

# Appraisal of Public Investment: Chile

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*Chile has managed to promote economic growth and keep discipline in its public finances through the unrelenting and disciplined use of transparent cost-benefit analysis for all public investment projects. This brief discusses some of the most salient characteristics of the Chilean system for evaluating public investment projects.*<sup>1</sup>

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CHILE HAS ACCUMULATED OVER THREE DECADES of a successful experience on the systematic appraisal of public investment.<sup>2</sup> Modern project appraisal for public investment started in 1975, with the establishment of the National System of Investments (SNI) at the Ministry of Planning (MoP),<sup>3</sup> currently administered jointly with the Ministry of Finance (MoF). The MoP performs appraisals for all public-investment projects on the basis of cost-benefit analyses (CBA) carried out with a clearly specified methodology—including a shadow social price system and a social rate of discount. The SNI currently comprises an online databank with over 300,000 entries—*i.e.*, policy ‘initiatives.’

As explained by Ernesto Fontaine (1997), every public-investment project is subject to the same CBA discipline, under a set of clearly specified methodologies published by the MoP. The law mandates that the capital budget sent by the MoF to Congress can only include projects within the SNI, which have also been favorably assessed by the MoP. Among other prudential qualities, this process screens out ‘white elephants,’ and also rules out the possibility of investment projects entering the budget at the congressional stage—the only entry door is the SNI.<sup>4</sup>

Fontaine (2004) discusses several elements that account for the success of project appraisal in Chile. These include: the continuity of the strong political will that has supported the system over decades, the substantial amount of training and capacity building at all levels of government, the (sophisticated) simplicity of the methodological manuals published, and constantly updated, by the MoP, and the practice of reviewing the appraisal of projects before they reach the feasibility stage—*i.e.*, before they have too many clients and beneficiaries—so that projects may be reformulated, or abandoned, before they acquire a life of their own.

## 1. The National Investment System

The National Investment System (SNI) refers to a set of norms, techniques and procedures which govern the public investment process. The objective of the SNI is to improve the quality of the public investment, by selecting the projects with the social largest net present value—and thereby increasing the country’s net worth. The SNI is jointly administered by the MoP and the MoF, and its main tools are:

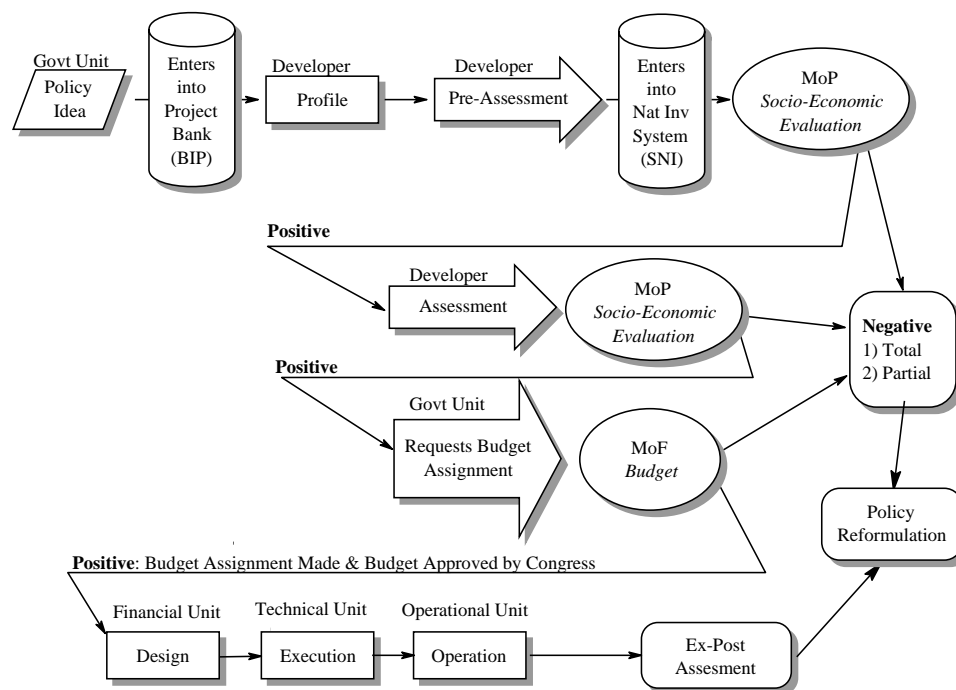
- (1) Methodologies for preparing and assessing projects from a coherent and homogeneous socio-economic perspective—including a specified set of shadow prices, and a social discount rate (currently 8%).
- (2) Continuous training of officials to develop adequate technical capacity at all levels of government, and in all regions.

- (3) A publicly available integrated data bank of projects (BIP), enabling efficient and coordinated public-finance management and well-informed policymaking.

