regained its previous stable rate to reach 12 percent in 1994. A real increase in FNDR resources equivalent to 9 percent more than the 1994 budget figure is scheduled for 1995.

(ii) Regionally allocated sector investments

- 1.21 A number of ministries and state agencies allot a percentage of their budgets to projects or programs on which allocation decisions are made in the regions. This category includes the secondary roads and rural potable water supply programs of the Ministry of Public Works (MOP); the urban paving program of the Ministry of Housing and Urban Development (MINVU); the neighborhood development and urban upgrading programs of the Ministry of the Interior (MINTER); the sports infrastructure program of the Sports and Recreation Directorate (DIGEDER); and some of the programs under the Fondo de Solidaridad e Inversion Social [Solidarity and Social Investment Fund] (FOSIS).

(iii) Programming agreements

- 1.22 Current legislation authorizes the regions to sign agreements for the conduct of joint activities with the ministries and with other regions or other state entities. To date, the application of such programming agreements has been limited. The government hopes that the agreements will be used more widely in the future, especially as a means of fostering a greater concentration of investments between the sector ministries and the regions.

(iv) Regional financing goals

- 1.23 In 1994, 21.6 percent of investments by the central government were determined by the regions; the FNDR accounted for 12 percent and ISARs for 9.6 percent. There has not yet been any significant use of the programming agreements. The government has set 1999 as its goal for doubling the volume of investment resources subject to regional decisionmaking, thereby boosting the figure to 43.2 percent of spending. To do so, it plans to raise the FNDR resources to 10.7 percent of investment, at the same time hoping that ISARs will account for 23.2 percent. It is also proposed to promote the use of programming agreements so as to bring their share up to 9.3 percent.
- 1.24 Clearly, attaining the proposed goal will be contingent mainly on sector resources (ISARs and programming agreements), rather than resources directly controlled by the regions (the FNDR). This situation poses a challenge for the regions: in addition to improving their ability to allocate FNDR funding efficiently, they must improve their capacity for agreeing on investments with sector

ministries. The regions are ill prepared to cope with the complex process of negotiating with the sectors, in particular for large-scale projects and multiyear investment programs.

b. Communal finances

- 1.25 At present, municipal revenues are derived from the Municipal Common Fund (FCM) (40 percent); ^{3/} municipal business tax (20 percent); land taxes (19 percent); vehicle permits (9 percent); other fees (9 percent); and cleaning rights (3 percent). In addition, the municipalities receive direct transfers from the central government to pay for the social services they administer. As noted earlier, these transfers have been inadequate. With approval of the Municipal Revenue Law and the government's plan to increase the amount of transfers starting in 1995, this shortfall will be covered, thus permitting efficient operation and maintenance of those services.

C. Resource allocation problems in the regions

1. Interregional allocation of FNDR resources

- 1.26 The volume of FNDR resources is set annually by the central government in the Budget Law. FNDR resources are therefore subject to the discretion of the central government and determined by the budgetary constraints faced by that authority. This is why the amounts allocated to the FNDR have posted significant variations in many of the years since its inception. That situation was resolved in the past few budget years, when the FNDR displayed reduced but stable growth.
- 1.27 Distributions from the FNDR are made in accordance with a formula which incorporates 17 regional and socioeconomic variables of equal weight. A study conducted at the request of the Administrative and Regional Development Undersecretariat (SUBDERE) points out a number of problems with this mechanism, including the flawed definition and weighing of the variables included in the regional allocation formula. ^{4/} Some of them measure similar factors; others do not

^{3/} Created in 1979 (Decree Law 3,063), the FCM is financed by 60 percent of land tax receipts, 50 percent of vehicle permit fees, and 65 percent of business taxes paid in the communes where collections are highest, plus fiscal contributions under the Budget Law. The FCM resources are distributed among the rest of the communes pursuant to a formula that favors the municipalities with the lowest amount of resources of their own and the highest proportion of low-income inhabitants.

^{4/} Fisher, Ronaldo, "Asignación de Fondos Regionales e Incentivos a la Eficiencia" [Regional funds allocation and efficiency incentives], University of Chile, Santiago, September 1994.

differentiate between regions; and still others are correlated. 5/

- 1.28 Another problem has to do with the perverse incentives stemming from the variables used to define efficiency, and their inclusion in the allocation of 5 percent of the FNDR. This stimulus for "efficiency" penalizes regions with remaining unspent funds in a given budget year, thus fostering the preparation of projects which often hold no priority but are easily executed. Since 90 percent of the resources are allocated on the basis of a series of socio-economic and regional indicators, the formula also penalizes efficient resource use, for whenever a region's indicators improve, it will be assigned less funding in the future.
- 1.29 To solve those problems, the SUBDERE study recommends a methodology that calls for the use of new socioeconomic and regional indicators; reduced weighing of the indicators which cause distortions in distribution (but which must by law be considered in the formula); and the construction of an efficiency indicator in the provision of services, measured on the basis of changes in the services as compared with a base year. 6/
- 1.30 The discretionality built into the yearly determination of the total amount of FNDR funds to be distributed, and the resulting variations in that amount, have created problems for regional investment planning. This has led the communes and regions to concentrate on the short term, and on projects of limited scope that can be adjusted to budgetary constraints. That impact will be minimized, however, as a result of the signals given by the central government regarding the stability of the FNDR and its intention of doubling the percentage of regionally determined investments.

5/ The formula uses output rather than revenue to measure the differences in development level between the regions. However, the almost sevenfold difference in the GDP per capita between Regions II and IX does not mean that the people in those regions are seven times richer or poorer. The problem is that only part of the value of production in the mining regions remains in the region. The rest goes to the head office (in the case of the copper corporation, CODELCO) or leaves the region as earnings of companies not located in the region.

6/ This efficiency indicator would be incorporated with an initial weighting of 10 percent, which would be increased to 25 percent over a period of five years. A change is also proposed in the indicator the 5 percent efficiency allocation specified in the law, reducing the weighting of the variables currently required by law, and including an indicator of the percentage of projects with cost overruns and one showing the average cofinancing share of the region's communes in the projects located in the region.

