



# Making decentralisation work in Chile: Towards stronger municipalities

Main findings & recommendations



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## FOREWORD

The OECD has been requested to accompany the Chilean government, in particular the Sub-secretariat for Regional and Administrative Development (SUBDERE), in conducting a comprehensive analysis of subnational government in Chile, and to provide recommendations that can assist SUBDERE in designing and implementing the municipal decentralisation programme. This programme is one of two pillars in the government's decentralisation agenda. It complements the regionalisation process, which aims at creating self-governing regions with more responsibilities and resources. The municipal decentralisation agenda focuses on empowering municipalities and modernising the municipal system by providing local authorities the tools, capacities, financial resources and legitimacy to improve their autonomy and performance, while reducing municipal disparities in terms of capacity and finance. The goal is to strengthen their ability to effectively carry out their responsibilities and deliver local public services in a more efficient, transparent, accountable, participative and equitable manner.

The objectives of this study are to provide a diagnostic of the situation, identify the main gaps, challenges and policy options for reform in light of national circumstances and in an international perspective. The study covers several dimensions of the municipal system, looking at municipal responsibilities, fiscal and human resources, local public services, democratic oversight, citizen participation and co-operation and co-ordination mechanisms across and among levels of government. The latter is a crucial issue, particularly in the context of a profound transformation of the multi-level governance framework. It is, therefore, essential to ensure that: i) reforms at the central, regional and municipal levels are well coordinated, ii) the governance framework is well-balanced and coherent and iii) the role of municipalities is adequately acknowledged.

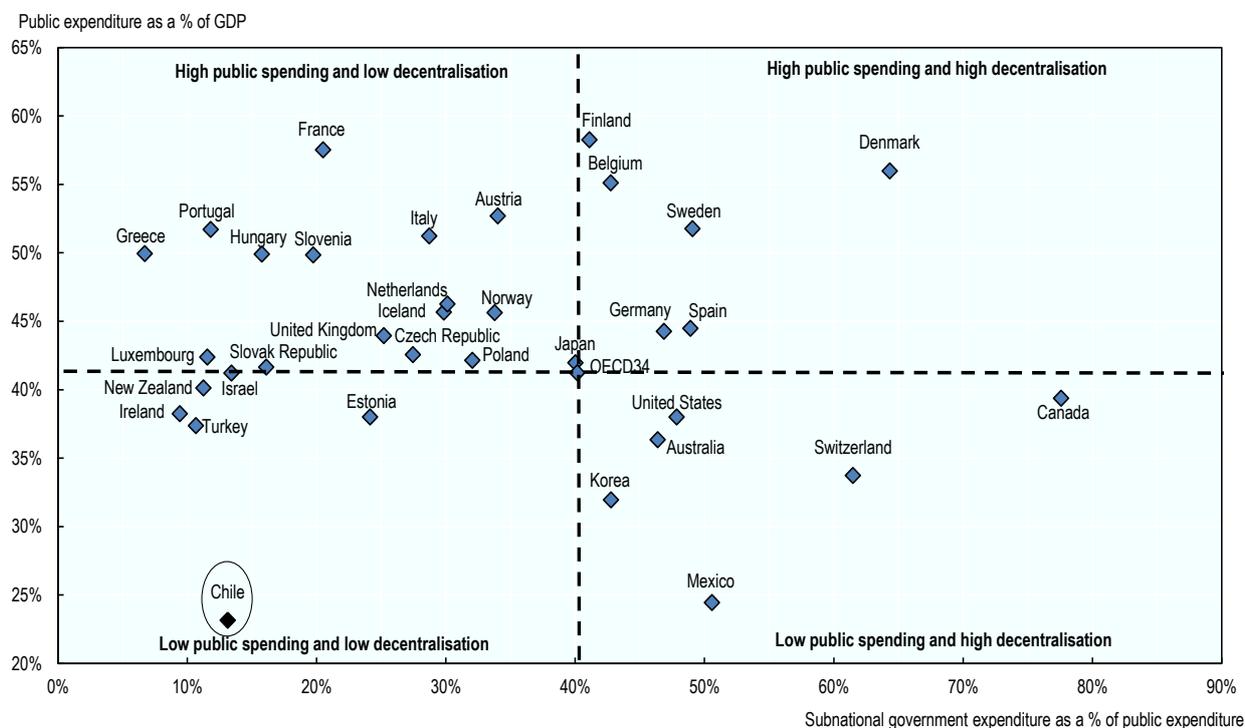
The full report is summarised in this document, which presents the main assessments and recommendations. The first section provides an overview of the organisation of Chile's multi-level governance system and of the decentralisation process in a historical perspective. It ends with an analysis of the role of municipalities in a changing institutional system, underscoring the challenge to transform Chilean municipalities from being mainly “public service providers” to genuine “local governments”. It is important to acknowledge the diversity of municipal realities and to reconsider the current uniformity principle by encouraging more asymmetrical approaches to local development. The second and third chapters are dedicated to fiscal challenges in the current context but also in the perspective of a further devolution or reorganisation of tasks. While there is, in Chile, a general propensity to limit financial public intervention, section 2 looks at the weaknesses of the Chilean local government finance system. It suggests ways to improve the current financing system in order to provide municipalities with the financial capacity to exercise their responsibilities. It also provides recommendations for establishing a stronger and more transparent fiscal responsibility framework in view of stronger fiscal decentralisation. Section 3 focuses on the need to design more appropriate equalisation mechanisms that go beyond the current “compensation system”, which is not fully efficient and which has some counter-productive effects on local and regional development. Sections 4 and 5 focus on improving municipal management and performance through adequate human resources and efficient tools for public service production, delivery and monitoring across the whole territory. One crucial dimension of decentralisation reform is community participation and democracy at the municipal level as a means to building a more inclusive and more democratic society. Section 6 is dedicated to this dimension, presenting the different formal mechanisms which are or could be used in Chile but also highlighting a range of other tools aimed at promoting transparency and accountability practices and greater citizen participation. Finally, section 7 deals with the need to strengthen strategic co-ordination and co-operation within and across levels of governments, made all the more necessary due to the decentralisation process as stressed above.

## INTRODUCTION

Chile's complex geography, history and economic development model, in place since the return of democracy, are all factors that explain why it is particularly challenging to engage the country in a decisive decentralisation process. One of the longest and narrowest countries in the world, with also one of the world's longest coastlines, Chile is characterised by its great variety of landscapes and climates. Unfortunately, the country also reaches world-record levels in terms of vulnerability to natural disasters and man-made hazards. In addition, despite demographic concentration, external/internal migrations and the significant integration of its population, Chile is a very culturally diverse country. In fact, a high proportion of its population identifies itself as indigenous (8.8%), one of the highest percentages in the OECD, after Mexico and New Zealand.

The concentration in settlement patterns and economic activity is high in Chile, which largely reflects the importance of mining-intensive activities that concentrate high-value economic activities in just a few regions, such as Antofagasta, Tarapaca and Atacama, as well as the importance of business activity, financial services and firms in the capital Santiago. This situation also results from the fact that Chile has opted for a mix of two models: on the one hand an economic model that trusts the market's ability to distribute resources and tends to limit public intervention; on the other hand, a "centralist political-administrative model" which is viewed as a way to maintain stability, protect national unity and contribute to economic efficiency. This model puts Chile in a unique situation compared to other OECD countries, one that is reflected in the low rates of both total public expenditure (as a percentage of GDP) and subnational expenditure (as a percentage of public expenditure) (Figure 1).

**Figure 1. The singularity of Chile: Very limited and centralised public intervention (2014)**



*Source:* created by the authors based on OECD data (2016b) and "Subnational Government Structure and Finance", OECD Regional Statistics (database), <http://dx.doi.org/10.1787/05fb4b56-en>. Note: 2013 for Chile, Mexico and New Zealand, 2012 for Australia and 2011 for Turkey. Data stated in local currency were converted in USD using purchasing power parity. OECD average is weighted.

In several respects, this model has been successful. It has managed to ensure internal political and macro-economic stability, national unity, economic efficiency, and growth. Chile has gone through an extensive modernisation process, bringing with it greater economic prosperity, increased living standards and lower poverty.

However, this economic development model has also significantly reinforced inter-regional and local disparities across the territory over recent decades, and especially since the recent global financial crisis. In fact, the “hyper-centralisation” of powers has gone hand in hand with a “hyper-concentration” of population, resources and power. While the metropolitan area of Santiago covers 2.1% of Chile's land area, it accounts for 41% of the country's population, 49% of GDP and 41% of employment. In 2013, Chile recorded the second highest level of regional concentration of GDP among OECD countries, after Greece, i.e. a concentration index of 55 vs. an OECD average of 39. The spatial inequalities are even more striking when the non-pecuniary dimensions of well-being are taken into account. Chile exhibits the highest levels of regional disparity among OECD countries when it comes to life satisfaction, environment, safety, and jobs as well as very wide disparities in education.

The regional development policies hitherto employed have not delivered. They have been largely driven by centralised, top-down and sector-based approaches, and have struggled to adapt to the different needs of Chilean regions. In addition, they have not enabled regions to use their assets to maximise their growth potential.

The limitations of the development model used until now are increasingly evident. In particular, Chile still has high productivity gaps compared to other OECD countries and its productivity growth has trended at below zero for much of the past two decades. A new model is needed to maximise growth and productivity across the territory, one that makes them more balanced and inclusive, and that can mobilise the place-based components of productivity and growth factors. Moving towards such an approach in Chile requires institutional changes in order to establish a governance structure capable of context-sensitive interventions. It is now necessary to reform the multi-level governance system to enhance the role of subnational governments. This approach should complement and enhance the impact of traditional structural reforms. It is increasingly recognised that, when designed and implemented properly, decentralisation, as an economic strategy, enables social and territorially inclusive growth. It does so by making the most of regional and local productive assets and, in some contexts, it can be part of structural reforms aimed at enhancing productivity. There is international evidence indicating that wealthier countries tend to be more decentralised and that decentralisation can promote growth (Box 1).

#### **Box 1. Decentralisation, wealth and growth**

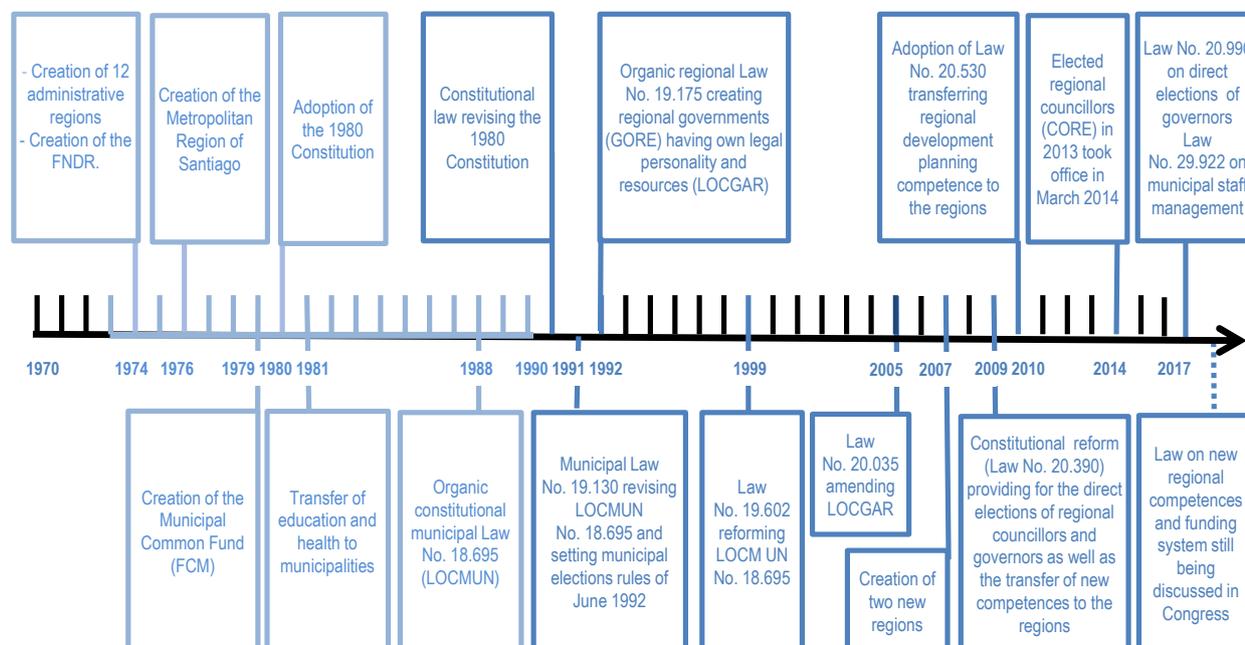
Some evidence suggests that decentralisation and growth are positively correlated. While decentralisation of expenditure is not necessarily associated with increased growth, recent research shows that decentralisation of tax revenue is good for growth. A 10 percentage point increase in the sub-central tax revenue share is associated with an approximately 2% jump in GDP per capita in the long run. Tax decentralisation seems to encourage the development of the subnational economic and fiscal base. It also shows that balanced decentralisation is conducive to growth: when the various policy functions are decentralised to a similar extent, subnational governments are better able to co-ordinate policy and to reap economies of scale and scope across functions.

Another study shows that the wealthiest countries tend to be more decentralised. If we compare the level of spending decentralisation, measured by the share in GDP or in public spending with the GDP per capita, there seems to be a positive correlation (Figure 2.). It means that most decentralised countries seem to have the highest per capita GDP while the most centralised have the lowest. Of course, this is not a golden rule and there are several counter-examples. In addition, the cause-effect link between decentralisation and the level of development may not always be clear, in particular which way the causation works and many other socio-economic factors can play a significant role.



slowing and scaling back the decentralisation initiatives, which have been often restricted to “administrative” decentralisation versus “political” decentralisation, and correlated “fiscal decentralisation”.

**Figure 3. Historical timeline of decentralisation in Chile 1970-2017**

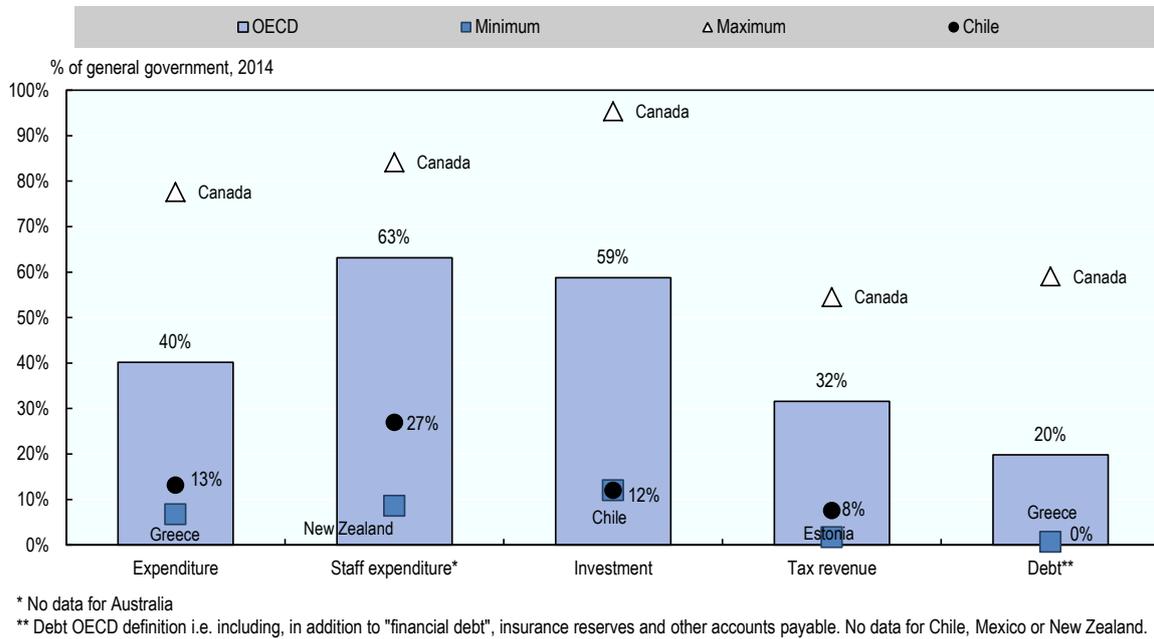


Source: diagram created by the OECD

Chile ranks among the most centralised countries in the OECD, alongside Greece and Ireland. In 2014, subnational government expenditure in Chile accounted for 3.0% of GDP and 13.1% of public expenditure versus the OECD average<sup>1</sup> of 16.6% and 40.2%, respectively (Figure 4). The same applies to public investment for which municipalities play a minor role (12.0% of public investment), with Chile ranking last among OECD countries. Chilean municipalities have limited own-source revenues and they largely depend on central government transfers earmarked to fund specific sectors or activities. Chile is the only OECD country where local borrowing is prohibited. Policy design and implementation are still largely defined from the centre by national ministries and public agencies in a top-down process. Locally, policy is carried out by deconcentrated state territorial entities and partially implemented by municipalities, often according to national uniform norms that do not take into account local specificities and needs.