### 1.1. The Appraisal Process

Fig. 1 displays a schematic representation of the project appraisal cycle. The process starts out with a ‘policy idea’ by a government unit which enters it into the BIP—and thereby gets assigned a project ID. This ‘idea’ needs to be developed into a project profile that is subsequently subjected to a pre-assessment study—including examination of legal and technical issues, as well as a socio-economic analysis. Once the required documentation is put together, the project ID is entered into the SNI. The MoP then makes an analysis, which includes legal issues, alignment with policy priorities (*e.g.*, impact on gender equality), environmental issues, stakeholder participation, etc. The MoP then may issue either a positive or a negative recommendation—which may be partial, asking for a reformulation, or straightforward rejection.

**Fig. 1.** Schematic Public-Investment Project Appraisal Cycle in Chile



Upon a positive initial recommendation, a full-fledged CBA is performed. Instead of using distributive weights or inserting poorly-measured external effects into the CBA calculus, the MoP’s preferred approach is to perform a simpler CBA on what can be reasonably measured, but allowing for positive recommendations in instances where, while the NPV may be negative, there may be important positive externalities. When benefits are not amenable to proper quantification, cost-effectiveness analysis is used.

On the basis of the analysis, the MoP—taking also into account the MoF sectoral draft-budget envelopes—issues either a positive recommendation (which can be unconditional, or conditional on small reformulations), or plainly rejects the project. The intersectoral

allocation is, in this way, handled by the draft-budget priorities. Multiyear projects with remaining execution balances are also counted against the pertinent sectoral envelope. Government units may typically hold a portfolio of approved projects exceeding the funds allocated to them, and must consequently choose themselves which projects to submit to the draft budget. Also, previously approved projects may be stopped later if conditions change very substantially (*e.g.*, cost overruns).

With a positive MoP appraisal, the government unit can request a budget appropriation from the MoF. When the budget is discussed by Congress, it is still possible that some allocations may shrink and some projects eliminated for the next fiscal year—what is most emphatically ruled out is the possibility of projects entering the budget without going through all the process described above.

If the project makes it to the capital budget then it will go through a financial design, an implementation by a technical unit before it finally enters the operation stage. The process continues to an ex-post assessment phase where different aspects of the process are evaluated, in the context of the comprehensive performance budgeting framework currently adopted by the government of Chile.

Fig. 2 shows the actual number of BIP projects processed in 2005 fiscal year. At the end of the process 5,433 projects (28% of the 19,262 entered into the BIP) make it to the approved capital budget—of which, 3,103 (57%) are new and 2,578 (43%) correspond to previously initiated multi-year projects.

**Fig. 2.** Summary of the 2005 Public-Investment Appraisal Process in Chile

Pre-Assessment			Assessment		Budget
IDs entered into the BIP: 19,262	IDs entered into the SNI: 11,821 61%	New IDs 8,954 76%	Entered in 2004 6,166 69%	Positive 2,851 46%	Budget 1,695, 59%
			Entered in 2005 2,788, 31%	Positive 1,896, 68%	Budget 1,408, 74%
		IDs from Proj in Execution 2,867, 24%	→	Positive 2,578 90%	Budget 2,350, 91%
	IDs not entered into the SNI: 7,441 39%				
<i>Total number of projects in the Budget:</i>					5,453
<i>% of Total BIP:</i>					28%

Source: BIP, MIDEPLAN.

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## Footnotes

- [1] This brief draws heavily from articles by E. Fontaine (1997, 2004), presentations by M. Marcel (2004), H. Arancibia (2006), and guidance notes posted on the web by MIDEPLAN.
- [2] Chile has enjoyed an average real-GDP per-capita growth of 3% since 1975. More recently, Giovagnoli *et al.* (2005) note that: “During the 90s Chile had one of the best socio-economic performances in the region. On average, GDP grew at an annual rate of 6.3%. [...] As a result of the economic progress, poverty—measured by the headcount ratio using the official moderate poverty line—significantly decreased from 45.1% in 1987 to 21.7% in 1998. For the first time, the country reached the third position among the lowest poverty rates in LAC, after Uruguay and Costa Rica. ”
- [3] The MoP is known in Chile as MIDEPLAN. Until 1990, it was an office attached to the president, and known as ODEPLAN. ODEPLAN was established in 1967 as a planning office advisory to the presidency, but the original focus was on macro (input-output) planning. In 1974 under the leadership of Roberto Kelly, the emphasis of ODEPLAN turned to project appraisal. In 1990, ODEPLAN was converted to the current Ministry of Planning. A few years later, the regional offices, SERPLAC (Secretaría Regional de Planificación, regional planning office) were created. In this brief we will refer to MIDEPLAN and SERPLAC jointly as MoP. See Fontaine (1997, 2003) for more details.
- [4] As we shall see below, once a project in the BIP has a pre-assessment study and other required documentation, it is entered into the SNI. Until 1995, the only exception were presidentially-sponsored projects, which required a special presidential petition and decree. In 1995, at the end of the Aylwin government, this was eliminated and now every single project must go through the system.

## 2. References

- Arancibia, H. (2006) “Cost-Benefit Analysis of Investment in The Budget Process: The Experience of Chile”, presentation at The World Bank, Washington DC, November 7, 2006.
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Several methodological manuals are available in Spanish at <http://www.mideplan.cl/>