2. Intraregional distribution of resources

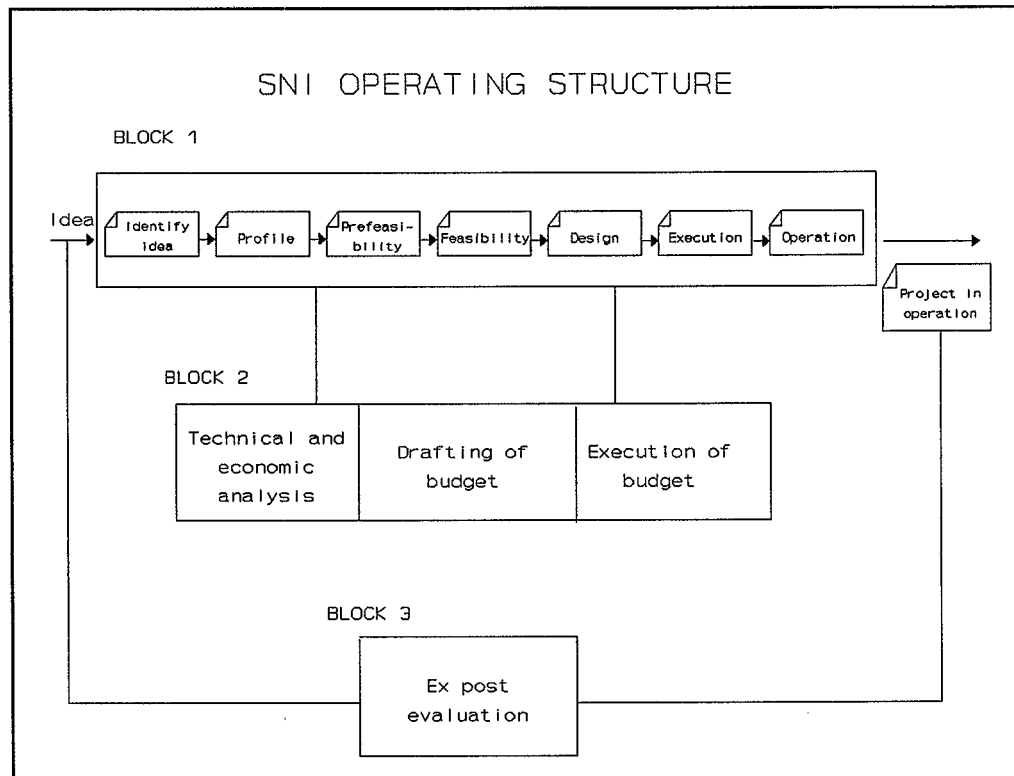
- 1.31 Most of the regions have worked out ad hoc criteria for distributing the share of FNDR funds allocated to each of them. In most cases, these criteria reflect short-term goals, designed essentially to satisfy, though only in part, the demands of funding applicants, especially the municipalities. Hence the FNDR resources are usually spread thinly among numerous small projects. That trend is evident in the fact that the average cost of the projects financed under PIM I and II was US\$128,400. Over 3,600 projects were financed under those programs, requiring a total outlay of US\$470.7 million. As a result, only part of the intraregional allocation of resources responds to regional objectives. Most of the investments are planned with a one-year horizon, and it is difficult to include projects of a regional nature or those with wider scope and longer execution periods. This prevents full advantage being taken of any synergies that may exist between projects.

3. Intersectoral allocation of resources

- 1.32 The intersectoral allotment of FNDR funds is determined by the effective demand for funds from the sectors or municipalities. There are no specific goals for the placement of resources by sector. But the strong role played by the FNDR in financing activities to eradicate poverty has triggered a concentration of investments in the education, health care and sanitation sectors, as noted above. The government has no plans to introduce sector goals in the allocation of resources, which is still being determined by the demand existing in the regions.

D. Problems of the national investment system in the administration of FNDR resources

- 1.33 The SNI consists of a group of institutions that take part in the evaluation of investment ideas. The structure of SNI operations and functions is geared to efficient allocation of public resources pursuant to the government's economic and social guidelines.



- 1.34 The operating structure consists of two distinct blocks of activities. Block 1 depicts the cycle of a project which is the responsibility of the executing units. To advance from one stage to the next requires the technical and economic recommendation of the external advisory technical agency, MIDEPLAN. Block 2 shows the tasks a project must perform to move along the stages of the cycle: technical and economic analysis; drafting of the budget; and execution of the budget.
- 1.35 The technical and economic analysis is administered by MIDEPLAN through its central units and the SERPLACs. All investment initiatives proposed by public agencies (including those financed by the FNDR) are evaluated pursuant to standard criteria and methodologies. Once approved, the projects are stored in an integrated project bank (BIP). The budget drafting subsystem contains the activities which allow an executing unit having the necessary financial resources to continue or to start on a new phase of the project cycle, including physical and financial followup on the projects.
- 1.36 Chile's SNI has been refined gradually over more than 20 years and has now reached a good level of development. This accounts for the existence of: (i) technical and economic analysis methodologies, classified by sector, with the corresponding manuals; (ii) the BIP, with nationwide coverage; and (iii) the national and regional

institutions that generate the communications channels necessary for interinstitutional coordination. At present, however, the SNI is hobbled by the small number of trained professionals on the staff of many of the SERPLACs.

- 1.37 During preparation of the program, an analysis was conducted of the project evaluation process performed by the SNI technical and economic study subsystem, by examining a sample of projects financed by the FNDR in different regions. The evaluation indicates that while the SNI is generally capable of selecting efficient projects, there are nevertheless certain problems which must be solved. 1/
- 1.38 Defects were detected at the preinvestment stage of the projects. Originators tend to prepare final designs without closely examining alternatives that would ensure adequate scale and selection of the least-cost alternative. In addition, the feasibility stage is not always properly completed, and as a result, problems (such as underestimating costs and the need for contract extensions) arise repeatedly during the execution period.
- 1.39 The project promoters frequently lack the technical skills to formulate the projects in accordance with SNI guidelines. They also lack the resources to engage private sector help for the conduct of studies, a problem which neither the regional governments nor the SERPLACs have been able to solve. As a result, the projects submitted to the SNI are very often poorly prepared. It is also observed that the project analysis methodologies are not uniformly applied in all of the regions, and that dissemination of those methodologies among project sponsors is inadequate. All too frequently, the technical units are plagued with a shortage of funds for proper supervision of project execution. The efficiency of the public bidding procedures and the quality of the contractors selected have minimized the adverse impact of that problem, however, since the works that were financed have been efficiently executed.

E. Consolidation of the environmental impact evaluation system

- 1.40 The General Law on Environmental Standards (Law 19,300 of 1994) created the environmental impact evaluation system (SEIA) administered by CONAMA and the regional environmental councils (COREMAs). These agencies are responsible for evaluating the environmental effects of investment projects. The recommendations of such evaluations must be incorporated into the projects and taken into account in the socioeconomic assessment performed by MIDEPLAN. The recent creation of that institutional structure and its present degree of consolidation require specific strengthening to ensure

1/ The evaluation report and its annexes are available for consultation in the project files.

that there are no delays in the analysis of the projects' environmental quality. In addition, the project promoters are not well versed in the environmental analysis criteria that will be used by CONAMA, which should be given wider publicity.

F. Challenges and prospects of the decentralization process

- 1.41 The decentralization process in Chile has made strides, mainly in the consolidation of regional institutions as entities separate from the central government and in establishing the FNDR as a stable source of financing for their activities. Institutional problems nevertheless remain, and their solution represents a significant challenge, one which the government intends to meet in the coming years.
- 1.42 The creation of regional governments with legal status and their own assets and the forthcoming consolidation of their staffing charts and resources for current expenses provide a framework for managing regional affairs with greater independence from the central government and enhanced community participation through the COREs. But the mechanisms for financing regional investments have not changed since the period prior to 1990. The money for the regions' investments continues to be supplied by transfers from the central government, but only half of it is used for purposes determined exclusively by the regions (FNDR). The sector ministries have a decisive influence on the way the rest is used (ISARs). The government would like to increase the amount of resources subject to regional decisionmaking (from 21 to 42 percent of central government investment by 1999). But the mechanisms proposed for achieving that goal - an increase in ISAR resources and larger allocations to the programming agreements - are not fully conducive to the decentralization of decisions. In particular, they present the regions with the challenge of at once improving their ability to administer FNDR resources while developing skills for negotiating with the ministries in order to influence the allocation of ISAR resources and attract sector investments to their respective territories.
- 1.43 The anticipated increase in municipal funding will give the municipalities more leeway to invest their own resources, thus reducing their pressure on the regions for financing. That will enable the regions to earmark a larger share of FNDR resources for investments of regional interest in the future. The regions will have to develop institutional capability to plan and execute this type of investment.
- 1.44 The interregional distribution of FNDR resources will improve as a result of implementing the new distribution formula, which fine-tunes this mechanism so that the allocation of funds better reflects the territorial distribution of investment needs and the regions' efficiency in accomplishing the government's objectives. The regions will also have to develop institutional capability to

follow up on objectives and goals and plan their investments in accordance with those accomplishments.