<sup>1</sup> These data are derived from the IMF and OECD national accounts harmonised according to the standards of the System of National Accounts (SNA 2008) and refer to the “general government sector” (S.13). Regional financial data are not included in subnational government data (S.1313) but are still part of the central government sector (S.1311).

**Figure 4. Chilean municipalities are weak social and economic actors compared to a majority of OECD countries**



Source: OECD (2016) Subnational government in OECD countries: key data (brochure) and "Subnational Government Structure and Finance", OECD Regional Statistics (database), <http://dx.doi.org/10.1787/05fb4b56-en>.

**Decentralisation has become a priority**

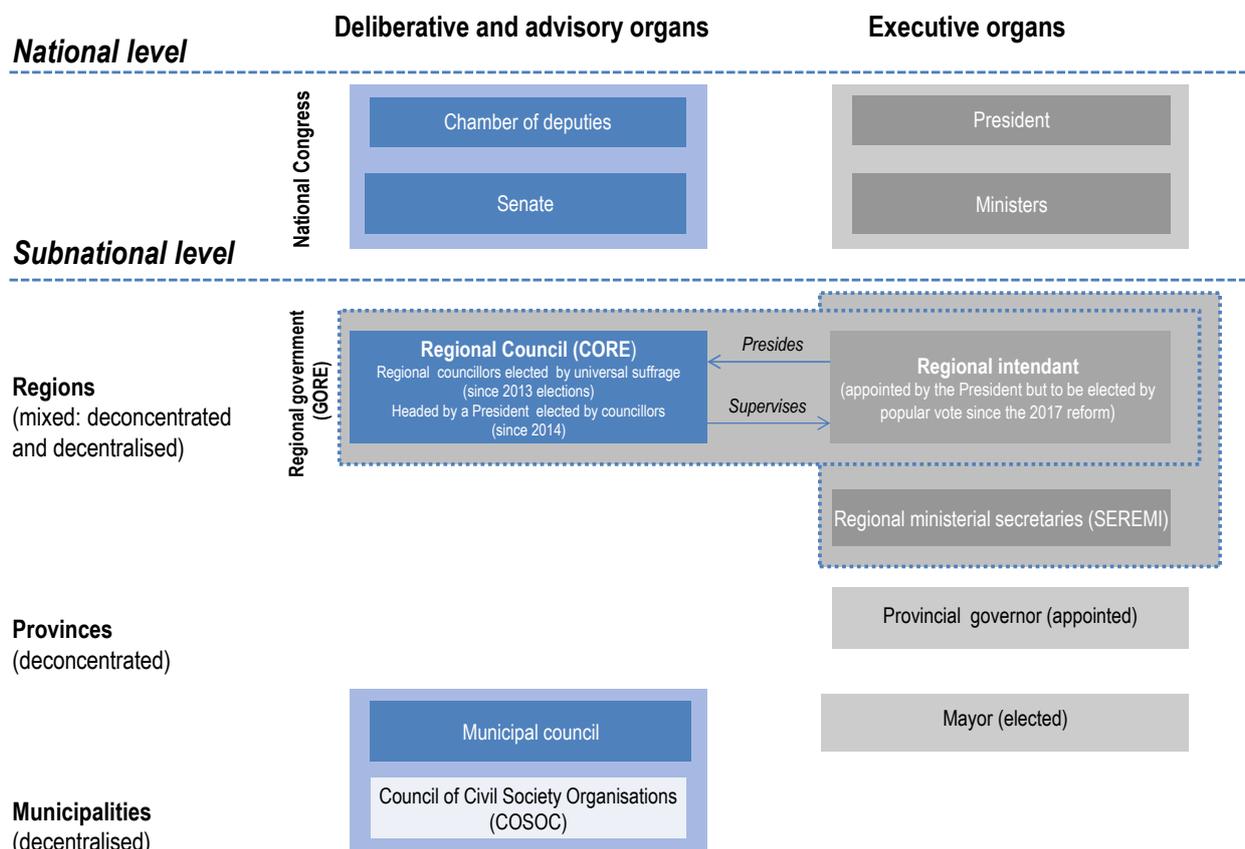
Decentralisation has become a priority on the Chilean policy agenda in the recent years. Overall, there is a growing recognition of the interdependencies between decentralisation, regional and local development, and increased productivity and growth, and important steps were taken in 2009 to further advance the agenda. However, because of resistance from various stakeholders, the government, at that time, was not able to launch a comprehensive decentralisation reform. Instead, intense legislative activity took place concerning both the municipal and regional levels, which allowed Chile to advance incrementally towards greater decentralisation and regionalisation.

A decisive impetus was given in 2014 when the president, Michelle Bachelet, put decentralisation at the core of the 2014-2018 presidential programme. In the framework of the Presidential Decentralisation Agenda, the government established a Presidential Advisory Commission for Decentralisation and Regional Development, which presented a detailed action plan in October 2014. The government started to engage in the preparation of bills and although progress was slow until 2016, it has recently accelerated, becoming concrete and marking a fundamental shift towards decentralisation.

The territorial agenda has two main pillars, regional and municipal. The regional pillar aims at rebalancing regional development and competitiveness by developing place-based policies adapted to the characteristics, assets and opportunities of each region, as well as by empowering regional actors through a process of political and administrative decentralisation. The process of transformation started in 1992 when a constitutional reform established a mixed regional government system (called "GORE"), formed by a regional executive (the intendant) appointed by the President of the Republic and a regional council (CORE) elected indirectly by the municipal councillors. In 2009, a new constitutional reform provided for the direct election of the CORE by popular vote for a four-year term, effective when the newly-elected regional councillors took office in March 2014. Finally, the process reached a new crucial step on January

2017 with the publication of the law No. 20.990 which provides for the direct election of the regional executive by popular vote (the law will be effective when the first elections of regional governors take place). This regionalisation process should also lead to the transfer of new responsibilities and financial means to the 15 regional governments, but the bills are still under preparation or being discussed in Congress.

**Figure 5. Current organisational chart of the Chilean multi-level governance system**



Source: created by the OECD.

At the municipal level, a process of modernisation and empowerment of the municipal system is underway. The 345 municipalities form the basic unit of the political and administrative structure in Chile. They are recognised as self-governing entities in the 1833 Constitution that provided for the election of local municipal councils through direct popular vote, a principle that has been maintained over time, except during the Pinochet regime. The Organic Constitutional Law on Municipalities, passed in June 1992, paved the way for municipal elections and restored municipal autonomy. Municipalities are still, however, governed by the 1980 Constitution and the Constitutional Organic Law No. 18.695 on Municipalities (LOCMUN), which has been amended several times since coming into effect in 1988. Defined as “public law corporations”, municipalities are autonomous and have their own legal personality and assets/resources. Their stated purpose is to promote the economic, social and cultural development of the comuna, with the participation of the local community.

The municipal reform aims at providing the municipalities with the tools, capacities, financial resources and legitimacy to improve their autonomy and performance while reducing municipal disparities in terms of capacity and finance. The objective is to strengthen their ability to effectively carry out their

responsibilities and deliver local public services in a more efficient, transparent, accountable, participative and equitable manner. To that end, a Memorandum of Understanding was signed in November 2014 between SUBDERE, the Chilean Association of Municipalities (ACHM) and the National Confederation of Municipal Officials of Chile (ASEMUCH). Within that framework, SUBDERE set up a Technical Advisory Committee for Municipal Modernisation. Composed of experts in municipal issues, including mayors, councillors and municipal workers, the CTAM developed a set of proposals for a thorough reform of the municipal system based on four strategic lines: modernisation, equity, autonomy and accountability. An Inter-ministerial Committee for Municipal Modernization, regrouping SUBDERE, the General Secretariat of the Presidency (SEGPRES) and the Ministry of Finance, was created in order to analyse the CTAM's proposals. One result was a major reform adopted in May 2016 embodied in law No. 20.922. This law allows mayors, with the consent of two-thirds of municipal council members, to manage municipal staff with more freedom and flexibility and to improve professionalisation and remuneration.

### ***Reaffirming the need for a gradual but comprehensive municipal decentralisation agenda***

Despite some fundamental advances, in particular concerning municipal staff, much more remains to be done, especially regarding the second pillar dedicated to the modernisation of the municipal system. The initial objective of the government was to design a comprehensive modernisation reform as part of the decentralisation agenda, and to gradually address a wide range of issues: municipal powers and responsibilities, fiscal resources, institutional and human capacities, local public services, democratic oversight and citizen participation at the local level, and co-ordination and consultation mechanisms across and among levels of government. At the core of this thinking was the objective to transform Chilean municipalities from service providers to genuine local governments, both empowered and accountable.

However, this ambitious approach has progressively become a more cautious and incremental process, increasingly disconnected from the decentralisation agenda, rather than being fully part of the multi-level governance reform. In particular, it seems that the regionalisation process has become the priority, placing the municipal reform on the backburner. Focusing reforms on the regional level must not come at the expense of careful consideration of the modernisation that urgently needs to be undertaken at the municipal level.

Instead, a systemic and multi-dimensional approach should be adopted to avoid building an imbalanced political structure (Figure 6). The regional and municipal pillars of the decentralisation process should be closely connected as municipalities and regions are part of the same multi-level governance system. Therefore, the regional reform has, and will have, major impact on municipalities and vice versa. In that perspective, it is crucial to link the regional reform and the municipal reform, and reinforce municipalities so they have a strong position in the evolving multi-level governance framework. In the same way, reforms concerning subnational governments cannot be designed or implemented by ignoring their strong impact on the overall system, in particular on the central government, both at the national (central ministries) and territorial levels (SEREMIS and other regional and local deconcentrated agencies).

The municipal reform is not just about modernisation. It should be given a new boost, reaffirming its initial ambitious objectives. It should be also carried out in closer co-ordination with the regional reform. In spite of major progress resulting from the 2016 law on municipal staff, a lot remains to be done in other areas of municipal governance to transform the municipalities into real local governments. The central aim needs to be to build a comprehensive municipal modernisation reform programme.

There are still many important challenges ahead that should be addressed in a more integrated manner, including a better definition of municipal responsibilities, increased municipal financial resources, greater equity and improved co-ordination mechanisms across and within levels of government. The need for more place-based policies and stronger citizen participation and control are also two forces that call for

greater weight for municipalities in the overall multi-level governance system. As the level of government that is closest to citizens, municipalities are particularly well positioned to carry out local development policies and to become an essential link of the “social pact”, which seems to be flagging in Chile.

**Figure 6. Chilean municipalities operate in a multi-level governance system undergoing profound changes**



Source: created by the OECD

In order to design a comprehensive municipal decentralisation agenda, it is necessary to adopt an “open-system” perspective of decentralisation, linking the three complementary and interdependent dimensions of decentralisation, i.e. political, administrative and fiscal. Decentralisation outcomes will depend on how the different elements of the reform are connected and interact. Finding the right balance between these three dimensions, and building capacity is key in the process. It is also necessary to design a gradual and well sequenced decentralisation process. A major challenge is to find the right sequencing of reforms, while decentralisation reform is also a learning process. Permanent adjustments are necessary to correct for potential deviations.

The first step of this process is to start by reflecting on municipal powers and responsibilities. Clear assignment of responsibilities is the entry point that should determine the entire decentralisation process. On this basis, an action plan, ensuring overall consistency between the different lines of the municipal reform, should be prepared and discussed by a permanent “decentralisation committee” involving relevant ministers, subnational government associations and key stakeholders (business and citizen associations, universities, etc.) with a secretariat coordinated by SUBDERE, based on the recommendations of the OECD report. Setting up a “decentralisation committee” could help to build stronger legitimacy, better anchor the decentralisation agenda within the national reform programme and foster its sustainability, a practice already employed in several countries undertaking multi-level governance reforms.

At the central government level, an inter-ministerial committee on regional and municipal decentralisation could be established to discuss and prioritise the recommendations of the OECD report, according to political choices, a more detailed analysis of the feasibility of measures proposed in policy reforms (technical, legal, financial, political, etc.), and possible implementation implications.

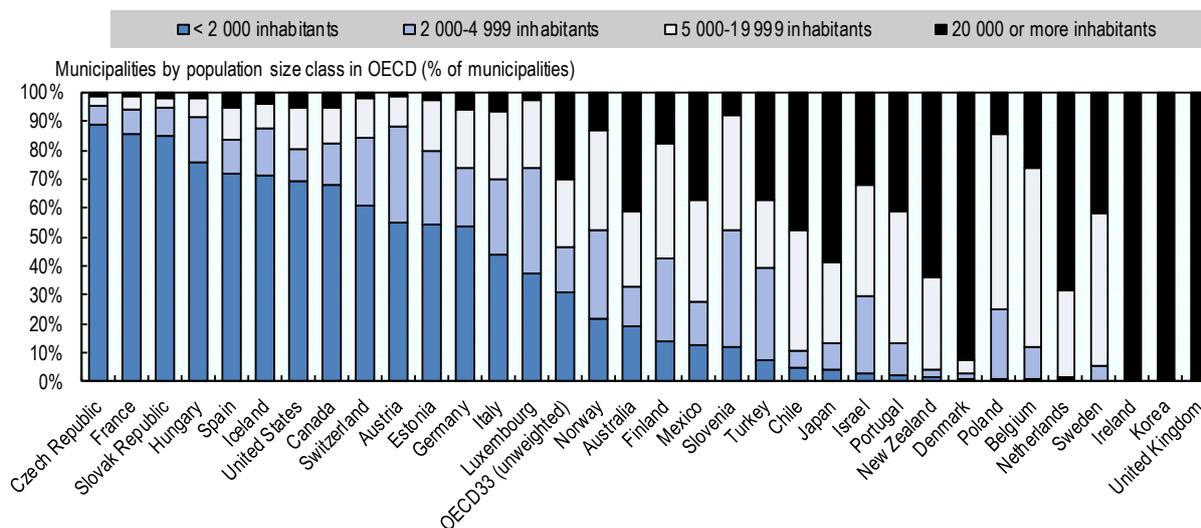
In fact, the implementation process that may follow the initial set of recommendations will be as crucial as the nature of the reform. The implementation plan should identify the necessary steps for a successful execution of the reform. It should include tools and indicators to permanently monitor and assess the progress of the action plan, and be assigned to the “decentralisation committee”.

***Reconsidering the principle of uniformity to recognise the extreme diversity of municipalities in Chile***

The decentralisation process is an opportunity to recognise the diversity of the Chilean municipal landscape, and to allow the design and implementation of policies, programmes and tools adapted to this diversity. To do so would require reconsideration of the principle of unity, which has been a cornerstone of Chile's structure.

Compared to other OECD countries, Chilean municipalities are, on average, large, both in terms of surface area and number of inhabitants. However, there are significant disparities between municipalities, with some very small municipalities (5% have less than 2 000 inhabitants), and a high proportion of small and middle-sized municipalities between 5 000 and 20 000 inhabitants (41% vs. 23% in the OECD on average) as shown on Figure 7.