- 1.45 The intraregional allocation of FNDR resources has been dominated by the municipalities' demands and the need to remedy the shortfall in investments in health care and primary education infrastructure not being met by sector spending. From that standpoint, the FNDR has acted as a substitute for the lack of investment in those sectors rather than a means of promoting regional development. At the same time, the typology of the projects financed has been greatly influenced by the need to satisfy the municipalities' demands. In an attempt to provide something for everyone, the regions have financed numerous small projects as part of the annual investment programs. In the future, they will need to be capable of using FNDR resources for projects that can produce a regional impact in the medium and long range, in the form of multiyear investment programs that take advantage of synergies between projects.
- 1.46 The SNI has encountered difficulties in analyzing FNDR projects efficiently. As a result, there have been deficiencies in terms of scaling, underestimated costs and the beneficiaries' inability to operate and maintain the infrastructures. The regions must strengthen their capacity for technical, economic, financial and institutional analysis of investments. At the same time, implementing a national environmental system headed by CONAMA and set up in the regions by the COREMAS presents the regional governments with the challenge of building environmental considerations into the design and evaluation of the investment initiatives they finance.

G. The Bank's participation in support for decentralization

- 1.47 The Bank has financed local investment programs similar to the one proposed here through two loans totaling US\$335 million: loan 141/IC-CH, approved in December 1984, for US\$125 million; and loan 578/OC-CH, approved in December 1989 and still in progress, for US\$210 million. Both loans were efficiently executed and have contributed a substantial share (80 percent) of the resources administered by FNDR. To comply with the government's goal of using FNDR resources as a weapon in the war on poverty, most of the investments financed by these loans were directed at the following sectors: education (34 percent); primary health care (20 percent); sanitation (17 percent); and urban roads (15 percent).
- 1.48 Through the preinvestment program backed by loan 634/OC-CH, the Bank is helping MIDEPLAN to improve the SNI, mainly by financing the development of methodologies and training of staff at the central administration offices for the system, among other activities.

H. Activities of other international agencies in the sector

- 1.49 The World Bank is financing a US\$20 million pilot project for institutional strengthening of the municipalities by means of technical assistance to boost the efficiency and fiscal discipline of 25 communes. The government plans to use its own resources to extend those activities to another 200 communes in 1995. With assistance from the United Nations Development Programme (UNDP), MIDEPLAN is setting up a regional development support program (PADERE). Over a three-year period, US\$6 million would be used to provide technical assistance for 13 regions to define and adopt coherent regional development strategies and begin formulating multiyear investment programs.

I. The Bank's sector strategy

- 1.50 The Bank's strategy for Chile calls for supporting programs that modernize the state and decentralize services to the regional and communal levels through investment projects designed to strengthen the administrative, technical and financial capability of the regions and communes so that they can assume responsibility for providing the services transferred to them by the central government and achieve more balanced development nationwide.
- 1.51 In the course of dialogue with the country, the Bank intends to discuss the problem of scarce human resources, which affects mainly primary health care services under municipal jurisdiction, for which infrastructure is financed under FNDR. It is hoped that a solution will be found in this way to the nationwide problem identified in the ex post evaluation of the Bank's loans to FNDR.
- 1.52 The proposed program is fully consistent with that strategy, and continues the support which the Bank has been providing for the decentralization process. The program is to finance a third stage of the PIM, which will also be part of the FNDR, focusing this time on the broader objective of strengthening the regional governments.
- 1.53 The local development program proposed here is a multiyear time slice initiative to support consolidation of regional governments in Chile, develop their autonomous ability to allocate resources, and finance investments that will bolster the socioeconomic development of the regions. The government has asked for the Bank's assistance in financing and implementing its regional investment program for the 1995 to 1999 period, during which it plans to double the volume of funding earmarked for regionally determined investments and to strengthen regional governments.

II. THE PROGRAM

A. Objectives

1. General objective

- 2.1 The proposed program - the third stage in the Bank's support for the decentralization process in Chile - will promote institutional development of the recently created regional governments. At the same time, it will finance investment projects proposed by the decentralized agencies of the government, regional governments and municipalities to promote socioeconomic development and, in particular, to improve living conditions for low-income groups.

2. Specific objectives

- 2.2 To develop the regional governments' independent ability to allocate investment resources, consolidating and rationalizing the use of instruments to finance regionally determined investments by the government, the Fondo Nacional de Desarrollo Regional [National Fund for Regional Development] (FNDR) and regionally allocated sector investments (ISARs); and to make use of the programming agreements as a vehicle for shared financing between regions and sector agencies for investments of regional interest.
- 2.3 To enhance the regional governments' capability for intraregional allocation of investment resources in keeping with the government's social development objectives and the priorities of regional development.
- 2.4 To improve the quality and proper targeting of investments: (a) by developing the skills of the municipalities and technical units of the deconcentrated government apparatus (regional ministerial secretariats, regional sanitation companies and services) for the planning, evaluation, design and efficient execution of investment projects; and (b) by strengthening the regional capability of the national investment system (SNI) for evaluating projects.
- 2.5 To continue to channel investment funds to the sectors of responsibility of decentralized entities assigned priority in the government's strategy for eliminating poverty and promoting regional development.

B. Description

- 2.6 The program will comprise two components; an investment component and an institutional development component. The investment component will provide the regions with funds to finance eligible projects that have been favorably evaluated by the SNI and assigned regional priority. The institutional development component will finance training and advisory services to enhance the capabilities

of the regional governments and the decentralized administration of the SNI.

- 2.7 During execution of the program, the resource allocation procedures will be fine-tuned in order to overcome any difficulties identified. They include:

- (i) implementation of a new formula for interregional distribution of resources that will be more efficient in pursuing the government's redistribution and regional development objectives;
- (ii) development and promotion of the implementation of methodologies for intraregional allocation of resources which are consistent with the program objectives and the government's aim of using investment resources to promote balanced socioeconomic development in the regions;
- (iii) use of the investment eligibility criteria agreed on with the Ministry of the Interior (MINTER) and the Ministry of Planning and Coordination (MIDEPLAN), to help rationalize the intersectoral allocation of investments, avoiding any duplication of financing windows and promoting cofinancing with the sector ministries when input from those ministries helps to ensure a more rational use of investment resources; and
- (iv) implementation of a procedure to evaluate the environmental impact of investments, based on existing legislation and institutions.

1. Institutional strengthening component

- 2.8 To supplement the institutional strengthening activities being launched by the government in support of the decentralization process, the program includes resources for institutional strengthening for the regional governments and for the SNI at the regional level, areas not covered by current programs.

a. Strengthening the regional governments

- 2.9 During execution of the program, the Administrative and Regional Undersecretariat of the Ministry of the Interior (SUBDERE) will carry out activities for organizational strengthening, decentralized management of investment resources and the development of human resources for the benefit of the recently created regional governments.

a.1 Organizational strengthening

2.10 The activities designed to heighten efficiency in the operations of the regional governments include the following:

- (i) Organizational development: consulting services to examine the regional governments' administrative structure and propose improvements in the organizational chart and structure of relationships between the various components; to fine-tune the description of administrative procedures and functions; and to draw up manuals and guides for the different governmental functions.
- (ii) Development of human resources: activities to develop the management skills of regional governments' staff, including staff in the offices of regional and provincial intendants and governors and members of the regional councils. The proposed activities include seminars on strategic management, techniques for settling organizational disputes, leadership styles, teamwork, and promotion of efficiency and quality on the job.
- (iii) Training: instruction of staff of the central units of SUBDERE and the offices of regional and provincial intendants and governors in decentralized management of investment resources, including workshops and courses on investment programming, budget law and budget systems (drafting, execution and control), and disbursements.

a.2 Decentralized management of public investment resources

2.11 The activities designed to improve the allocation of investment resources that are transferred to the regions by the central government include the following:

- (i) Investment planning and programming. Program for publicizing the government's social and economic policies which require active participation by the regions. Study of alternative ways to unify regional development financing windows. Advisory assistance services in the drafting of multiyear investment programs. Training workshops on the use of programming agreements.
- (ii) Intraregional allocation of resources. Design and dissemination of resource allocation methodologies consistent with regional development goals and the efficient use of investment resources. Preparation and distribution of regional public investment manuals for the use of intendants, council members and mayors.

- (iii) Evaluation and monitoring of investments. Development and implementation of methodologies for evaluating results and monitoring investments.

- b. Strengthening of the national investment system

- 2.12 MIDEPLAN will carry out a series of activities to complement those already in progress, which are designed to strengthen the regional capability for evaluating investment projects.

- b.1 Strengthening of the regional planning and coordination secretariats

- 2.13 Consulting services will be hired to assist in the orientation and evaluation of investment projects in the 13 regional planning and coordination secretariat (SERPLACs) to enable them to absorb the additional workload for the projects to be financed by the program without taking on extra professional staff. MIDEPLAN will call for bids on consulting contracts to provide the SERPLACs with specialized professional services from engineers, architects, project economists or financial analysts, as needed.

- b.2 Training in project preparation and evaluation

- 2.14 Regional courses on the preparation and evaluation of investment projects in the sectors eligible for financing under the program will be given to staff of the regional technical units, municipalities and other entities promoting projects which could be financed under the program.

- c. Implementation of the environmental impact evaluation system

- 2.15 CONAMA will strengthen the ability of the recently established COREMAs to assess the environmental impact of investments financed under the program, through the services of environmental experts and the dissemination of evaluation methodologies.

- 2. Investment component

- 2.16 This component will finance projects in the sectors under the responsibility of regions and communes that have been assigned priority from the standpoint of regional development and improving living conditions for low-income groups. As in the preceding stages, the program will finance eligible projects endorsed by the municipalities and by the regional technical units, as deconcentrated government agencies representing the sector ministries in the regions.

a. Investments contemplated in the program

2.17 The resources assigned to each region will enable them to finance the construction, expansion, and outfitting or rehabilitation of infrastructure in selected sectors for which the public sector has responsibility, including the contracting of civil works, equipment, technical preinvestment and environmental impact studies and final designs, and supervisory and consulting services.

2.18 The types of investments contemplated in the program are listed below:

- (i) Education. Construction, replacement, upgrading, expansion, outfitting and rehabilitation of municipal education facilities. Commencing in 1996, the program will finance comprehensive rehabilitation programs rather than individual projects.
- (ii) Health care. Construction, replacement, upgrading, expansion, outfitting, rehabilitation or standardization of primary health care facilities.
- (iii) Sanitation. Construction, expansion, service-level improvement and rehabilitation of integrated potable water supply and sewage disposal systems for urban communities. Civil works and equipment for systems to collect and dispose of household solid waste. The regions will use program resources to cofinance rural drinking water projects with sector resources.
- (iv) Highway system: Rural roads. Improvement of standards or rehabilitation of secondary, communal or regional roads. Urban paving. The provision of paved roadways, sidewalks, curbing, bridges and tunnels, traffic lights and signage on secondary urban streets. Starting in 1996, FNDR is to cofinance these projects with sector resources. New roads. Construction of new roads that are important for regional development purposes.
- (v) Rural electricity. Construction of new grids or expansion of existing ones to supply low-income rural communities; installation of electric power generating and distribution equipment for isolated communities.
- (vi) Rural telephone systems. Equipment for public telephones in rural communities.
- (vii) Flood protection. Construction and expansion or upgrading of flood protection works in low-income residential areas. Works for the channeling of rivers, streams and canals, including lateral protection works, dikes and retaining walls.

- (viii) Fishing facilities. Protection works, docks, ramps, storage facilities, services, repair shops and areas for the sale of products, for small-scale fishing coves. In 1996, the program will start to cofinance such projects with sector resources.

b. Eligible investments

- 2.19 Investments for which a region or commune is responsible will be declared eligible for financing under the program provided that: (a) demonstrated demand exists; (b) the methodologies agreed upon with the Bank for technical and economic, institutional and financial, and environmental analysis are in place; and (c) a sample of projects has been examined. During the analysis process, those requirements were met for projects in education, health care, sanitation, rural roads, urban paving and rural electrification (distribution). Other types of investments will be declared eligible for financing by the program when the executing agency agrees with the Bank on the analysis methodology and presents a sample of projects to the Bank's satisfaction.

c. Addition of new types of investments to the program

- 2.20 As the institutional framework is defined and responsibilities are assigned to the regions or communes, other investments - such as urban storm sewers, for example - could be added. The program Operating Regulations specify the procedures to be followed by the executing agency in declaring the eligibility of new sectors or types of projects. Those procedures require that the executing agency: (a) quantify the financing needs for such investments; (b) obtain the favorable opinion of the Finance Ministry for incorporating the new investments into the program; (c) reach agreement with the Bank on the methodology for technical, economic, institutional, financial and environmental analysis of the projects; and (d) present, to the Bank's satisfaction, a sample of the projects to be financed.

C. Scaling of the program

- 2.21 The Interior and Finance Ministries project real growth of 9 percent per annum over the 1994 allocation level for FNDR resources over the next four years. This will call for an investment program of US\$438.3 million to be disbursed between 1995 and 1999. The dimensions of the institutional strengthening component were set by MINTER and MIDEPLAN in consultation with the Bank.

D. Program for the first year

- 2.22 The integrated project bank (BIP) contains a portfolio of projects that are viable from the technical, economic, financial and institutional standpoints (i.e., they carry a recommendation from the

SNI) with a total cost of US\$293 million. Roughly US\$257 million of that amount is for sectors eligible under the program.

E. Cost and financing

INVESTMENT CATEGORIES	IDB CONTRIBUTION	LOCAL CONTRIBUTION*	TOTAL	%
1. ENGINEERING AND ADMINISTRATION	0	38,850	38,850	7.77
1.1 Engineering	0	10,200	10,200	
1.2 UCN administration	0	2,900	2,900	
1.3 UCR administration	0	3,150	3,150	
1.4 Supervision	0	15,200	15,200	
1.5 Preinvestment studies	0	7,000	7,000	
1.6 Consulting and evaluation	0	400	400	
2. DIRECT COSTS	74,250	364,000	438,250	87.65
2.1 Construction and equipment	74,250	364,000	438,250	
3. ASSOCIATED COSTS	0	6,300	6,300	1.26
3.1 Land	0	1,500	1,500	
3.2 Institutional strengthening of SUBDERE	0	2,500	2,500	
3.3 Institutional strengthening of MIDEPLAN	0	2,300	2,300	
4. FINANCE CHARGES	750	15,850	16,600	3.32
4.1 Interest	0	13,700	13,700	
4.2 Credit fee	0	2,150	2,150	
4.3 Inspection y supervision	750	0	750	
TOTALS	75,000	425,000	500,000	100.00
PARI-PASSU	15.0%	85.0%	100.0%	

* The local contribution figure shown under the heading of "Direct costs" includes the value-added tax applicable to all contracts, in accordance with prevailing practice.

F. Commitment and disbursements

- 2.23 The program resources cover FNDR allocations for the 1995 to 1999 period and would be disbursed within that time frame.

III. THE BORROWER AND THE EXECUTING AGENCY

A. The borrower

- 3.1 The borrower for this operation will be the Republic of Chile, which will assume the debt service along with responsibility for providing the local counterpart resources for the program.