**Figure 7. Municipalities by population size class in the OECD (% of municipalities, 2015-2016)**

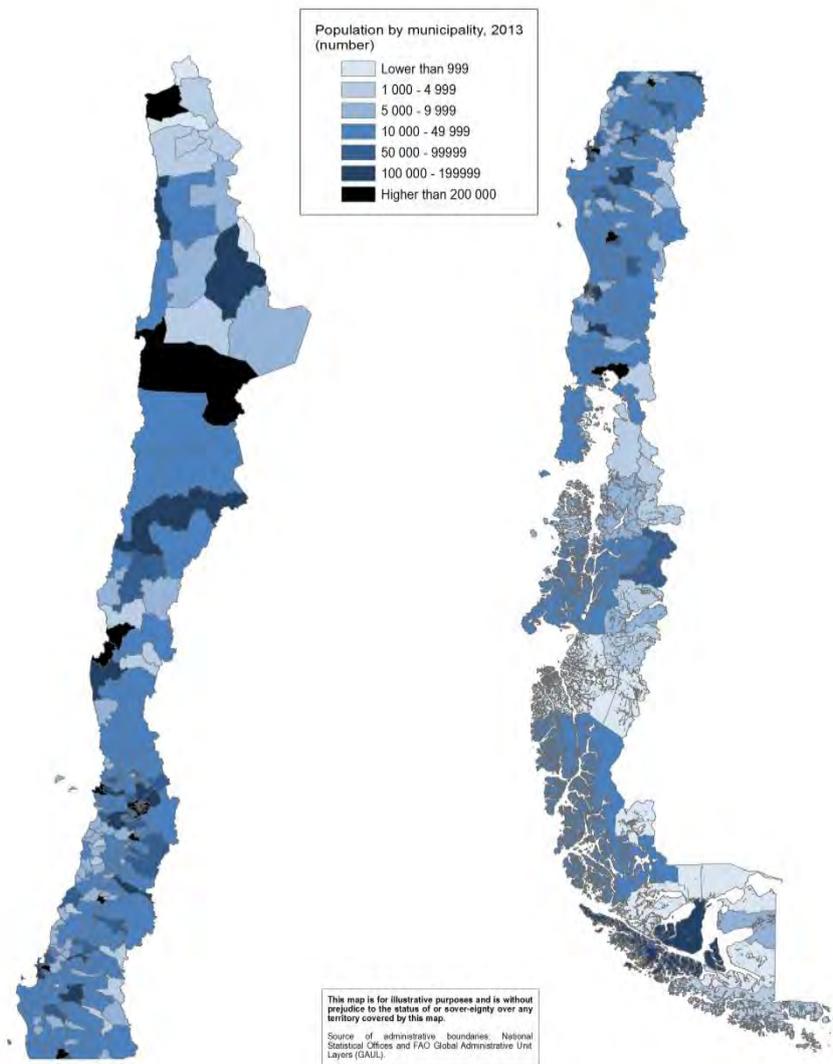


Source: OECD (2016), Subnational governments in OECD countries: Key data (brochure).

Among municipalities there also is considerable diversity. The majority of municipalities in Chile have a low density: 62% have a population density below 50 inhabitants per km<sup>2</sup> (Figures 8 and 9). According to the OECD definition of rural areas, 92% of the territory in Chile is rural. While the territory is mostly rural, the population is largely urban: 64.1% of inhabitants live in predominantly urban or intermediate regions. The 345 municipalities are also very diverse in terms of socio-economic characteristics and resource levels. There are large disparities between urban and rural municipalities, especially remote and low density municipalities located in mountainous areas or on numerous island territories with difficult and poor connections. Urban municipalities also face specific problems, with

worsening internal inequalities within functional urban areas, especially in the three Chilean metropolitan areas (Santiago, Valparaíso and Concepción). Chilean municipalities appear to have extremely uneven poverty rates, ranging from 0.3% in Vitacura to almost 60% in Alto Biobío. Some 21% of Chilean municipalities have a poverty rate over 30%.

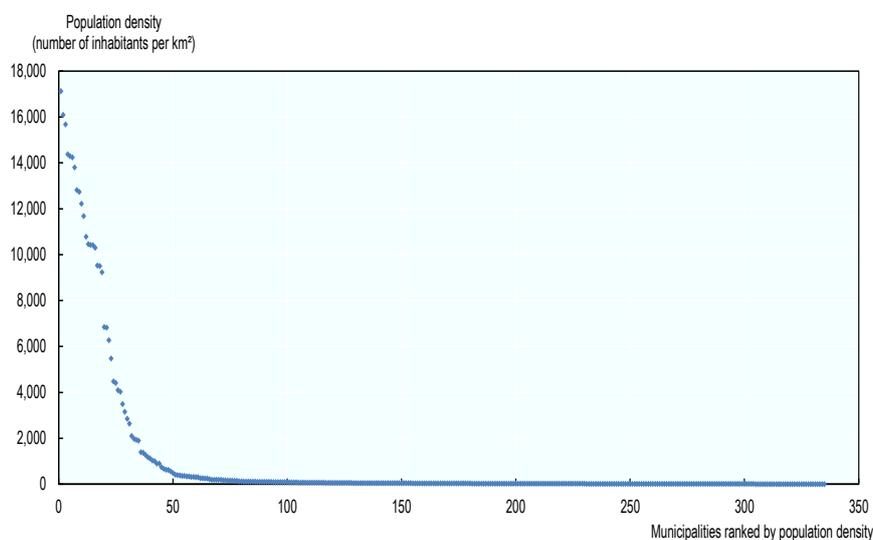
**Figure 8. Population by municipality**



Source: OECD based on SINIM data.

Note: Map is for illustrative purposes and is without prejudice to the status of or sovereignty over any territory covered by this map.

**Figure 9. Distribution of municipalities in Chile ranked by population density, 2014**



Source: OECD based on SINIM data.

Despite this diversity, the administrative organisation (mayor, municipal councils, COSOC), responsibilities and financing of municipalities are all based on the principle of uniformity. According to the law No. 18.695 (LOCMUN), municipalities have many statutory competences, which are uniform across municipalities, regardless of their size or specificities. They are broken down into six exclusive and twelve non-exclusive functions that are shared and can be implemented directly or in conjunction with the central government, the region or the provinces, as well as with external public and private organisations. Shared functions include primary and secondary education and basic public health, which account for a considerable proportion of municipal activities. New tasks are regularly given to municipalities in several areas, resulting in municipalities sometimes being identified as a "service supermarket". This situation tends to increase the burden on municipalities as they do not have adequate human, technical and financial resources, raising questions about the efficiency and quality of municipal public services. In addition, freedom for municipalities to choose management methods for local public services is restricted by the LOCMUN. They can use the formula of "corporations" in some defined areas but not that of "municipal public companies". Reliance on the private sector to provide services is widespread. This usually takes the form of concessions, which tend to be directly managed by the central government, rather than by the municipalities, themselves. Overall, in many municipalities, responsibility for service provision is shared between the public and the private sector, sometimes making the situation particularly complex.

In some areas, such as education, health and employment, growing concerns about continuing this system of shared responsibility between the central government and the municipalities. A project to "de-municipalise" education is currently being discussed<sup>2</sup>. Restructuring municipal responsibilities should form

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<sup>2</sup> A major reform of the national system of public education is being designed. Called "*Nueva Educación Pública*" (NEP), the reform will have a significant impact on the management and funding of schools. In fact, the reform intends to remove the administration and management of public schools from municipalities and create a system of public education, based on new providers of public education: Local Education Services (*Servicios Locales de Educación*). The reform was not taken into consideration in the present analysis as the bill creating the NEP (Bulletin 10368-04) was still being discussed at the time of the study.

part of a broader reflection, involving all key stakeholders, on the reassignment of functions among levels of government, particularly in light of the future regional responsibilities. Reducing the number and scope of shared competences and increasing “territorial-based” exclusive responsibilities, could be envisioned.

To advance further in its decentralisation process, Chile could explore additional approaches to address the diversity and heterogeneity of its municipalities. Recently, there has been some progress in this area. Extreme regions that are geographically very remote and Chilean islands benefit from special treatment. The increasing use of municipal delegations (*delegaciones municipales*) also allows municipal activities to be adapted to the different needs of local communities. In the 2000s, SUBDERE also started to carry out several studies to better identify territorial diversity and design more place-based and differentiated tools and programmes. This new approach made it possible to effect several changes to legislation and instructions, and to design specific programmes tailored to territories. It also resulted in the creation, in 2012, of a concrete tool created to allocate funds: a new typology of municipalities (FIGEM) that permits the classification of Chile's 345 municipalities into five categories according to spatial and socio-economic criteria. The National System of Municipal information (*Sistema Nacional de Información Municipal – SINIM*), which is considered a best practice tool, could also be reinforced in that perspective. Other countries, where territorial diversity is also high, such as Colombia or South Africa, use such categorisation for different policy purposes, including the assignment of responsibilities and revenues, and financial management. Chile could be more proactive in pursuing and strengthening differentiated approaches of local management. Chile could start experimenting with asymmetric decentralisation to promote place-based policies, for example assigning differentiated competences – but also revenues – according to different categories of municipalities. Asymmetric decentralisation could also be an interesting way to support the development and integration of indigenous communities.

## **Box 2. Key Recommendations for designing and implementing the municipal decentralisation agenda**

### **1. Promote a comprehensive decentralisation agenda for the municipalities**

- Adopt an “open-system” perspective of decentralisation linking the three complementary and interdependent dimensions of decentralisation (political, administrative and fiscal).
- Design a comprehensive municipal decentralisation agenda, as well as a gradual and well-sequenced process.
- Begin by reflecting on municipal powers and responsibilities. Clear assignment of responsibilities is the entry point that should determine the entire decentralisation process.
- On this basis, an action plan should be prepared and discussed by a permanent “decentralisation committee” involving key ministers, subnational governments’ associations and key stakeholders (business and citizens’ associations, universities, etc.) under the coordination of SUBDERE.
- At the central government level, an inter-ministerial committee on regional and municipal decentralisation could be established.
- An implementation plan, identifying the necessary steps for a successful execution of the reform, should be prepared including tools to permanently monitor and assess the progress of the action plan. It would be monitored by the “decentralisation committee”.
- Closely link the municipal decentralisation agenda with the regionalisation agenda. The municipal decentralisation agenda should be fully embedded in the overall multi-level governance reform, including central government reform. The municipal agenda should not be limited to the objective of modernisation but should also strive to create genuine “local governments”.
- Promote the involvement of subnational government associations at the national and regional levels as partners of the reform process through participation and consultation mechanisms.

### **2. Towards more flexibility and differentiated approaches**

- Recognise the diversity and heterogeneity of municipalities and design and implement policies, programmes and tools adapted to the diversity of territories. To that aim, the FIGEM classification and the municipal information system (SINIM) could be updated and enriched.
- Reduce the number and scope of shared competences and increase exclusive responsibilities.
- Create incentives to promote the use of municipal associations for horizontal co-operation in service delivery and coordinated investment (see also chapter 6).
- Give municipalities the possibility to delegate some tasks to a higher level of government (provinces or regions) through *ad hoc* agreements for a given period.
- Assign responsibilities to municipalities in a differentiated way according to their characteristics and capacity, based on “municipal categorisation”. Large and capable municipalities would have higher budget responsibilities than smaller ones. Chile could start experimenting with asymmetric decentralisation through pilot projects.
- Assess the efficiency of municipal delegations in order to determine the possibility of improving their recognition and functioning.
- Consider asymmetric decentralisation as an effective way of supporting the development and integration of indigenous communities.

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## 2. Improving the municipal finance system

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### *Limited and highly-centralised public intervention*

Chile's choice of development model shapes the possibilities and conditions under which local political responsibilities are carried out. As a result, Chile's economic framework is conservative in terms of fiscal public engagement and local government involvement. This is reflected in the low level of most public finance indicators both at the national and subnational levels.

At the national level, Chile's total public expenditure and revenue are among the lowest of all OECD countries. Weak public engagement in Chile is also reflected in public investment figures. Highlighting the country's strict management of its public finances, Chile has one of the healthiest fiscal balances of all OECD countries. Public debt is low compared to OECD countries and is by far the lowest in Latin America. The use of the private sector to meet the needs of the population (education, healthcare, social protection, etc.) reduces the importance of the public sector.

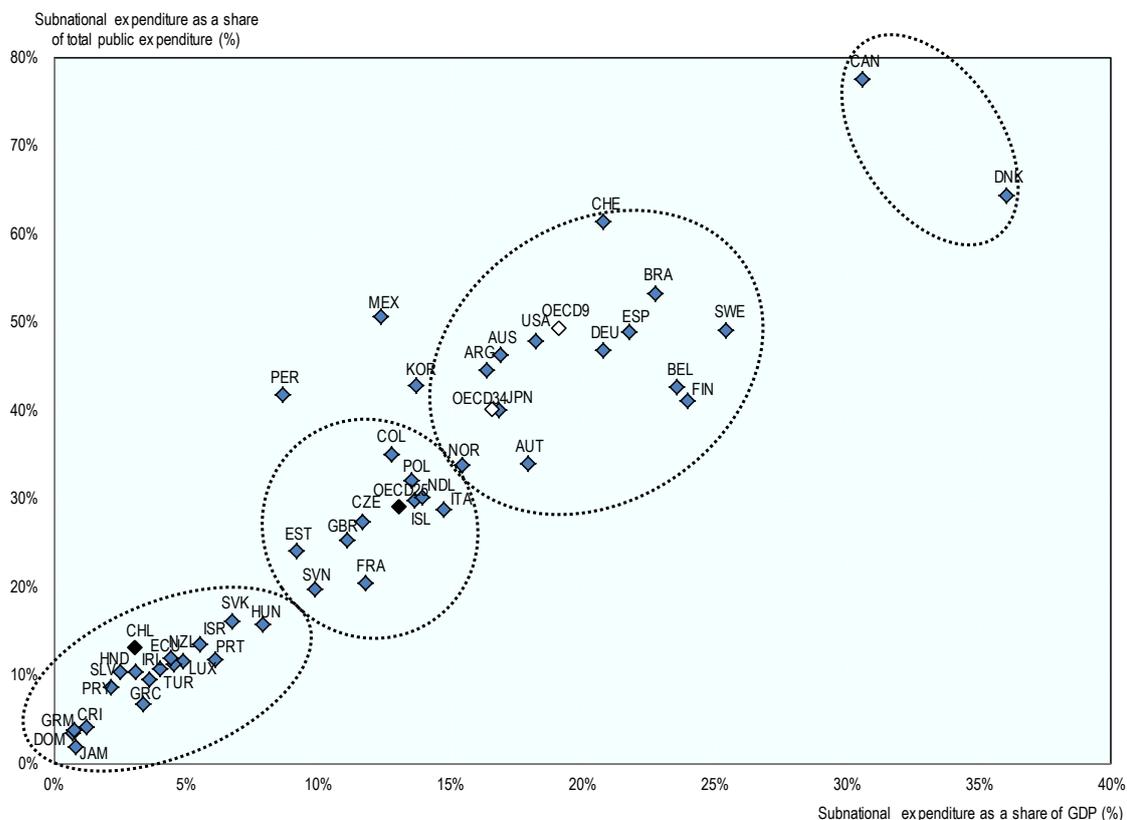
At the subnational level<sup>3</sup>, all fiscal indicators reflect the weakness of the municipal sector, underscoring the extent to which Chile is a centralised country. The local sector plays a limited role, especially compared to many other Latin American countries or OECD members, and lacks resources and a real ability to act.

As a percentage of total public expenditure and GDP, municipal spending is also very low, reinforcing the perception of Chile as a highly-centralised country (Figures 4 and 10). This is also the case when compared to federal and unitary countries in Latin America.

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<sup>3</sup> Regional accounts are still included in the central government sector.