B. The executing agency

- 3.2 The program executing agency will be the borrower itself, exercising that function through the Administrative and Regional Development Undersecretariat (SUBDERE) of the Ministry of the Interior (MINTER), which is responsible for administering the Fondo Nacional de Desarrollo Regional [National Fund for Regional Development] (FNDR). SUBDERE will be directly responsible for the coordination, supervision and administration of the program at the central level.
- 3.3 The following agencies will also take part in executing the program:

- (i) the Ministry of Planning and Coordination (MIDEPLAN), which will be charged with conducting the technical, economic, financial and institutional evaluation of the projects to be financed under the program; and
- (ii) the National Environment Commission (CONAMA), which will rule on the environmental impact of projects financed under the program.

C. Organizational structure for execution of the program

1. Central government level

a. Ministry of the Interior

- 3.4 MINTER has been the subject of detailed analysis in other operations financed by the Bank; accordingly, a full description of its structure and functions is not included here. The analysis focuses on the offices directly involved in the program. MINTER is the cabinet ministry responsible for the government and internal administration of the country. To that end, it has two undersecretariats:

- (i) The Undersecretariat of the Interior, charged with advising the Minister of the Interior on matters of government and internal administration of the state; and
- (ii) SUBDERE, charged with execution of modernization and administrative reform plans; coordination of development programs for the regions, provinces and communes;

and evaluation and control of municipal management. SUBDERE's functions include administration of the FNDR.

- 3.5 The national steering unit (UCN) for the program, which is located in SUBDERE, has the following main responsibilities: scheduling and monitoring progress in execution of the program; supervision of public bidding and disbursements of funds; budget control; verifying compliance with provisions of the program Operating Regulations; execution of the institutional strengthening component; and preparation of reports for the Bank. The UCN has 13 regional coordinating units (UCRs) which are responsible for execution of the program in the regions.
- 3.6 The program resources, to be added to the FNDR, will be transferred by the Ministry of the Interior to the regional governments, which will in turn transfer the works, once they are completed, to the end beneficiaries of the program.

b. Ministry of Planning and Coordination

- 3.7 The following divisions come under the authority of the MIDEPLAN Undersecretariat:
- (i) The Regional Planning Division, which is responsible for supervising the regional planning and coordination secretariats (SERPLACs) for the 13 regions; and
 - (ii) The Planning, Studies and Investment Division, which - through the Project and Information Unit of the Investment Department - supervises the operations of the national investment system (SNI) and manages the integrated project bank (BIP).

c. National Environment Commission

- 3.8 CONAMA, a decentralized public service agency with legal status and its own assets, reports to the President of the Republic through the Ministry and General Secretariat of the Presidency. Its internal bodies are the Board of Directors, the Executive Management Board, the Consultative Council, and the regional environmental councils (COREMAs).
- 3.9 CONAMA proposes the government's environmental policies to the President and reports to him on compliance with current laws. It acts as a consultative and coordinating body in regard to environmental matters, maintains an environmental information system and manages the environmental impact evaluation system (SEIA). It will take part in educational activities, dissemination of environmental data, the preservation and conservation of nature and the environmental heritage, promoting citizen participation in these areas. It also finances projects featuring environmental preservation and

conservation and serves as a counterpart agency in such projects with international financing.

2. Regional level

a. Regional government

- 3.10 The regional government, through the office of the intendant and the regional council (CORE), is responsible for selecting and prioritizing the projects to be financed by the program. To be eligible for the program, each project must obtain a recommendation from the SNI. The investments are executed by the office of the regional intendant with the aid of technical units (the regional branches of the government services or ministries) or municipalities.
- 3.11 The disbursement of funds is supervised by the UCR of SUBDERE, which ensures that the program Operating Regulations are duly observed in the region.

b. Regional planning and coordination secretariats

- 3.12 The SERPLACs are responsible for the technical, economic, financial and institutional analysis of projects financed under the program. Once they are satisfied that the projects are fully consistent with the methodologies and parameters agreed on by the SNI with the Bank, the SERPLACs issue a recommendation for the project to be included in the BIP; this is an indispensable condition for its consideration for financing with FNDR and program resources.

c. Regional environmental councils

- 3.13 The COREMAs are responsible for controlling the environmental quality of the projects. They are deconcentrated bodies of the national environmental system, and a regional director represents the service in each of the country's regions. They include the intendant, who serves as chairman; the governors of the region; the regional ministerial secretaries; and four regional councillors. They have technical committees, composed of the regional director, who serves as chairman; and the regional directors of public services with jurisdiction in the environmental field. Each region has a regional environmental consultative council, made up of two scientists, two representatives of NGOs, two representatives from the private sector, two labor representatives, and the intendant's delegate.

IV. PROGRAM EXECUTION

A. Execution mechanism

- 4.1 The program will be executed by the institutions responsible for administering the Fondo Nacional de Desarrollo Regional [National Fund for Regional Development] (FNDR): at the central level, the national steering unit (UCN), which reports to the Administrative and Regional Development Undersecretariat (SUBDERE) of the Ministry of the Interior (MINTER) and, at the regional level, the respective regional coordinating units (UCRs) set up at each of the offices of the regional intendants. The Ministry of Planning and Coordination (MIDEPLAN) and CONAMA will take part in execution. MIDEPLAN will act through its decentralized regional agencies, the regional planning and coordination secretariats (SERPLACs), which would be charged with evaluation and approval of the projects slated for presentation to the regional councils (COREs) for prioritization. CONAMA will act through the regional environmental councils (COREMAS), which will evaluate the environmental impact of the projects and recommend the mitigation measures that must be taken into account for approval by the SERPLACs.
- 4.2 The execution process will adhere to the operating and financial procedures established by: (i) the stipulations of the loan contract between the Bank and the borrower; and (ii) the program Operating Regulations. The entry into force of the program Operating Regulations will be a condition precedent to the first disbursement of the financing.

B. Mechanism for allocation of resources

1. Interregional allocation

- 4.3 The funds appropriated each year for the FNDR under the Budget Law are distributed among the 13 regions pursuant to a formula that includes considerations of equity and efficiency in achieving the FNDR's territorial and social compensation objectives. Given the problems with the variables used (as discussed in Chapter I), however, MINTER revised the current methodology, introducing new variables and changes in weighing and bringing in new concepts of spending efficiency. The new methodology was given preliminary approval by the Bank's analysis mission; and it was agreed that MINTER would work out the definitive version to specify the allocation formula that would be used, starting with the budget for 1996. The definitive methodology and the formula to be applied is to be submitted to the Bank for consideration by April 30, 1995. The entry into effect of that mechanism is a condition of the contract.

2. Intraregional allocation

- 4.4 The procedures used to determine the yearly investment budget vary from one region to the next. As noted earlier, in some cases resources are simply distributed proportionally among the communes, which detracts from the ability to promote projects of regional interest. The institutional development component will help the regions work out methods for intraregional allocation of funds that are more in line with the program objectives of fostering regional development and assigning priority to benefiting low-income families through efficient projects.

C. Operating Regulations

- 4.5 Execution of the program will be governed by the Operating Regulations. The principal requirements of the regulations are:

1. Project identification and selection

- 4.6 The intersectoral allocation of the program resources will depend on the demand for investments, as expressed for each sector by the project promoters in each region. Such allocation will therefore vary from region to region, and from year to year within a given region.
- 4.7 The selection process for investments to be financed by the program consists of four stages: (a) the project profile; (b) the pre-feasibility study; (c) final designs; and (d) prioritization, which involves the principal regional institutional agents: the project promoters; the deconcentrated planning agency, or SERPLAC; COREMA; and the regional government.

a. Project profile

- 4.8 The projects to be financed by the FNDR are identified by the municipalities or technical units (regional secretariats of sector ministries, regional sanitation companies, or any other deconcentrated government entities). Following the procedures established by the national investment system (SNI), the project promoters must prepare a profile containing a description of the project that outlines objectives, alternative solutions, estimated cost and an environmental brief - later to become the environmental impact statement (EIS) required under the law once the accompanying regulations have been issued - assessing the probable impact of the project and the applicable sectoral environmental standards. That document is reviewed by the SERPLAC and the COREMA. The SERPLAC instructs the project sponsor as to the prefeasibility studies required. The COREMA examines the project's environmental impact, identifying the ecological benefits it offers, and may: (a) approve the environmental brief (or EIS), recommending the mitigating measures needed; or (b) request an environmental impact assessment (EIA) to determine such measures.