**Figure 10. Subnational government expenditure as a % of total public expenditure and as a % of GDP in OECD and selected Latin American countries, 2014 (2013 for Latin American countries)**

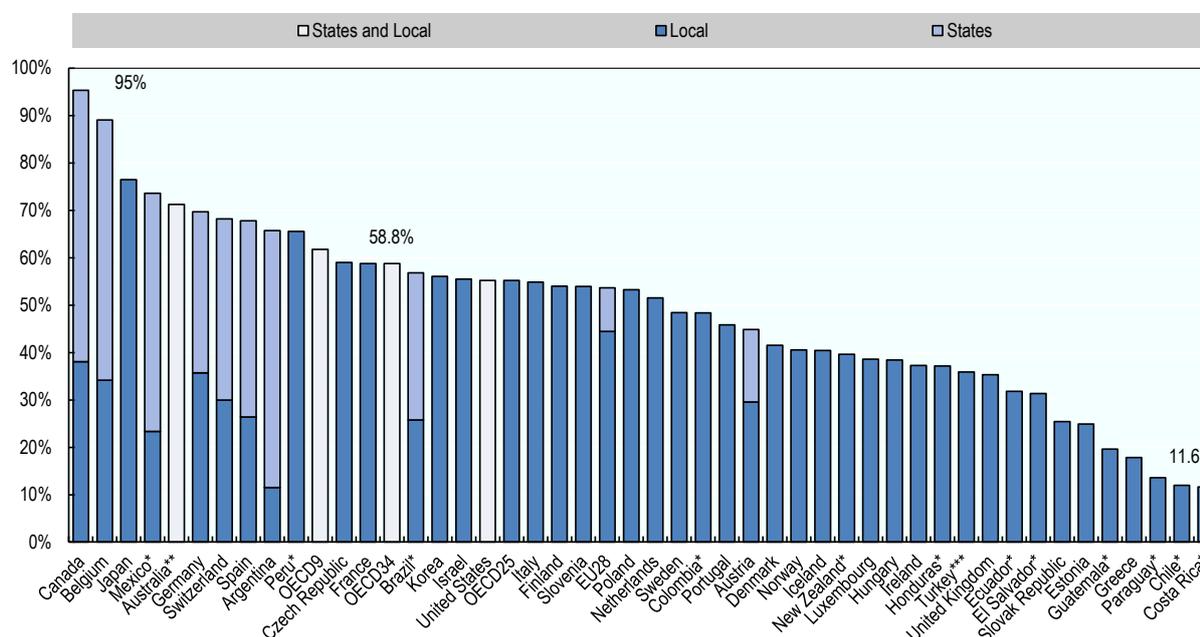


Sources: OECD elaboration based on OECD (2016), Subnational governments in OECD countries: Key data (brochure) and “Subnational Government Structure and Finance”, OECD Regional Statistics (database), <http://dx.doi.org/10.1787/05fb4b56-en> and OECD/UCLG (2016) Subnational Governments around the world: structure and finance.

Note: 2013 for Chile, Mexico and New Zealand, 2012 for Australia and 2011 for Turkey. OECD averages are weighted.

The low level of local public investment in Chile also emphasises the extent to which public action is centralised. Chile’s local investment is last among all OECD countries. Chile stands in stark contrast with the average for OECD countries and even numerous Latin American countries where subnational governments play a key role in public investment (Figure 11). In correlation with total expenditure, subnational public revenue in Chile is among the weakest across all indicators.

**Figure 11. Subnational government investment as a % of public investment in OECD countries and selected Latin American countries (2014)**

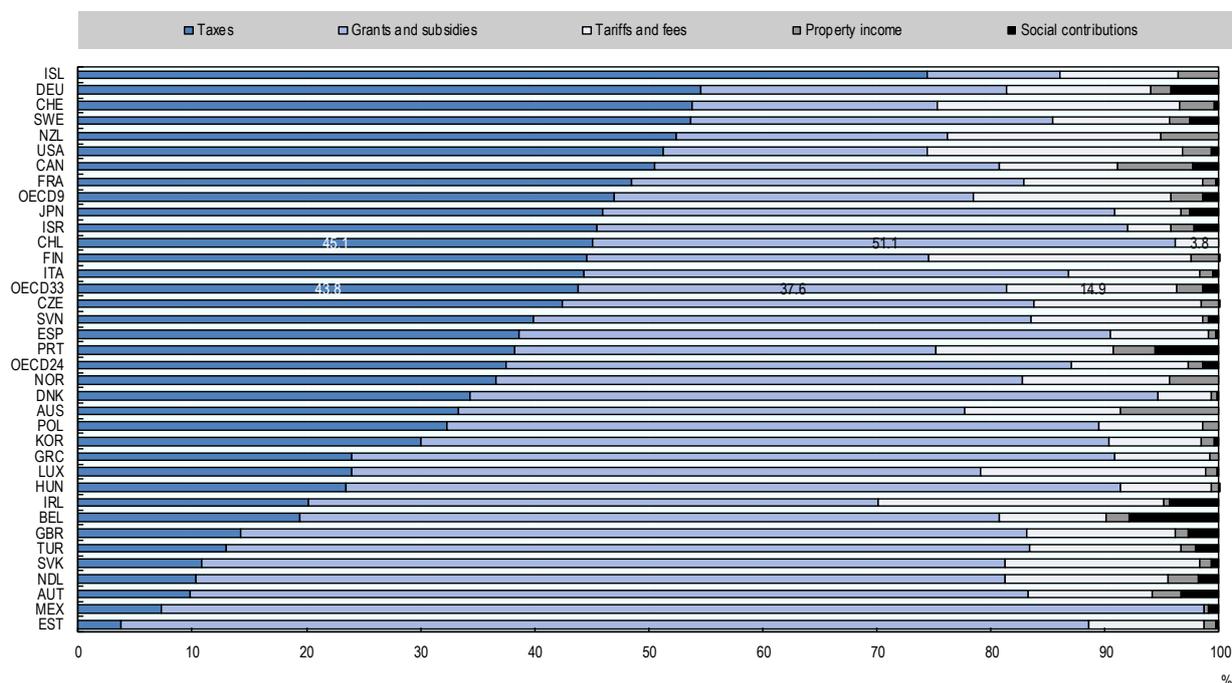


Sources: OECD elaboration based on OECD (2016), Subnational governments in OECD countries: Key data (brochure) and “Subnational Government Structure and Finance”, OECD Regional Statistics (database), <http://dx.doi.org/10.1787/05fb4b56-en> and OECD/UCLG (2016) Subnational around the world: structure and finance.

Note: 2013 for Latin American countries and New Zealand; 2012 for Australia; and 2011 for Turkey. OECD averages are weighted.

In terms of municipal revenue, the share of grants and subsidies (51% of municipal revenue) reflects a high level of dependency on the central government, well above the OECD average (38%). The share of tax revenue (45%) is slightly above the OECD average (Figure 12). However, local tax revenues account for a mere 1.4% of GDP (OECD average: 7%) and 7.6% of public tax revenues (OECD average: 31.6%), while there is a marginal contribution from other revenue streams (i.e. tariffs and fees, property income such as asset sales and rents and social contributions).

**Figure 12. Structure of subnational government revenue (% , 2014)**



Sources: OECD elaboration based on OECD (2016), Subnational governments in OECD countries: Key data (brochure) and “Subnational Government Structure and Finance”, OECD Regional Statistics (database), <http://dx.doi.org/10.1787/05fb4b56-en> and OECD/UCLG (2016) Subnational governments around the world: structure and finance.

Note: 2013 for Latin American countries and New Zealand, 2012 for Australia and 2011 for Turkey. OECD averages are weighted.

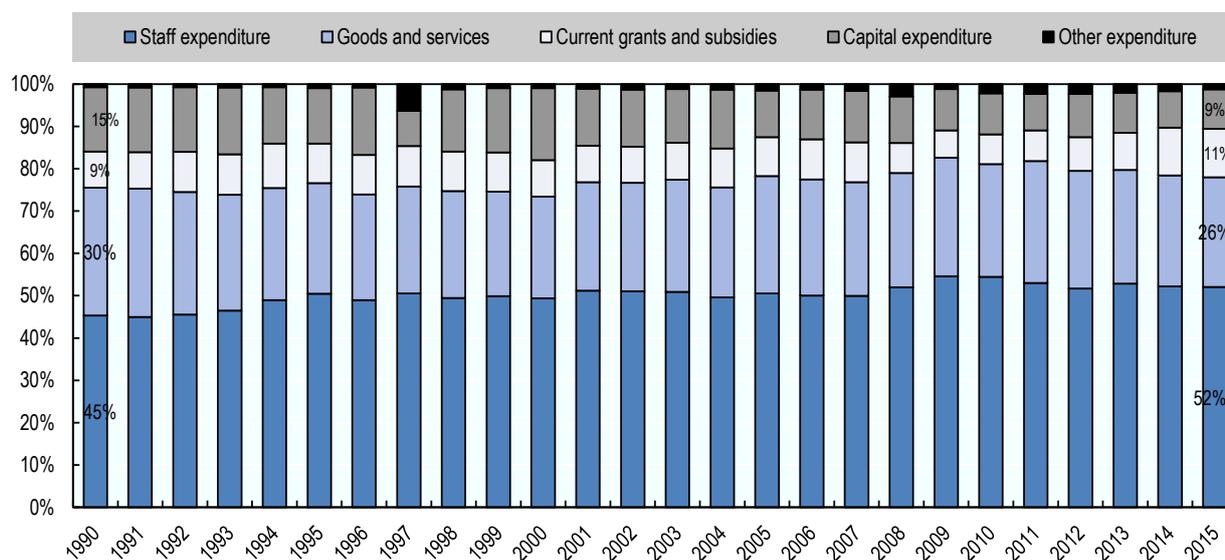
Finally, municipalities cannot borrow funds, although the use of short-term floating debt (commercial debt) and other forms of “hidden debt” is common.

***Unsteady increase of municipal budgets over a long period characterised by an increase in staff costs and central government transfers***

An analysis of municipal budgets over the 1990-2015 period, based on DIPRES data, shows an increase of municipal expenditure per capita (4.9% higher in 2015 vs. 1990 in real terms), as a share of general government expenditure (from 9.8% to 14.0%), and as a percentage of GDP (from 2.1% to 3.5%). In real terms, this growth has been higher than for the general government, and is significant. However, seen against the sustained economic expansion of GDP and the large social needs, this uptick can be considered both hesitant and modest.

The changes that took place over this 25 year period were unsteady and of varying intensities. After a decline of expenditure between 2000 and 2006, there has been a significant increase, in particular since 2010. This expansion is due, in particular, to an increase in staff expenditure, which has been considerable in the municipal education and health sectors (municipalities are in charge of paying teachers and medical staff). The share of staff expenditure in total municipal expenditure grew from 45% in 1990 to 52% in 2015 (Figure 13). By contrast, the share of capital expenditure in municipal expenditure fell from 15% in 1990 to 9% in 2015. The rollercoaster ride taken by municipal revenue between 1990 and 2015 was accompanied by a change in the composition of municipal resources, characterised by a steady drop in tax revenue as part of total revenue and the growing importance of grants, subsidies and operating income.

**Figure 13. Change in composition of municipal expenditure 1990-2015 (% of total expenditure)**



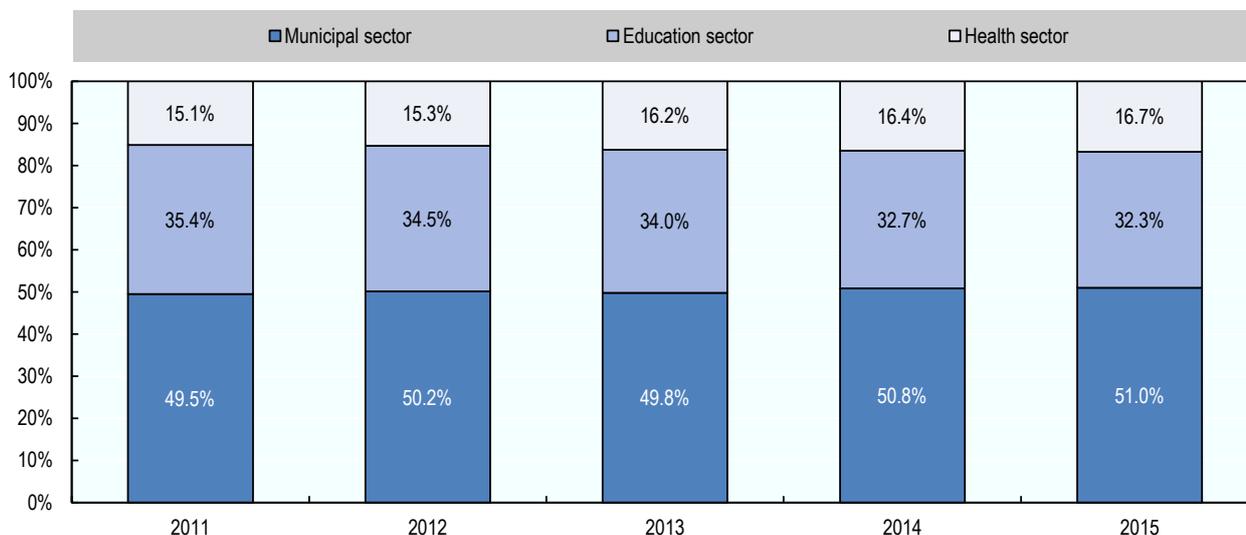
Source: OECD elaboration based on *DIPRES - Estadísticas fiscales, Estado de operaciones del gobierno general, municipalidades, 1990-2015, moneda nacional. Transacciones que afectan el patrimonio neto.*

### ***A complex budgetary architecture partly reflecting the breakdown of municipal responsibilities***

Municipalities have wide responsibilities, sometimes exclusive, sometimes shared, including two major competences that are particularly sensitive politically, socially and economically, as mentioned above: primary and secondary education, and basic health services. In the education and health sectors, subsidies transferred directly to municipalities by line ministries do not cover costs in many rural municipalities. Municipalities, therefore, have to supplement national financing with local resources. In addition, the central government tends to regularly increase tasks assigned to municipalities, which are not sufficiently compensated. In the end, municipalities have a very broad spectrum of functions that they cannot perform because of significant financial constraints and limitations, or that they perform while increasing their deficits and “hidden debt”.

The attribution of responsibilities is partly reflected in a budgetary architecture that is divided into three budgets/sectors: the municipal sector (internal management, municipal activities, community services, social programs, recreational programs and cultural programs), which represents around 51% of total municipal expenditure and revenues; the education sector which represents 32% of expenditure; and the healthcare sector, representing 17% (Figure 14). Each sector has its own financing system in terms of expenditure and revenue. As these budgets are not consolidated at the municipal level, it makes the overall understanding and assessment of municipal finance particularly complex. There are not 345 municipal budgets but more than 1 000 budgets, giving the impression of financially “fragmented municipalities”.