- 4.9 The prefeasibility studies are to set forth the objectives in detail; examine the alternatives; select the least-cost alternative that meets the project requirements; estimate the benefits; and calculate the socioeconomic indicators (net present value, internal rate of return or cost-efficiency, as the case may be). In addition, the studies are to analyze the beneficiary's ability to operate and maintain the works properly; for all investments in infrastructure, emphasis will be placed on the availability of skilled human resources to operate the services. The project is then reviewed by the SERPLAC, which evaluates the prefeasibility study to certify that it is consistent with SNI methodology and practices. In cases where an EIA is required, the COREMA reviews the study at this stage and grants its approval if the project meets the SNI eligibility criteria. The SERPLAC issues the socioeconomic recommendation, which allows the project's sponsor to complete the final designs.

b. Final designs

- 4.10 Having received the RS, the entity sponsoring the project completes the final designs, incorporating the measures recommended by the COREMA to mitigate environmental impact. The results of the final designs are reviewed by the SERPLAC, which - if SNI eligibility criteria are met - issues the definitive socioeconomic recommendation. Projects thus recommended are included in the regional project pipeline.

c. Prioritization

- 4.11 The regional government establishes the priority of investments based on indications made by the regional council in its annual discussion of the draft budget submitted by the intendant's office.

d. Execution of the projects

- 4.12 Once the investment budget has been approved by the CORE, the regional government signs execution agreements with the project sponsors or other suitable technical agencies, which then proceed to issue contracts for the works (or for the procurement of goods, if applicable) pursuant to the established rules.
- 4.13 The executing agencies will abide by the measures agreed on with the Bank for projects that have been declared eligible for financing by the program.

2. Discretionary limits

- 4.14 Pursuant to SNI regulations, the SERPLACs are authorized to approve projects having a total maximum cost equivalent to US\$400,000. Projects which exceed that figure are examined and approved by the central MIDEPLAN Investment Department. During the program execution period, the project analysis capacity displayed by the

SERPLACs will be reviewed at the annual evaluation meetings, and the ceiling will be raised for those which demonstrate adequate capacity.

3. Eligibility criteria

a. Sectors

- 4.15 Initially, the eligible sectors would be: (i) education; (ii) health care; (iii) sanitation (drinking water supply and sanitary sewer systems); (iv) highways (rural roads and urban paving); and (v) rural electrification (distribution). Other types of investments for which the regions are responsible will be declared eligible for financing under the program once the executing agency has reached agreement with the Bank on the analysis methodology and presented a sample of projects to the Bank's satisfaction.
- 4.16 The eligibility of other sectors would be subject to MIDEPLAN's completion of its review of analysis methodologies, to be submitted to the Bank along with five typical projects from each sector for issue of the Bank's statement of nonobjection. The sectors in question would be: (i) flood protection; (ii) road systems (new construction); (iii) sanitation (collection and disposal of solid wastes plus rural potable water systems); (iv) rural electrification (generation); and (v) small-scale fishing facilities.

b. Projects

- 4.17 The projects must satisfy SNI criteria for technical, economic, institutional and financial eligibility and complete the analysis cycle in order to obtain the definitive recommendation. In conducting environmental impact evaluations for projects under the program, the COREMAs will use the criteria agreed upon with CONAMA, which are included in the Operating Regulations.

c. Responsibility for project eligibility

- 4.18 The pertinent offices of the SNI (MIDEPLAN and/or SERPLACs) and the environmental impact evaluation system (CONAMA and/or COREMAs) will be responsible for reviewing the projects. The Bank will conduct periodic ex post reviews of random samples of projects to assess the degree of compliance with the methodologies and procedures agreed upon.

4. Cost recovery mechanisms

- 4.19 When the beneficiaries of municipal projects cannot be clearly identified, when the disaggregation of costs is not warranted, or when local laws do not permit charges to be made, the municipality's general revenues will be used as a cost recovery mechanism. In

such cases, evidence will be required that the project will not generate a current account deficit for the municipality.

- 4.20 When the law provides for direct collection of project costs from the beneficiaries, revenues from the application of tariffs, rates and any other fees are to be sufficient to defray the expenses of operation, maintenance, administration and unsubsidized investment. In these cases, the FNDR will finance the projects through the reimbursable contribution modality permitted by law, and only the share of project costs directly benefiting low-income families will be subsidized. The FNDR has developed an acceptable methodology for estimating such subsidies. When this situation arises, the sponsors will reimburse the regional government for the unsubsidized portion of the project. MINTER will work out specific mechanisms for processing such reimbursements.

5. Works supervision

- 4.21 Responsibility for supervising the works will rest with the technical unit itself. This task can be performed directly by the technical unit when it has the technical skills to do so. If not, it can be done under contracts with individual consultants or a specialized consulting firm. In each instance, a statement will be required from the UCR to the effect that it has no objection to the proposed procedure. Irrespective of whether the work is contracted out or performed by the technical unit, the cost of supervision will be recognized as part of the project expenses that are chargeable to the local contribution to the operation. The COREMAs will monitor compliance with the environmental recommendations contained in the EIS or EIA.

6. Transfer of resources

- 4.22 The program resources will be transferred by the central government to the regional governments for each individual project, based on the budgetary framework defined by the interregional allocation of resources and the budget approved by the CORE. The regional governments will in turn pass those funds on to the agencies that will perform the works; i.e., bodies within the various ministries (technical units) or other public agencies (municipalities). Once project execution is complete, the regional governments will transfer the respective real estate and movable property to the program's end beneficiaries, which may be public or private agencies.

D. Procurement of goods and contracting of services

- 4.23 Based on the execution results of the local development multiple investment program, stages I and II (PIM I and II), estimates call for the program funds to be distributed among the various components as follows:

Civil works	US\$394.5 million
Equipment	US\$438.0 million
Project consulting services	US\$ 7.4 million
Institutional development consulting services	US\$ 4.8 million

- 4.24 It is anticipated that approximately 60 percent of the consulting services will be provided by consulting firms, and the remainder by individual consultants.
- 4.25 Current IDB procedures will be used in procuring goods and hiring services for construction of the civil works to be financed with the loan proceeds, and those procedures will be deemed to be an integral part of the loan contract. 8/
- 4.26 The processes involved in all international public bidding conducted by the UCN will be subject to ex ante scrutiny at each stage (tender conditions, call for bids, contract award and contracts). The procedures for local bidding conducted by the technical units, on the other hand, will be reviewed after the fact, based on random samples which convey an idea of performance in the various regions, sectors and technical units. The conditions for all public bidding under the program - including national tenders - will require them to be open to interested companies from all of the Bank's member countries.

E. Disbursements

- 4.27 Considering the nature of the operation, the volume of transactions that will be required in the procurement of goods and services, and the characteristics of a global program, plans call for the provision of an efficient and rapid mechanism that will expedite disbursement procedures for the program funds.
- 4.28 To that end, disbursements will be made pursuant to the Bank's procedures, except in the case of substantiated advance payments and reimbursements of prior outlays. In such instances, the executing agency will simply submit the disbursement request to the IDB country office, accompanied by an itemized list of payments and a checklist of disbursements and local contributions; the substantiating documents will remain in the possession of the executing agency.

8/ The following thresholds for international bidding under the program are recommended as agreed with the Bank Procurement Policy and Coordination Office: (i) for the contracting of works, US\$3 million; and (ii) for the procurement of goods, US\$350,000. It is also recommended that the international roster from the previous program continue to be used for the new operation.

- 4.29 The executing agency is to ensure that the information contained in the itemized payment statement is duly supported by the documents customarily required by the Bank. The executing agency is to retain the originals and/or copies of the contracts, orders, invoices, receipts, payment vouchers, suppliers' certificates, statements of origin and any other documents substantiating the data appearing in the itemized list. All such documentation is to be duly identified, properly filed and available for review by authorized IDB personnel and external auditors. It is to be kept in an active file, at the location indicated by the executing agency, for a period of at least five years from the date of the final disbursement of the IDB loan.
- 4.30 In the course of their inspection visits, the field office staff will run a sample check of the support documents for the disbursements. At the time of the technical and/or financial inspection, an examination will be conducted - also based on sampling - to verify the presence of documents substantiating the applications and evidence that the resources listed in the reimbursement requests have been used as stipulated in the loan contract. Should any errors be found, a larger percentage of documents is to be checked, and the execution agency is to be instructed to make the corresponding deductions from future disbursement requests.

F. Program followup

- 4.31 The borrower, through the executing agency, is to submit annual reports to the Bank on implementation of the program. These reports are to be presented to the Bank within the third quarter of each fiscal year commencing with the first year of execution and including one additional year from the date of the final disbursement.
- 4.32 Each year during the program execution period, the Bank and the borrower will conduct a joint evaluation to examine compliance with the program objectives from the standpoint of the interregional and intraregional allocation of institutional resources in connection with the projects financed. The annual program followup reports will be used for that purpose.
- 4.33 Taking into account the original criteria and objectives of the program design, the areas on which the followup measures should focus are: (i) the adoption of mechanisms for the intraregional allocation of resources; (ii) the extent to which institutional strengthening activities - such as improvements in the SERPLACs' project analysis skills, consolidation of the regional government, and capacity at the COREMAs for evaluating project environmental impact - have been carried out; (iii) the impact of the program on the regions' administrative and operational status; (iv) the impact of the program on service quality and coverage; (v) project costs and the expense of the institutional development activities financed; (vi) training of regional personnel; (vii) operation and

maintenance of services; (viii) cost recovery; and (ix) program targeting. The parameters shown in the table below will be used in such followup:

ACTIVITIES	TERMS	GOALS
A. STRENGTHENING OF THE REGIONAL GOVERNMENTS		
1. Organizational strengthening		
a. Organizational development	2 years	13 regions
b. Development of human resources	5 years	13 regions
c. Training	3 years	13 regions
2. Decentralized management of public investment funds		
a. Investment planning and programming	4 years	13 regions
b. Intraregional allocation of resources	4 years	13 regions
c. Investment evaluation and followup	3 years	13 regions
B. STRENGTHENING OF THE NATIONAL INVESTMENT SYSTEM		
1. Strengthening of the SERPLACs	1 year	Hire consultants in 13 regions
2. Training in project preparation and evaluation	5 years	13 regions
C. IMPLEMENTATION OF FNDR ENVIRONMENTAL IMPACT EVALUATION SYSTEM		
1. Entry into force of environmental control procedures	1 year	All projects evaluated

- 4.34 Staff requirements at the country office and at headquarters have been examined and found to be compatible with staff availability. An estimated 34 person-weeks will be required at headquarters and 40 person-weeks at the country office during the program execution period.

G. Operation and maintenance

- 4.35 Each year the executing agency will evaluate the operating and maintenance activities executed by the beneficiaries of the investments financed to date under the program. To this end, a sample of the investments financed that is representative both territorially and sectorally will be reviewed. In cases of noncompliance with the operating and maintenance requirements, the executing agency will adopt sanctions that may include declaring the noncompliant beneficiary ineligible for future financing unless the situation is

remedied. The executing agency will include the results of such evaluations in the annual monitoring reports.

H. Ex post evaluation

- 4.36 To facilitate the ex post evaluation to be carried out by the Bank, the borrower, through MINTER, will reach agreement with the Bank on the structure and content of the semiannual reports required under the general conditions.

I. Audit

- 4.37 Beginning in the fiscal year when program execution starts, and throughout the execution period, financial statements for the program are to be presented annually within the first four months following the end of each fiscal year. The financial statements are to be accompanied by an opinion of the Office of the Comptroller General, including comments as to compliance with contract conditions.

V. PROGRAM JUSTIFICATION

A. Overall program impact

- 5.1 The program will help to further the process of decentralization in Chile by helping to improve the regional governments' ability to make decisions on the use of investment resources for which they have discretionary authority.
- 5.2 Special emphasis has been placed on steps to heighten efficiency in the allocation of resources which the nation has earmarked for regional development. Those measures include:
 - (i) implementation of a revised formula for interregional allocation of resources, which will be conducive to more equitable and efficient distribution of the resources of the Fondo Nacional de Desarrollo Regional [National Fund for Regional Development] (FNDR), for example, by increasing the share received by regions with greater numbers of poor population groups, and rewarding those whose investments perform well on the indicators employed for allocation of FNDR resources;
 - (ii) streamlined intersectoral allocation of investments to promote the use of multiyear investment programming methodologies that embrace the objectives of medium and long-term regional development;
 - (iii) minimizing the adverse impact of overlapping financing windows, which is due to the existence of sector resources in sectors eligible for program financing under the cofinancing rules;
 - (iv) promotion of the use of the FNDR by the regional governments as a mechanism for attracting sector investments, thus boosting the volume of resources that could be used by the regions to accomplish their development objectives;
 - (v) strengthening of the regional apparatus of the national investment system (SNI), which will assume full responsibility for evaluating investments and will ensure that the task is performed efficiently and in a manner congruent with the national criteria and the factors agreed upon with the Bank in the Operating Regulations; and
 - (vi) establishment of a procedure for evaluating the projects' environmental impact to ensure that no adverse effects are produced thereby; or, in the event

that such effects are inevitable, to ensure that the projects include mitigating measures.

B. Impact of the investments

- 5.3 The program will finance investments having a favorable effect on living conditions for the low-income population. It is nevertheless hoped that pressure from the municipalities to obtain FNDR financing for investments in education and health care will ease off in the future. There is significant demand for such funds, and it is anticipated that the program will continue to receive requests for this type of financing. More than 35 percent of the projects in the pipeline - and in the integrated project bank (BIP) - that are eligible for program financing are for education and health care. The data available show that over 70 percent of the beneficiaries of investments financed by the local development multiple investment program, stages I and II (PIM I and II) in these sectors were families living in poverty.
- 5.4 Program resources are available for the regions to continue investing in infrastructure that supports the production sectors; for example, by improving the roads and infrastructure that serve small-scale fishery. The regions will also be able to invest in environmental protection for the low-income population, such as flood protection works, to cite another example. Generally speaking, the eligibility conditions will enable the FNDR to be flexible in meeting demands for regional investment, while observing the necessary safeguards to ensure efficient allocation of the resources.

C. Environmental impact and control and mitigation measures

- 5.5 It can be concluded, based on the analysis performed, that there is a positive determination and an environmental awareness, along with a well developed legal framework, the regulatory and normative components of which are now taking shape. While the staff complement is relatively small, their skills in environmental matters and the means to ensure compliance with environmental criteria and conditions are now being addressed by a training process covering the different institutions that will play a part in processing the projects financed by the program.
- 5.6 Control of the investments' environmental quality will start with disclosure of the criteria to be applied under the program to establish conditionalities for maintaining that quality. An information campaign, addressed to the agencies that will be directly or indirectly involved in the projects, includes the system of penalties established by the Environmental Standards Law that is to be enforced by the regional environmental councils (COREMAs). Agreement has been reached with the National Environment Commission (CONAMA) on procedures which guarantee that timely consideration will be given to environmental impact in the design and execution

of the projects, and it is believed that supervisory capacity will be sufficient to ensure compliance with the environmental regulations..