**Figure 14. Change in the weight of local expenditure by sector (2011-2015) (% of total expenditure)**

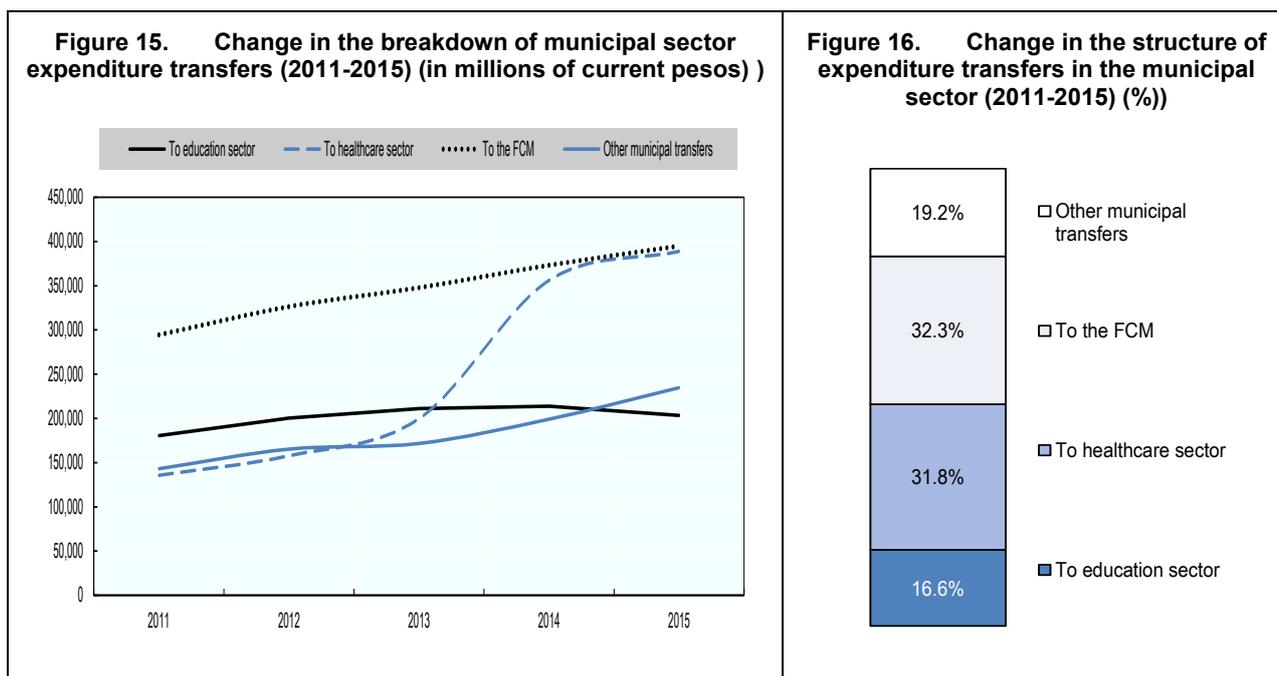


Source: OECD elaboration based on SINIM, Evolución presupuestaria (<http://www.sinim.gov.cl/>). Note: Data are not consolidated.

Municipal corporations add additional complexity to the municipal system. These bodies administer and manage education and health services in lieu of the municipal departments or services. Due to the lack of a consolidated approach at the municipal level, actual financial commitments remain unclear. This situation is unsatisfactory in terms of financial and democratic transparency, and also for budgetary data comparability.

***Contrasting financial changes in the education, health and “municipal sector” over the recent years***

From 2011 to 2015, the sharing of financial commitments of local governments between the three sectors, based on SINIM data, has changed significantly for both expenditure and revenue. Expenditure in the education sector has decreased, while it has slightly increased in the health sector. The municipal sector is the most dynamic. However, its growth stemmed in large part from local subsidies transferred to the education and especially to the health sectors to cover structural deficits, as well as from transfers to the Municipal Common Fund (Figures 15 and 16). Overall, transfers represented one-third of total municipal sector expenditure.

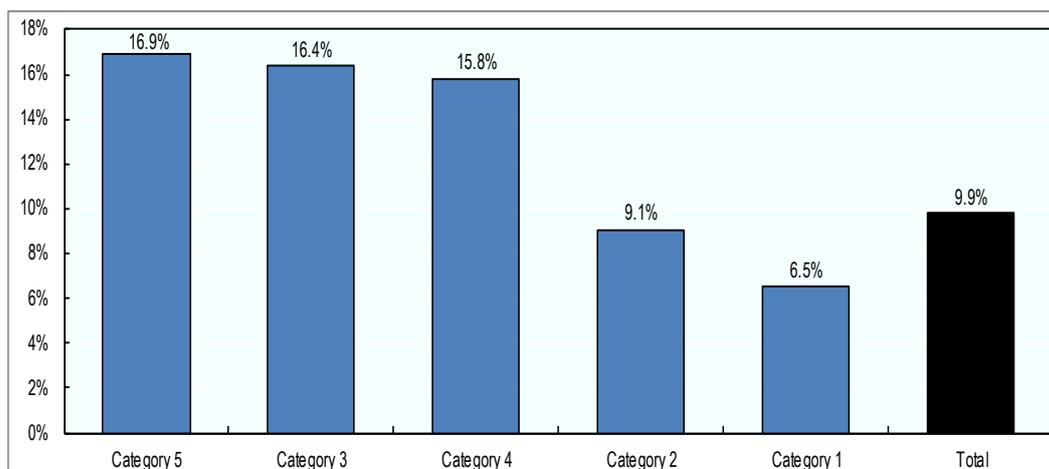


Source: OECD elaboration based on SINIM, Evolución presupuestaria (SINIM: <http://www.sinim.gov.cl/>).

In the education and health sectors, staff expenditure accounts for the lion's share of overall expenditure (79% and 75%, respectively), although it seems to have slowed since 2010, reflecting, perhaps, the effectiveness of relatively strict prudential rules that were designed to keep such costs under control.

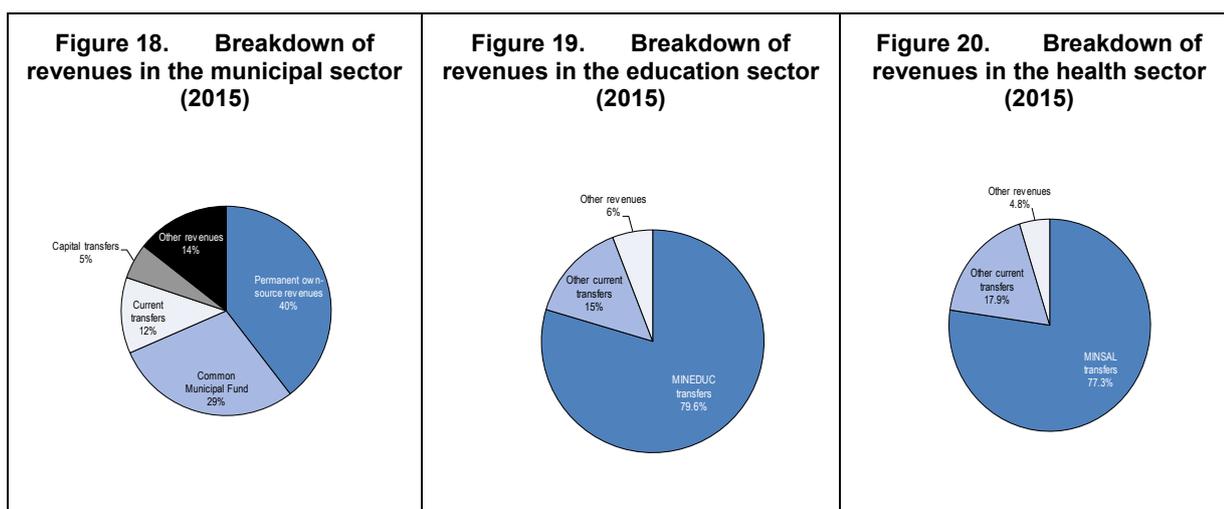
Municipal investment is very low, representing 9.9% of expenditure for the municipal sector, 3.2% for education and 1.6% for health. In the municipal sector, it is interesting to note that there is a marked difference among municipalities in the level of propensity to invest, which has an inverse relationship with population size. For example, investment represents only 6.5% of expenditure in large municipalities (Figure 17). Despite huge needs to pursue the goals of sustainable development, environmental protection, economic growth and social equality, municipalities have very little room for investment. Overburdened by the weight of current expenditure and lacking own source revenues, they cannot generate self-financing for investment. This situation is made even more difficult because of a lack of capital transfers and subsidies and the fact that municipalities are not allowed to take out long-term loans.

**Figure 17. Investment by FIGEM category of municipalities (% of total expenditure, 2015)**



Source: OECD elaboration based on SINIM, *Evolución presupuestaria* (SINIM: <http://www.sinim.gov.cl/>).

Revenues vary substantially from one sector to the next. For the education and health sectors, the percentage of current transfers is extremely high, and has increased in recent years (95% of total revenues in 2015). The main sources are line ministries (MINEDUC and MINSAL for 80% and 77%), but the share of transfers from the municipal sector has increased (Figures 19 and 20). In the municipal sector, there is a larger diversity of revenue sources comprising permanent own-source taxes (around 40% of municipal sector revenue, including the territorial tax, vehicle registration tax, patent tax, cleaning fee, fines and other rights and concessions), the Municipal Common Fund (FCM, 30%), current transfers (12%), capital transfers (5%) and other revenues (Figure 18). In total, the structure of municipal revenues was more dependent on current transfers at the end of the period, while the share of tax revenue has decreased. All three areas – municipal sector, education and health – increasingly depend on current and capital grants while municipal taxation power is weak. This situation generates strong fiscal imbalances and reveals an increasing dependence on external funding from the central government.



Source: OECD elaboration based on SINIM, *Evolución presupuestaria* (SINIM: <http://www.sinim.gov.cl/>).

These recent changes point to the slow pace of decentralisation, and do little to confirm a strengthening of Chile's political decentralisation. The central government's recent willingness to use fiscal policy to stimulate economic activity may also create a paradox for decentralisation. The confirmation of this trend, without modifications to the institutional distribution of power and resources within the multi-level governance system, would accentuate the concentration of the central government's capacity to intervene. The limitations on Chile's subnational finances risk delaying the development of a commitment to decentralise by national political authorities and the central administration. Without the political emancipation of the regions, and /or functional and financial strengthening of municipalities the risk is even greater.

### ***The deficiencies of municipal resources***

The question of whether the municipalities have sufficient resources cannot be addressed without tackling the issues of competences, expenditure and investment needs. Besides the question of the assignment – or redistribution – of responsibilities, which is raised within the framework of the decentralisation programme, there is the pressing challenge to adapt to current technical and societal changes and to support real territorial development. To catch up to its peers or simply upgrade its public capital stock – necessary to pursue the goals of sustainable economic growth and inclusiveness – Chile needs to accelerate public investment in infrastructure, particularly in urban areas. Municipalities can play a major role in this respect, if they have more room for manoeuvre in terms of resources.

The analysis of municipal revenue focuses on three diagnoses: the fragmentation and rigidity of the grant system, ineffective existing taxes, and the weak capacity to levy other resources.

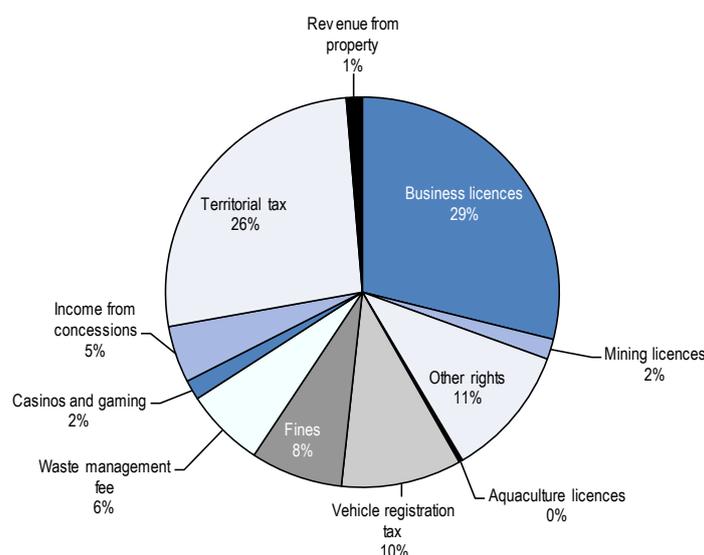
The grant system is complex and rigid, leaving municipalities little leeway to maximise this revenue source. In addition, it is fragmented between education, health and municipal sector transfers. Unable to cover municipal needs, especially in the education and health sectors, the current system requires the municipalities to complement central government transfers with their own subsidies. The municipality is clearly stepping in and substituting for the lack of central support. Meanwhile, the municipal sector is characterised by a low level of grants (current and capital) which are all earmarked and distributed in a piecemeal fashion by numerous ministries. Capital transfers, including the National Fund of Regional Development (FNDR), are scarce and lack flexibility. They do not meet municipal investment needs both in terms of quantity and quality. There is often a lack of co-ordination between sectors and sources of capital funding (regions and sector ministries), leading to dysfunctions and inconsistencies. The funding system, often based on open competition and complex procedures, may put less capable municipalities at a significant disadvantage. Such financial subordination keeps municipalities dependent both politically and administratively from the central government. A decentralisation and modernisation process would demand an easing of this bureaucratic and vertical structure.

The tax system appears to be lacking local leeway and is out of step with the prospect of decentralisation. Municipal power to act on two aspects of local tax autonomy is limited: their capacity to influence tax bases is limited; their prerogatives to set tax rates are seriously limited or non-existent. In addition, the bulk of municipal tax revenues are transferred to the FCM.

The territorial tax (the largest tax before it is transferred to the FCM and second largest after the transfer, (Figure 21) is more like a national tax – allocated to municipalities based on a distribution mechanism using the territorial distribution of the net value (after exemptions) of property wealth – rather than a genuine, local own-source tax. A significant share of the resource is redistributed, via the FCM, in the name of redistributive principles. Municipalities cannot set the rate and the territorial tax includes a long and extremely precise list of total or partial exonerations that are provided by the central government and which substantially erode its effectiveness. In 2014, nearly two-thirds of all properties benefited from

an exemption, 80% of which were agricultural properties. This results in the loss of over one-third of the potential tax collection on non-agricultural properties (35%) and one-fifth on agricultural properties (21.6%).

**Figure 21. Breakdown of permanent own revenue in 2015 (%)**



Source: OECD elaboration based on SINIM, *Evolución presupuestaria* (SINIM: <http://www.sinim.gov.cl/>).

The high percentage of exemptions is a large and sensitive political question. The tax is not only a matter of financial tools; it is also a vital link between the citizens and the community. In this sense, the high proportion of exemptions simultaneously illustrates and solidifies the weakness of the notion of “consent to taxation” (as in many other Latin American countries). The disappearance of the fiscal link dilutes the “tax agreement”, a prerequisite to the proper functioning of a modern and developed society. Beyond this fundamental issue, Chilean territorial tax exemptions face two pragmatic difficulties: i) how to fully compensate municipal budget shortfalls (the contribution of the national budget being far from covering the loss) and ii) exemptions clearly reveal the duality of the Chilean municipal structure as few municipalities are actually effective in collecting taxes.

Municipalities have little room for manoeuvre concerning municipal business licenses, which are granted by municipalities to establish and conduct a commercial activity in a set location. This obliges businesses to pay a tax that is annually set by each municipality. These taxes differ depending on the nature of the activity. The rate set by the municipality can vary within a range of 2.5-5 % and is applied to the value of the company’s capital, which is recorded with the Internal Tax Service. The municipal business licenses raise several questions related to the way they are designed and applied. The other sticking points are directly linked to the local nature of the tax and include horizontal tax competition, especially in metropolitan areas, and wealth concentration, with business licenses reflecting the geographic concentration of economic activity. If regional capitals are included, nearly 80% of income from municipal licenses is concentrated in municipalities belonging to category 1 of the FIGEM (i.e. municipalities mainly located in the Metropolitan Region of Santiago).

The vehicle registration tax, which applies to all owners of a motor vehicle, is the third most important tax. Here again, municipalities have no taxing power as the rate is determined nationally with no local variation and more than two-thirds of revenues generated are redistributed by transfer through the FCM.

The cleaning fee or waste management fee, whose payment may be disassociated from or linked to the business license tax, is a resource concentrated in major urban municipalities and is one of the only revenue sources for which local officials have decision-making authority on the rate. Collection, however, is flawed and it appears that many citizens fail to pay this tax, perhaps because they are not aware of it, thus provoking an accumulation of debt.

Finally, because of regulatory limitations, Chilean municipalities rarely charge, directly or indirectly, for public services. When they do, contributions from users tend to be modest. Very few municipalities receive revenues from concessions since concession holders frequently operate in their territory but have a contract with the central government (e.g. ports, roads, mining, etc.). Likewise, revenues derived from property income are limited. The top ten municipalities account for more than half of revenue generated from their properties.

### ***Municipalities cannot acquire public financial debt but they are de facto indebted***

Chile's cardinal rule is to prohibit any use of borrowing by municipalities, except when explicitly authorised by the Ministry of Finance and only after a specific law is passed. However, municipalities have developed certain practices and use more circuitous and unorthodox routes, which, de facto, has led them to contract short-, medium- and long-term debt. Three techniques are used: leasing and leaseback operations, commercial debt and arrears which is referred to as floating debt (*deuda flotante*); temporary pension debt resulting from failure to pay social security contributions (*deudas previsionales*), particularly in the education and health sectors. This has raised a lot of red flags.

Even if floating debt is widespread in the management of Chilean municipalities, it does not represent a major issue at the aggregate level. According to SUBDERE, floating debt represents around 1% of municipal revenues, with almost 40% of it concentrated in 10 municipalities. The temporary pension debt is also very concentrated. As of 31 December 2015, among the 80 municipalities and municipal corporations holding such debt, six held 50% of this debt. Municipal corporations represented 83% of total adjusted debt.

### ***Different ways can be explored for improving municipal financing***

The idea of consolidating and expanding municipal financial resources opens up a variety of directions to explore based on both optimising and diversifying existing funding sources. In this perspective, a gradual and asymmetric approach could be followed. In fact, it seems necessary to acknowledge the reality that different financial models (particularly for credit) will fit the budget characteristics and conduct of some municipalities but not others (asymmetric fiscal decentralisation).

The relevance and efficiency of Chile's complex system of intergovernmental grants should be assessed as a whole, i.e. by taking into account the three sectors. Central government transfers at the national level should be better coordinated, at least among the largest contributing ministries, as well as at the regional level. The functioning of the National Fund for Regional Development (FNDR) should be reviewed and the share of specific earmarked grants reduced in favour of general purpose grants based on a formula. In particular, some capital transfers could be distributed under the form of general grants instead of specific subsidies, at least to larger municipalities.

The local taxation system could be improved to enhance own-source tax revenue raising capacity. This would imply strengthening the local tax base, i.e. consolidating tax bases of several municipal taxes through different technical improvements (i.e. territorial tax, business tax, cleaning fee), as well as reinforcing municipal tax autonomy. The decentralisation process should introduce the possibility of empowering municipal officials with taxation authority. This could take two forms: i) offering tax breaks to promote social- or family-oriented policies while contributing to local economic development; ii) extending the ability to set tax rates.

A more extensive use of user contributions, property income, concessions and other public-private partnerships (PPP) schemes is another way of diversifying resources and improving the local financing system, in particular for increasing investment. Given the limited practice of these financing tools by Chilean municipalities, the room for improvement is substantial. In particular, municipalities should be supported to further charge for services they provide in a range of areas. An appropriate legal framework and pricing scheme would need to be established, allowing users to be charged according to their financial capacity, and avoiding exclusion of less favoured households. When designed well, pricing schemes can reconcile economic effectiveness and social justice concerns. Property income could be also better exploited in Chile through improved techniques of asset management. Chile could look at international experiences to develop its own model of municipal companies, which would also involve loosening its legal framework on municipal public enterprises. The use of the public domain could also generate more revenue through the development of a land-based financing instrument. Better exploiting municipal concessions is another avenue to explore. Chile could envision “municipalising” several existing concession contracts. This could give municipalities the right to be closely involved in concessions operating in their jurisdictions and facilitate the development of “municipal concessions” so that they become a strategic municipal tool for local development. Finally, supporting large municipalities in the development of PPPs, could also be envisioned.

### ***Expanding borrowing capacities in a prudent manner for the most capable municipalities is an inevitable debate***

Without calling into question the principles of healthy public financial management in Chile, it is legitimate to ask if strong restrictions on municipal borrowing are economically, socially and territorially justified. Public infrastructure needs to be increased, but also existing public capital stock must be upgraded to pursue the goals of sustainable development, environmental protection, economic growth and inclusiveness. The current financing system fails to provide the adequate conditions that would enable local infrastructure to be improved and economic development to accelerate. Using credit to finance investment seems economically and socially legitimate (i.e. a better allocation of resources over time, better intergenerational justice, and financial necessity resulting from lack of local savings and capital transfers to invest). In anticipation of future changes resulting in stronger fiscal decentralisation, which would enhance municipal creditworthiness, Chile needs to envision the conditions in which borrowing would constitute an advantageous financing method for Chilean municipalities. In recent years, attempts were made to change the situation by authorising municipal borrowing, in particular under the initiative of SUBDERE, but they did not come to fruition. This issue should be addressed again. In particular, it seems appropriate to examine less restrictive ways of accessing credit for the most capable cities, which could be authorised to borrow in a controlled manner and through strict prudential rules.

There are different avenues to explore, combining the implementation of appropriate prudential rules, a control of the borrowing market (e.g. contracting loans with the Treasury or public bank) and also adapting borrowing mechanisms to the diversity of municipal needs and capacities, instead of applying a blanket legally-based solution. To assess creditworthiness, setting up an internal or external mechanism for rating municipalities could be an option.

### ***Investing in human capital and citizens for a “fiscal pact”***

With greater responsibilities, a more complex organisational and financial structure and a wider range of intervention (including access to credit), comes greater legal and financial risk for the municipality. Fiscal decentralisation requires significant investment in human capital, central support, and reinforced training of municipal financial managers and elected officials in financial management and debt techniques. This could be accomplished through the Municipal and Regional Training Academy (*Academia de Capacitación Municipal y Regional*). Technical assistance can also be provided by universities through agreements. Independent of professional or managerial skills, this training must also continue to safeguard the ethics of the spirit of public service.

Improving municipal financing also implies involving citizens to a greater extent in the fiscal decentralisation process through a “fiscal pact” with society, in particular to develop free consent to taxation. Not only must fiscal reforms be communicated and explained, their social acceptance must be underpinned by awareness, and citizens must buy into and participate in the creation of reforms well before they are implemented.

### ***Establishing a stronger and more transparent fiscal responsibility framework: a necessary corollary of greater fiscal decentralisation***

Chile has a strict fiscal framework for municipalities, requiring a balanced budget for both current and capital accounts. Comprising three different budgets (municipal sector, education, health), the municipal budgeting and accounting framework is particularly complex. For a truly complete view, it would be necessary to include municipal corporations as well as information about municipal associations. This situation is unsatisfactory in terms of financial and democratic transparency and for budgetary data comparability.

One major obstacle to fiscal health is the structural mismatch between subnational spending obligations and the allocation of revenues, especially in education and health sectors. This mismatch is a common source of deficits and floating and temporary pension debt (*deudas previsionales*) of municipalities, which has caused concern and needs to be taken into account to ensure long-term fiscal sustainability. Any fiscal rule would remain ineffective if there is a structural problem of unfunded mandates.

Municipalities have full autonomy to estimate their own revenues in the budget process. However oversight mechanisms for ensuring a correct and unbiased estimate of own revenues do not exist.

Internal control is carried out by municipal control units but there are great disparities in the role and capacity of these units among municipalities. The municipal council is also responsible for overseeing budget execution but its effective role is still very limited. External control is done by the Comptroller General’s Office, which has regional offices. However, due to the amount of entities subject to audit, this process only includes a formal examination of reported accounts in order to ensure that they comply with the minimum standards and guidelines.

Fiscal discipline is the necessary corollary of fiscal decentralisation reform. Adequate fiscal rules are useful tools to realise the potential efficiency gains from local autonomy, while meeting the objectives of sustainable longer term finances. Therefore, fiscal decentralisation reforms need to provide for the definition and implementation of sound budgetary, accounting and reporting frameworks. These need to be based on common standards for all levels of government, which would facilitate the monitoring, control and transparency of financial operations. Strengthened fiscal decentralisation also requires rethinking the role of the state in the exercise of budgetary and financial controls on subnational governments. Finally,

fiscal decentralisation needs to set up, or reinforce, co-ordination mechanisms in fiscal matters across levels of government.

Chile could benefit from having a more comprehensive fiscal framework, presenting a consolidated view of municipal budgets (sectors and corporations), ensuring that decentralised responsibilities are financed with sufficient resources, that the budget comprises a precise and transparent estimation of revenues, and that there is a current budget balance rule. The fiscal framework should also include provisions on municipal borrowing, with respect to both existing practices, which should be more transparent (floating debt and temporary pension debt and leaseback contracts), and potentially increasing access to credit. In fact, if Chile decides to allow municipalities to issue debt, the government should develop a clear set of fiscal rules for “responsible borrowing” to ensure economic stability and sound fiscal management. It should also include more regular audits and controls, as well as enforcement mechanisms and sanctions for non-compliance. In all these areas - balanced budget rules, subnational government debt and debt-service restrictions, tax and expenditure-growth ceilings and enforcement mechanisms of subnational government fiscal rules - Chile could draw from on experience in other OECD countries. Finally, communicating complex fiscal rules to public officials and citizens in a comprehensive way is a key issue, as is the need to improve human resources and technical and ethical skills.

### **Box 3. Key Recommendations for improving the municipal financing system and fiscal responsibility framework**

#### **1. Improving the municipal financing system**

- Improve the system of intergovernmental grants, by:
  - Developing a comprehensive and coordinated approach to the grant system;
  - Reviewing the National Fund for Regional Development (FNDR);
  - Reducing the share of specific earmarked grants and developing the use of general purpose grants;
  - Experimenting with general capital grants for large municipalities based on a formula.
- Improve the local taxation system to enhance own-source tax revenue raising capacity, by:
  - Consolidating municipal tax bases: examine the way to reduce the number and level of exemptions and to introduce compensation; reviewing property values’ assessment; improving the quality of land registry maps; reviewing the system of business licenses; improving the recovery of the waste management fee; developing tax service agreements.
  - Extending decision-making authority of municipal officials on taxation, and their ability to modify bases (tax breaks) as well as to set tax rates.
- Diversify municipal resources: develop tariffs and user charges; increase property income and explore the formula of “municipal companies”; profit from the use of the public domain and develop land-based financing mechanisms; better exploit municipal concessions and support the development of PPPs for large municipalities.
- Expand municipal borrowing abilities for the most “capable” local authorities, based on strict prudential rules, rating mechanisms, differentiation and borrowing market control.
- Reinforce training of municipal financial managers and officials in financial and debt management, in particular through the Municipal and Regional Training Academy, which should be strengthened, and through agreements with universities.
- Involve citizens more fully in the fiscal decentralisation process (“fiscal pact”).

#### **2. Reinforcing the fiscal responsibility framework**

- Present a consolidated account at the municipal level, including all sectors and corporations, and information on municipal associations as they develop.
- Introduce measures to avoid unfunded or under-funded mandates.
- Make a more precise and transparent estimate of the revenues expected to be collected during the year.

**Box 3. Key Recommendations for improving the municipal financing system and fiscal responsibility framework (cont'd)**

- Reinforce the role of the Comptroller General's Office in this process (consolidated national assessment, guidelines).
- Enhance current budget balance rule.
- Improve/define municipal borrowing rules and monitoring mechanisms for existing debt and in the event borrowing rules are loosened for selected municipalities.
- Reinforce internal and external control and accountability.

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### **3. Designing more appropriate equalisation mechanisms for better territorial equity and performance**

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In Latin America, more so than in the rest of the world, social inequalities combine with territorial inequalities. Chile does not appear to be an exception to this rule. The diversity of its territories and the way they are occupied exacerbate geographic disparities.

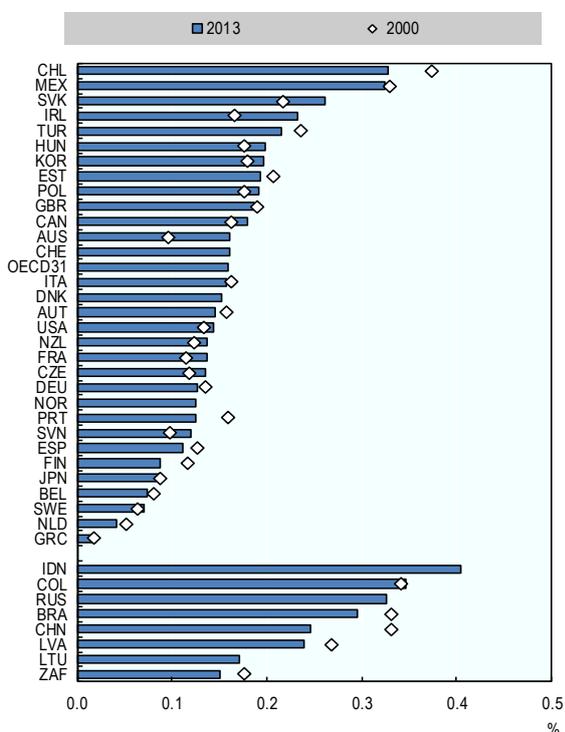
***Chile is characterised by strong inter-regional and inter-municipal disparities***

Chile records the second highest level of regional concentration in GDP among OECD countries (concentration index of 55 vs. 39 OECD average). Chile, together with Mexico, the Slovak Republic and Ireland displayed the greatest disparity in GDP per capita across TL3 regions in 2013, according to the Gini index among OECD countries (Figures 22 and 23). The high level of regional inequality is not only driven by Santiago and regions specialised in the mining activities, but also by the underperformance of a wide range of regions. Regional disparities are also high when looking at well-being or multi-dimensional indicators.

Regional disparities overlap with inter-municipal disparities. With 345 local political-administrative structures, there are as many unique situations as there are municipalities – especially given the diversity of their population densities, geography and size. Although disparities between municipalities are determined in part by the region in which they are located, each case is different and ultimately depends on the level of their resources and expenditures (spending needs or costs of services), which can differ significantly depending on local circumstances.

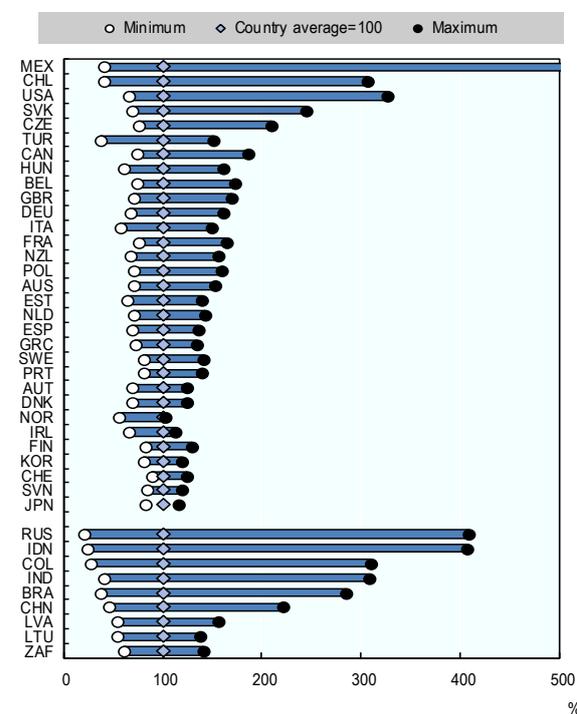
A poorly-designed decentralisation process may exacerbate this situation and lead to increased disparities across municipalities. In fact, there is a certain amount of risk that only the most financially, technically and administratively robust municipalities will truly benefit from greater decentralisation. There are several examples of adverse effects of decentralisation in Latin America, such as increased income gaps and wider disparities in terms of access, scope and quality of local service provision.

**Figure 22. Gini index of inequality of GDP per capita across TL3 regions, 2000 and 2013**



Source: OECD (2016a) *Regions at a Glance 2016* <http://dx.doi.org/10.1787/888933363221> - Note: in Chile, TL3 are the 54 provinces.