D. Impact on women

- 5.7 The program has no specific impact on women. The investments to be financed with FNDR resources will generate equal benefits to all persons residing in the beneficiary communities.

E. Framework of the Bank's country strategy

- 5.8 The proposed program is consistent with the Bank's strategy for Chile, since it supports modernization of the state and the decentralization of services to the regions and communes. Moreover, it finances investment projects designed to improve the regions' ability to support economic development and improve living conditions for the low-income population, both of which are targeted by that strategy. Given its features, the program is considered to be consistent with the mandates of the Eighth Replenishment.

F. Technical feasibility of the investments

- 5.9 The investments financed under PIM I and PIM II have been generally well designed and properly executed. Any errors found in the cost estimates will be corrected by the measures adopted for the program, including strict application of the project cycle, strengthening of the regional planning and coordination secretariats (SERPLACs), and training of the project promoters. At the same time, the steps agreed upon to improve supervision of the works and contracts with the private sector when the executing agencies lack capacity for that purpose will make it possible to surpass the achievements of the previous operations.
- 5.10 In short, the program is technically viable and no difficulties are anticipated that would keep the executing agency from disbursing funds for investments that are eligible and in keeping with the provisions of the Operating Regulations.

G. Financial institutional viability

- 5.11 In view of the execution of PIM I and PIM II within the periods allotted, the experience acquired by the Administrative and Regional Development Undersecretariat (SUBDERE) and the permanent status of that same institutional setup for program execution, combined with the institutional development component (mainly in regard to the SNI), it is possible to guarantee the program's institutional viability and efficient execution within the time frame envisaged.
- 5.12 A number of factors - the 5 percent real annual growth of the FNDR over the last nine years, the assurances of the Finance Ministry as

to its future growth, the nature of the program resources as a nonreimbursable transfer, and the borrower's responsibility for providing the local counterpart resources - suffice to guarantee the financial viability of the program.

H. Socioeconomic viability

- 5.13 Chile has invested substantial resources in the institutionalization and fine-tuning of a system for preparing, evaluating and executing public projects: the SNI. The underpinnings of the system are as follows: (i) methodology manuals for the preparation and analysis of public projects; (ii) the BIP with nationwide coverage, containing a pipeline of projects at different stages of development; (iii) agencies of national and regional scope for interinstitutional coordination; and (iv) a minimum mass of professionals with special training in areas relevant to the project cycle.
- 5.14 In view of the foregoing, and of this operation's status as the third stage of the FNDR, the Bank has engaged a consulting firm to conduct an evaluation of the SNI, based on a sampling of 50 projects covering seven sectors distributed over four of the country's regions. The evaluation of the SNI's functions in connection with FNDR projects shows that despite certain identified weaknesses, the projects prepared and evaluated by the SNI are acceptable to the Bank. It is therefore proposed that this system be used to assess the technical and economic eligibility of FNDR Stage III projects. It should be noted that the present operation includes resources to strengthen the system (see chapter II) so as to overcome the problems pinpointed by the study in question.
- 5.15 During the analysis of the operation, agreement was reached with the Chilean authorities to the effect that, initially, projects in the sectors targeted in the second stage of the FNDR would be eligible. Those sectors are: health care, education, rural electrification (distribution), sanitation (potable water supply and sanitary sewer systems), and highways (urban paving and rural roads). Other sectors, such as rural telephone systems, flood protection, rural electrification (generation), small-scale fishing facilities, sanitation (solid wastes and rural potable water systems) or new roads would become eligible once the Ministry of Planning and Coordination (MIDEPLAN) completes the review of analysis methodologies it currently has under way and presents it to the Bank along with five projects in each sector with a view to obtaining the Bank's statement of nonobjection.
- 5.16 The BIP has a portfolio of projects that are viable from the technical, economic, financial and institutional standpoints; i.e. they have been given the SNI's RS recommendation, with a total cost of US\$293 million. Sectors eligible for the program account for US\$257 million of that amount. The following table shows the

sector distribution of projects that have received the RS recommendation and are included in the FNDR's budget for 1995.

Eligible sectors	Projects		%	in US\$ millions	%	Cost/project in US\$ millions
	Analysis methods	#				
Education	Cost-efficiency	358	24.8	89.7	30.7	251
Health care	Cost-efficiency	202	14.0	54.5	18.6	270
Transport (*)	Urban cost-efficiency Rural cost-efficiency	252	17.5	51.2	17.5	203
Potable water and sewer systems	Water: cost-efficiency Sewer: cost-efficiency 1/	105	7.3	42.4	14.5	403
Energy	Cost-efficiency	336	23.3	19.9	6.8	59
SUBTOTAL		1,253	86.9	257.6	88.0	206
Other sectors (not eligible)		188	13.1	35.0	12.0	186
TOTAL		1,441	100.0	292.6	100.0	203

* Includes rural roads and urban paving projects.

1/ Computed on the basis of a cost-benefit analysis of a sample of projects.

I. Impact on low-income groups

- 5.17 The information examined on projects in the SNI portfolio includes data that can be used to identify beneficiaries in the low-income bracket. But that information is not entered in BIP files, so the percentage of low-income beneficiaries in projects listed for the 1995 budget could not be ascertained. Based on the sectors and the types of construction eligible, however, it is estimated that the share of low-income groups who would benefit from the program would be substantially the same as in the previous stage, when it was close to 65 percent. That figure compares favorably with the estimated percentage of the poor in Chile's population, which is 33 percent. Pursuant to the guidelines set forth in the report on the Eighth General Increase in the Resources of the Bank (document AB-1704), it has been determined that the proposed program is consistent with the mandate to target low-income groups, in accordance with conditions prevailing in Chile.

IMPACT ON LOW-INCOME GROUPS BY INVESTMENT SECTOR
1990-1993 PERIOD

SECTOR	% OF LOW-INCOME BENEFICIARIES
POTABLE WATER	66.0
SEWER SYSTEMS	75.6
EDUCATION	66.4
ENERGY	76.3
PAVING	59.6
RURAL ROADS	40.4
HEALTH CARE	67.0
TOTAL	65.2

J. Risks and safeguards

- 5.18 Since the operation under review here marks the third stage of the Bank's participation in the FNDR, a proven institutional and operational foundation for program execution is already in place. Accordingly, there are no major risks that could significantly affect execution.
- 5.19 The main risk would arise if the SNI and SEIA were unable to evaluate the projects efficiently, in which case there would be no guarantee that the projects were competently prepared and accurately evaluated. The institutional development component calls for resources to strengthen the entities involved, and the project team considers the activities envisaged as sufficient to lessen that risk. The team also recommends that the contract include, as a condition precedent to the first disbursement, the requirement that the executing agency place in effect the legal mechanism whereby MIDEPLAN and CONAMA undertake to carry out the necessary institutional strengthening activities.

Appendix I
CH/CH-5284-2
CH-0004
Original: Spanish

PROPOSED RESOLUTION

CHILE. LOAN /OC-CH TO THE REPUBLICA DE CHILE
LOCAL DEVELOPMENT PROGRAM. STAGE THREE

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the República de Chile, as Borrower, for the purpose of granting it a financing to cooperate in the execution of the Local Development Program, Stage III. Such financing will be for the amount of up to US\$75,000,000, or its equivalent in other currencies, except that of Chile, which are part of the Ordinary Capital resources of the Bank, and will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.