**Figure 23. Regional variation in GDP per capita (as a % of national average), 2013 (TL2)**

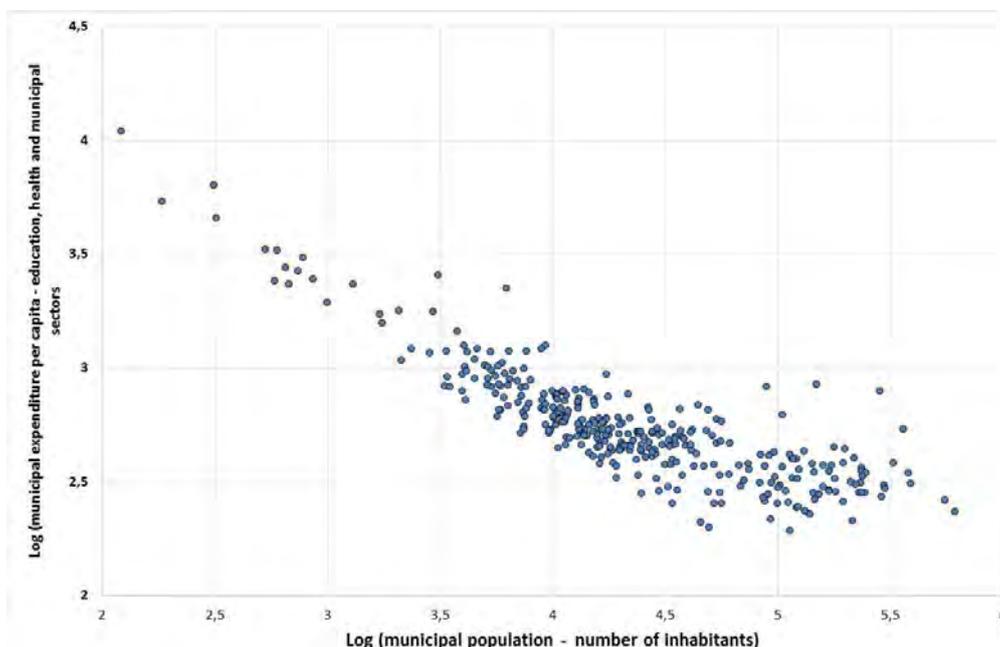


Source: OECD (2016a) *Regions at a Glance 2016* <http://dx.doi.org/10.1787/888933363233> - Note: in Chile, TL2 are the 15 regions.

***Identifying the magnitude of inter-municipal disparities and the diversity of their origins***

Inter-municipal fiscal disparities are wide. Municipal expenditure budget amounts range from 1 to 325 between the smaller and larger municipalities. However, on a per capita basis, there is an inverse relationship between the demographic size of the municipality and the main financial indicators: this is a prominent and essential characteristic of the Chilean municipal system. The relationship is non-linear: the level of per capita expenditure decreases with the increase in population size to a threshold of around 90 000 to 110 000 inhabitants. Beyond this size, they are of a somewhat similar order of magnitude. This relationship is true for all three sectors (municipal sector, education and health), albeit to different degrees (Figure 24). The geographical representation of levels of per capita expenditure reveals significant differences between extreme territories (north and south), sparsely populated and some mountain areas with high values, and the largest number of municipalities with lower levels of per capita expenditure. It means that local interventions face structural constraints because of low and dispersed population, which increases the costs of services.

Figure 24. Local expenditure of all three sectors per capita and population (log-log scale) (2015)



Source: OECD elaboration based on SINIM, *Evolución presupuestaria* (SINIM: <http://www.sinim.gov.cl/>).

The high level of education and health expenditure per capita in small and isolated municipalities is explained by the way they are funded. They receive substantial subsidies from the ministries of education and health as well as from the FNDR which is, in addition, complemented by the contribution from the municipal sector. By contrast, in heavily-populated municipalities, the municipal contribution tends to substitute for the central government transfers, education or health, thus absorbing a large share of municipal sector own revenues. Therefore, depending on the municipality, the municipal contribution either complements or substitutes state funding. Substitution effects seem greater for health than for education, meaning that the vast majority of municipalities contribute significantly to the financing of the health sector.

As far as the municipal sector is concerned, fiscal disparities are wider than those of the education and healthcare sectors because of the more diversified structure of resources, as well as a wider variety of local preferences. The dispersion indicators of municipal expenditure are two to three times higher than those of education and health. But, once again, as was true for education and health, the smallest municipalities have a particularly high level of per capita expenditure. This type of relationship tends to lend credence to the assertion that economies of scale are at work and that being underpopulated, for the smallest municipalities, comes at a cost.

Expenditure, based on its nature, paints a fiscal picture that is even more varied. The biggest disparities concern some categories of expenditure that are very fragmented, for example municipal sector investment. Again, municipal per capita investment shows an inverse relationship with population: the smaller the municipality, the higher the per capita investment. This inverse relationship between a municipality's demographic size and its per capita investment demonstrates, once again, the presence of sub-density costs in the provision of local public facilities. This is one of the challenges that must be faced in order to ensure that all citizens, in a large country and with scattered towns and villages, have equal access to public infrastructure and services. The dispersion of the population makes it more difficult to take

advantage of economies of scale and thereby reducing unit costs or even per capita spending. Savings would be expected to increase with the increase in the size of the population to be served.

In terms of municipal sector revenue, per capita dispersion indicators are significant and higher than for expenditure. In fact, the contributions of the FCM are discriminatory by nature. Revenues with the least dispersion include the territorial tax and driver's license fees while those with the highest dispersion include municipal business licenses.

A multidimensional analysis of expenditure and resources allows clusters of municipalities to be identified at the national level (with a strong dimension effect) but also at the level of the metropolitan region of Santiago. The latter shows strong internal fiscal disparities, which are mainly determined by municipal revenues. It distinguishes a first cluster of municipalities with sufficient capacity to guarantee a certain level of financial autonomy (i.e. wealthy municipalities, with low poverty rates) and a second cluster comprising poorer municipalities that are strongly dependant on external resources, in particular the FCM. The governance of the metropolitan region, which appears to be both fragmented and structured around these clusters, is one of main technical, financial and political challenges of the future. It will be crucial to find the adequate institutional arrangements to enable the sustainable development of the metropolis based on more solidarity and inclusiveness.

***The Municipal Common Fund: an efficient compensation system which has however adverse effects on territorial equity and performance***

In 1979, Chile implemented an equalisation mechanism to reduce inter-municipal fiscal disparities: the Municipal Common Fund (FCM). Designed for the “cohesive redistribution of own resources between the municipalities”, it is mainly a “compensation” system based on the horizontal redistribution of municipal resources across municipalities.

The FCM's resources come from automatic contributions from municipalities via the transfer of a portion of their tax revenues (i.e. territorial tax, municipal business licenses, vehicle registration tax, and the tax on vehicle transfer and revenues from fines). Municipalities are net contributors when contributions are higher than the allocations they receive or are net receivers when allocations outweigh contributions. The FCM's mission is unequivocal: decrease inter-municipal inequalities and provide additional resources to municipalities with the lowest tax revenues so they can fulfil their basic competences.

**Table 1. Revenue sources of the FCM**

Revenue source	Quota	Contributors
Territorial tax	65% 60%	Municipalities of Santiago, Providencia, Las Condes, Vitacura All other municipalities (341)
Municipal business licenses	65% 55%	Municipalities of Providencia, Las Condes, Vitacura Municipality of Santiago
Vehicle registration tax	62.5%	All 345 municipalities
Tax on vehicle transfer	50%	Taxpayers (who sell a vehicle)
Revenue from fines (contraventions)	50%	Offenders to the Traffic Law
Fiscal contribution	218.000 UTM	State

Source: OECD elaboration based on SUBDERE information.

This mechanism has become a crucial part of how municipal budgets are financed, and redistributes revenue among municipalities on a massive scale – accounting for 29% of total municipal sector revenue and over 42% of their permanent own resources. The architecture of the fund is implicitly based on the two pillars underlying territorial inequalities, i.e. disparities in terms of charges (needs) and in terms of resources. The first category represents 35% of FCM funds and the second 65%. This implies that, in Chile, 35% of inter-municipal inequalities result from greater needs (e.g. because of higher costs for a given service) and the remaining 65% result from limited resources (e.g. due to weaker per capita tax bases).

This horizontal equalisation mechanism between municipalities is commendable in light of the principle of solidarity, reinforcing the feeling of belonging to the same nation. It plays a strategic role in the redistribution of resources according to redistributive justice, as the system benefits the most disadvantaged municipalities in terms of tax wealth and/or demographic constraints (small size) or geographical and climatic constraints (large area). It aims at supporting the most vulnerable municipalities, especially the smallest in such a way that each municipality (regardless of its size or wealth) is able to perform its basic constitutional functions. According to these conclusions, the FCM is indeed effective in achieving that goal. The smaller or less densely populated the municipality the more it receives per capita. Several studies confirm the redistributive character of the FCM. It thus reduces inter-municipal inequalities and ensures greater political cohesion in the municipal system in Chile.

However, the FCM has been continuously criticized and its mechanisms have been modified several times without fundamentally altering its basic approach. Today, this mechanism (and its effects on the broader system) is being called into question. Improving on the current “compensation” system, aimed at fostering a certain degree of equity while avoiding or minimising the potential negative or adverse effects of equalisation arrangements, are under consideration.

The FCM is a politically and economically contested mechanism. There are very few contributors (i.e. only Providencia, Las Condes, Vitacura and Santiago for the municipal business licenses) while the beneficiaries, the majority of municipalities, are highly dependent on FCM contributions. The biggest net contributors point to the predatory nature of the tax, which targets a few municipalities that have been labelled “rich”, resulting in a “Robin Hood” effect. In that sense, the FCM’s priority is more to favour inter-municipal solidarity than territorial equity or fairness. Territorial equity would imply mobilising all potential contributors according to their level of wealth per inhabitant (possibly applying a progressive scale) while the current mechanism instead raises resources from a “concentrated source”. Therefore, despite FCM’s significant results in terms of solidarity, it is not possible to validate the assertion that the mechanism is effective with regard to the criterion of territorial equity.

The overall logic of the mechanism and its modus operandi are questionable in a number of ways: the complexity and lack of transparency of the allocation algorithm, based on some methodological approximations (lack of indicators about wealth inequalities and the cost of services provision is a major shortcoming); a mechanism which is outdated and fundamentally incompatible with the precepts of territorial equity; counterproductive and disincentive effects (fundamentally encouraging “fiscal laziness” and increasing dependency); the borderline ineffective measures of its actual redistributive “yield”; and its lack of impact on reducing deeply-rooted inter-territorial inequalities.

Overall, this mechanism should be preserved, but it also requires strengthening and renewal in order to combine solidarity and equity principles and economic efficiency. Various avenues can be explored to help accomplish this.

### ***Changing the FCM's operating procedures***

The financial importance of the FCM, its strategic role and the political and technical debates that it creates, place the instrument at the heart of issues related to the modernisation and cohesion of the Chilean municipal system.

The overall objective of the reform would be to widen the base of municipal contributions and to make it less selective, as well as to better assess municipal wealth in order to determine contribution and benefit levels. The horizontal mechanism could be complemented by a greater vertical equalisation mechanism through state grants.

The revision of the FCM can be envisioned according to a dual perspective: a methodological and pragmatic vision positioned on a short-term timeframe based on the FCM's current approach; a more prospective and political reflection positioned on a medium- and long-term timeframe. This second approach would be part of a more ambitious modernisation dynamic and would combine the treatment of inter-municipal inequalities with the consolidation of regional power.

The first scenario involves technical revisions to modify the allocation rules of the FCM. This includes a review of the way inequalities – in terms of charges and resources – are measured for both needs and revenues. It also suggests changing the distribution algorithm of the FCM in order to integrate more “equity objectives”, even though “political objectives” remain essential. The FCM architecture (balance between the four items assessing charges and resources disparities) and its allocation criteria (relevance of indicators according to the objective) should indeed match the political objectives that the fund serves but without neglecting greater territorial equity.

The second scenario is part of a firm and long-term commitment to the decentralisation process, building on the regionalisation trend, with a timeframe of ten years. It proposes to review the two founding principles of the FCM, which are “horizontal equalisation” and a “one-size-fits-all” design (i.e. the same rule applies to all municipalities, regardless of size or environment). Against this backdrop, a hybridisation of the two mainstays of the FCM could be considered: i) the horizontal approach of the mechanism, could be given more “verticality” via the contribution of central government grants; ii) the uniform approach could shift to a more regional approach where its allocation mechanisms would be adjusted according to local situations to better reflect territorial and social realities. The new equalisation system could combine nationally-collected resources and regionally and locally differentiated distribution (i.e. distributed differently between territories). This new approach can foster political cohesion (via more co-ordination and a learning process of co-management), economically sound territorial development strategies, and a more effective allocation of public funds and public policies. There are also risks and challenges associated with this new approach, hence the importance of a well-designed mechanism and shared governance.

#### **Box 4. Key Recommendations for reforming equalisation mechanisms**

##### **1. Modifying the allocation rules of the FCM (short term approach)**

- Review the measure of inequalities regarding both charges (spending needs based on costs of provision of municipal services) and resources (proper assessment of real wealth).
- Review the FCM's distribution algorithm i.e. general architecture (re-evaluating the relative weight of each share) and indicators (choice of indicators and modes of calculations)

##### **2. Revising the FCM's intervention approach (medium and longer term approach)**

- Increase vertical equalisation via the state budget.
- Adopt a regionalised approach to differentiate and tailor procedures in the allocation of FCM funds.

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#### 4. Modernising human resource management in Chilean municipalities

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Thanks to reforms over the recent years concerning salaries and bonuses, and human resource management (HRM) and professionalisation, Chilean municipalities now have the same public sector employment arrangements as the central government. However, they do not necessarily have the same employment conditions. Consequently, municipalities remain weak in their capacity to perform their duties due to difficulties in attracting and retaining a highly-skilled workforce. Low salaries, limited career opportunities, low qualifications, centralisation and weak HRM functions are just some of the factors that hinder the attractiveness of municipal public administrations as employers.

##### ***Municipal public employment arrangements are complex but should improve soon***

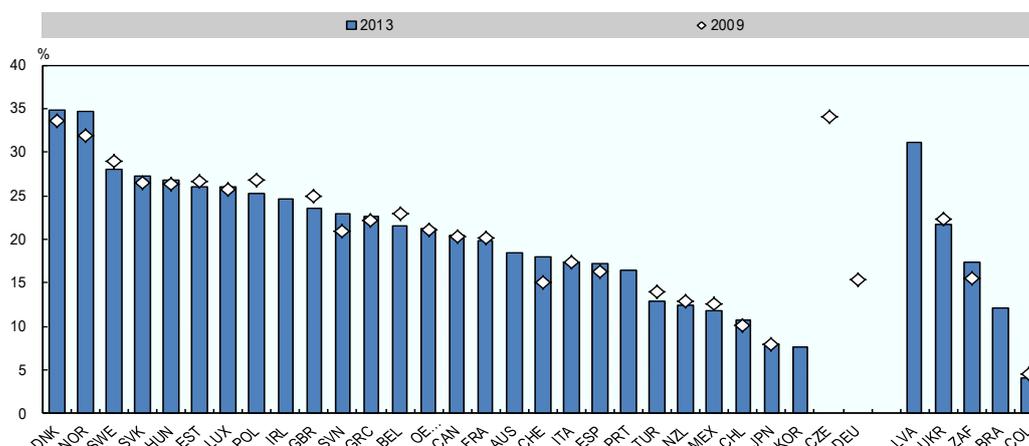
The management of municipal employment is particularly complex. Reflecting the same complexity as seen with budgetary issues, there are three categories of “municipal employees”: those working in the education sector (teachers, administrative and technical staff), health sector (doctors, nurses, administrative staff, etc.) and the municipal sector. While they are under the municipal government purview, they are all governed by specific regulations, i.e. different conditions in terms of wage scales, careers, training system, mobility, performance evaluation, etc. The labour relationship between education and health workers with the municipality is regulated by different regulatory frameworks. However, one of the main issues for municipalities is that the salary conditions are negotiated at the ministerial level between the central government and the national associations of professionals in both sectors, without taking into account the particularities of each municipality.

Until recently, the regulatory framework has provided little flexibility in municipal workforce management. Adding to recent improvements in recognising and strengthening the municipal sector’s civil service, law No. 20.922, published in May 2016 and known as the *plantas* law, represents a major step towards decentralisation of the management of municipal staff. It gives more freedom and flexibility to the mayor to manage municipal staff according to municipal needs in terms of workforce and qualifications. Effective in 2018, the law gives mayors the power to increase the number of civil servants (*planta* staff), improve their remuneration and organisation (new number of positions and grades) and increase the share of contractual staff (*contrata* staff) from 20% of municipal expenditure to 40%.

##### ***There is a need for greater workforce planning and management in municipalities***

Law No. 20.922 aims at addressing the lack of staff in terms of quantity and qualifications, a situation many municipalities face. In fact, Chile has one of the smallest public workforces among OECD countries, which reflects the country’s decisions with regard to the scope, level and delivery of public services (Figure 25).

**Figure 25. Public sector employment as a percentage of total employment, 2009 and 2013**



Source: OECD (2015), *Government at a Glance 2015*, OECD Publishing, Paris.

While Chile is very centralised, the share of municipal workers in the total public workforce is significant, representing more than half. This high share comes from the fact that education and health workers are managed by municipalities (even if a large part of education and health staff belong to the private sector). In terms of public expenditure however, municipal staff expenditure accounted for less than 30% of public staff expenditure, revealing imbalances in terms of levels of qualification and remuneration between the central government and municipalities. Overall, municipalities employed around 275 000 workers, out of which 43%, 25% and 32% are respectively in the education, health and municipal sectors.

**Table 2. Distribution of public employees across levels of government in Chile, 2015**

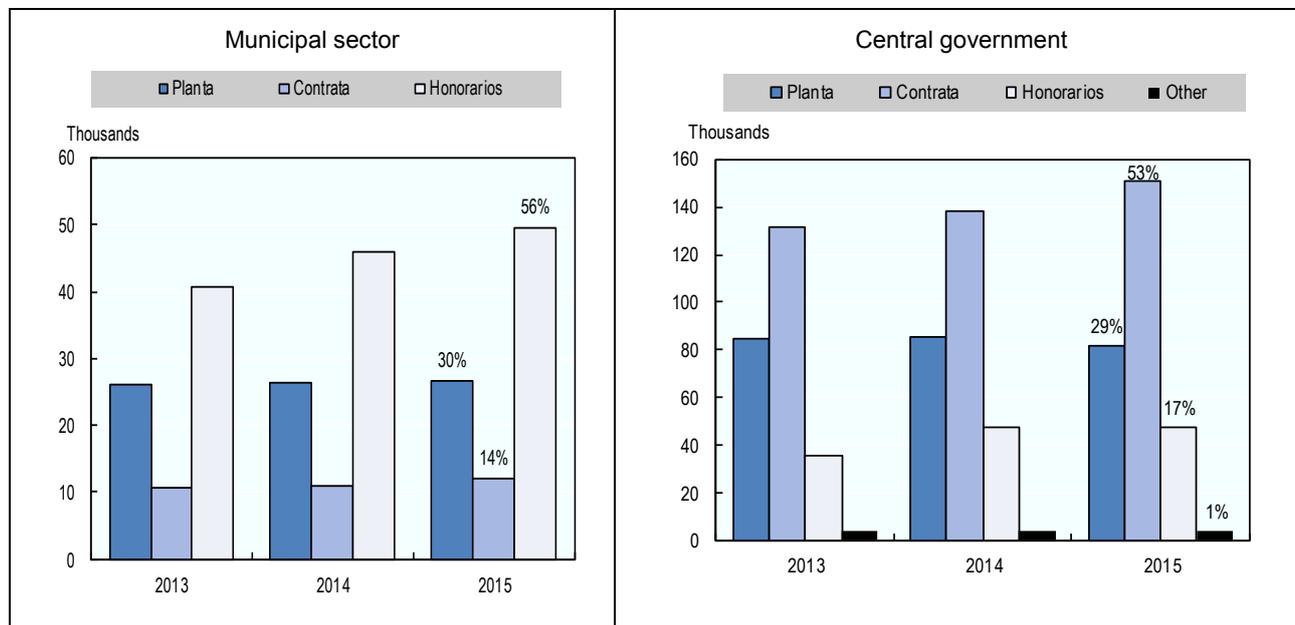
Sector	Number of personnel	%
Central government	236 736	46
Municipalities	274 177	54
- Municipal administration	88 629	32
- Health	68 712	25
- Education	116 836	43

Source: OECD elaboration based on SINIM ([www.sinim.gov.cl](http://www.sinim.gov.cl)) and DIPRES (2016), *Estadísticas de Recursos Humanos del Sector Público 2006-2015*, Dirección de Presupuestos.

While a municipality has 257 employees on average for the municipal sector, there is a great heterogeneity with 37% having less than 100 employees and 3% more than 1 000 employees. The large majority of municipal employees are temporary. The share of workers in the civil service system (*planta*) is 30%, that of workers under a fixed-term contract (*contrata*) 14%, while the share of workers under fee-for-service contracts (*honorarios*) reached 56% (vs. 17% for the central government) (Figure 26). This confirms that, until now, there has been very little flexibility at the municipal level with respect to *planta* and *contrata* staff. This has induced municipalities to hire an increasing number of short-term employees, which is not the best – or most sustainable – way to manage a municipality. This has been very problematic for municipalities, as the tight control on recruitment has limited their ability to restructure and reskill their staff, while also generating job insecurity and high staff turnover. In the

education and health sectors, the situation is different as here there is a larger share of *planta* and *contrata* staff, which absorbs most of the financial resources municipalities have allocated to pay for salaries.

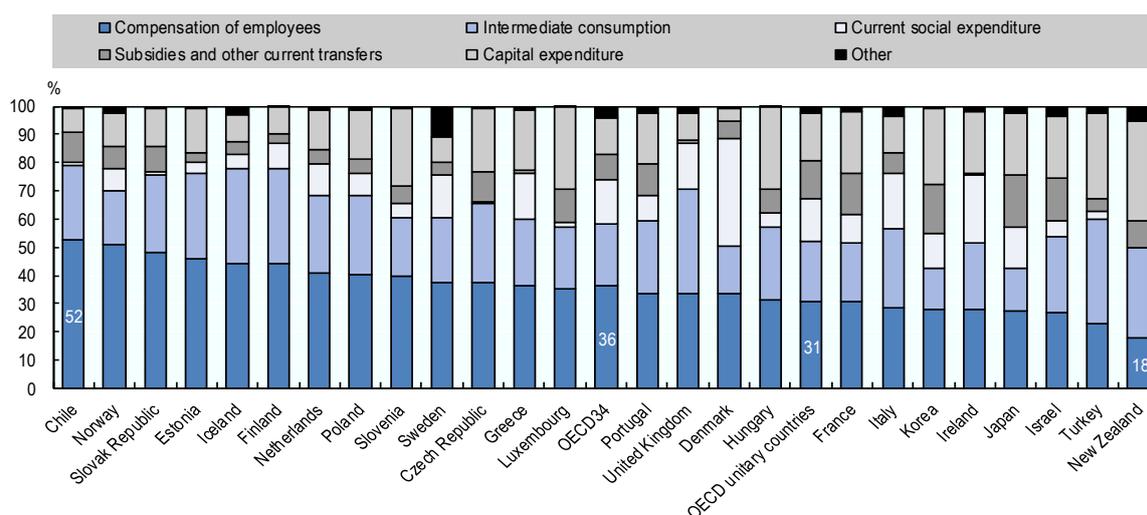
**Figure 26. Breakdown of staff according to their status in the municipal sector and in the central government**



*Note:* In the municipal sector the ‘honorarios’ group includes the category *Honorarios a Programa* which refers to programmes co-managed with external public entities. For the central government ‘other’ refers to civil personnel classified as *honorarios asimilados a grado, jornales permanentes* and *those hired under the Labour Code* as reported by DIPRES in <http://www.dipres.gob.cl/594/w3-propertyvalue-23222.html>. Source: OECD based on SINIM data. [www.sinim.gov.cl](http://www.sinim.gov.cl) and DIPRES (2016), *Estadísticas de Recursos Humanos del Sector Público 2006-2015*, Dirección de Presupuestos.

Overall, staff spending accounts for 52% of municipal spending, the largest share in the OECD, while Chile is among the most centralised countries. This is mainly due to education and health staff spending (Figure 27).

**Figure 27. Structure of public expenditure at the subnational level, 2014**



*Note:* 1) 2013 figures; 2) 2011 figures. Other (\*) refers to paid taxes, financial charges (including interest), adjustment for the change in net equity of the households in the pension funds.

*Source:* Subnational governments in OECD countries: Key data (brochure) and “Subnational Government Structure and Finance”, OECD Regional Statistics (database), <http://dx.doi.org/10.1787/05fb4b56-en>.

The new caps on the municipal workforce established by law No. 20.922 intend to give more room for manoeuvre to municipal governments so they can adjust their public workforce to better meet their needs. In this respect, it would be useful to develop strategic workforce planning, based on the development of the Municipal Information System (SINIM) as an observatory of municipal staff.

***Employment conditions in the municipal sector remain critical and municipal capacity needs strengthening***

Municipalities fail to attract and retain talent due, in part, to low pay, particularly at professional and management levels, combined with limited opportunities for career development and training. The salary gap widened with the development of the “senior civil service programme” in central government that does not cover municipal managers. Municipalities can only recruit less experienced people or younger qualified employees but who tend to remain only for short periods. After this first experience, they move rapidly on to more attractive jobs. Recent reforms will improve this situation for professional and managerial staff but it seems insufficient as the reform does not concern non-professional staff (e.g. auxiliaries, technical and administrative staff) and *contrata* staff. Municipal public employment could be made more attractive through fairer and more competitive salaries for all staff. A more comprehensive reform of the salary system should be planned to support municipal human capital plans, and their core functions and responsibilities. It should be linked with a new pay programme to meet municipal needs for years to come. First, Chile could adopt a salary scale for both the central and subnational levels. That would also facilitate mobility of staff across levels of government. Second, the compensation system could be reformed to improve flexibility and fairness in compensation and attract talented people. In addition to attracting employees, efforts need to focus on retaining talented people, particularly in remote and less favoured areas, by developing a “total reward” approach that would take into consideration all aspects of compensation (i.e. pay, benefits, learning and development, and work environment and conditions). This could be partly decentralised to municipalities.

In addition, recruitment and promotion are not in step with municipal realities. Municipal, education and health *planta* staff is hired through a competitive public process in accordance with the norms established by the corresponding statute. For other staff however, recruitment and promotion seem to depend on personal and political factors rather than merit. In addition, there are limits across and within levels of government (central, regional and municipal) as the system is very rigid with few cross-overs from one level to another but also within municipalities. Even for *planta* staff, although there is a clear and defined recruitment and selection process through a public competitive exam process, the transparency of the process seems insufficient and could be enhanced through specific measures (e.g. selection committees, interviews and participation procedures) and support from specialised bodies.

On top of that, there is gap of competencies and skills in the municipal public workforce. Despite significant progress in terms of training options for municipal employees, including the Municipal and Regional Training Academy developed by SUBDERE, and obligations imposed on municipalities in this field (e.g. an annual training plan), training does not always seem to meet the professional and technical needs of the local public administration. Training is not always viewed and implemented as it should be for various reasons, including understaffing, lack of motivation from mayors faced with high turnover, and lack of funding. As a result, municipalities still face a gap in competencies and skills in relation to their tasks and development challenges ahead. In a context of scarce municipal financial resources and a huge need for highly-qualified people, Chilean municipalities need to develop training strategies focused on learning and development placed at the core of their HRM strategy. Training should be provided at different stages of the public servant’s career, using the latest training and development methods while evaluating the cost effectiveness of training, developing municipal leaders and managers, and encouraging continuous training.

As far as competencies are concerned, Chile, like many countries, emphasises diplomas and formal qualifications to access public employment. According to SINIM, the level of professionalisation (people with diplomas) has grown in recent years, reaching almost 30% in 2015 on average. There are, however, wide disparities across municipalities (from around 2% to 68%). Focusing on academic degrees to measure the level of professionalisation may not be enough to assess the capacity levels of a municipality, as diplomas do not guarantee the employee will acquire the competences that are indispensable for better performance. Therefore, with the support of the central government, municipalities could also begin the shift towards “competency management” and make the HRM process more flexible. Chilean municipalities could use the accumulated experience of *ChileValora* in the certification of labour competencies to define and certify competencies for jobs at the municipal level and develop the use of job profiling.

Performance assessment and management in municipalities is weak, unlike at the central level for which Law No. 18.833 established an evaluation system. This is in contrast to the education and health municipal sectors where evaluation is carried out according to national norms, established by supervisory administrations. In the municipal sector, the problem seems to originate in the lack of managerial skills and awareness of the importance of performance management within the municipality's senior manager group. The *Sistema de Alta Dirección Pública* (ADP), a senior manager system, implemented at the central level, has not been extended to municipalities, and municipal managers are not trained to be managers. While there are some initiatives in this area, efforts have been needlessly hampered by inadequate and inappropriate structures and training of managers. Thus, it is necessary to place greater emphasis on public employees' evaluation for improvement purposes in all sectors. An integrated and mutually-supportive system should be established to generate synergy effects. Changes have to form part of a coherent performance management strategy that could be promoted by SUBDERE.

Finally, as performance and efficiency issues become more urgent in municipal public governance and management, more attention needs to be paid to the role, tasks and capabilities of senior and mid-level municipal managers, whose role is key in the process of transformation. Extending the coverage of the ADP system to the municipal level would be a way to enhance management capability at the municipal level.

### ***An HRM function should be strengthened through more decentralisation and professionalisation***

The current reforms concerning staff management are steps in the right direction. However, more could be done to make public workforce management at the municipal level a reality, giving municipalities the capacity to adjust their workforce to respond and adapt effectively to their most pressing needs and objectives. Local authorities need to develop a human resource management strategy, and for that it seems necessary to delegate some HRM responsibilities to municipalities. Delegation of HRM authority would not be without its challenges for Chilean municipalities, as it would entail a major cultural change. All municipalities would not have the capacity to take on this responsibility. This delegation could therefore be also done in a gradual and differentiated way according to municipal capacities and the learning process.

Further decentralising HRM functions would involve establishing reinforced accountability mechanisms. Decentralisation or delegation does not mean withdrawal of the state, quite the contrary. Shared values and common structures and processes across levels of government are all the more necessary. It may be a paradox, but delegating authority over HRM to municipalities may need to be accompanied by a strengthening of certain central functions including oversight of municipal public administrations. The National Directorate for the Civil Service could play a leading role here.

Decentralising HRM functions would also require innovating and building municipal capacity to assume these new responsibilities. All 346 municipalities do not have the capacity to take on HRM functions. As indicated above, it could be implemented gradually and in differentiated manner. Another

complementary way would be to encourage the creation of municipal associations to organise jointly shared back office services, including HRM.

This would also allow HRM professionals – lacking in numerous municipalities – to be hired. Beyond that, it is essential to professionalise the HRM function in municipalities. This can include establishing an HRM unit, based on HR professional standards, as part of the municipal organisational structure. Such a unit could play a strategic and integral role in enabling change and supporting improved public service delivery and the modernisation of the municipal system.

#### **Box 5. Key Recommendations for modernising Human Resource Management**

##### **1. Workforce planning and management**

- Engage in strategic workforce planning with the support of the National Directorate for the Civil Service and by using SINIM in a more strategic manner.

##### **2. Strengthening municipal HR capacity**

- Make municipal salaries of non-professional and *contrata* staff more attractive and competitive.
- Adopt a total “compensation package” including training and better working conditions in addition to pecuniary elements.
- Enhance transparency in recruitment and promotion; develop a more sophisticated, credible and transparent recruitment process by creating special bodies supporting professionalisation.
- Establish a training strategy focused on learning and development.
- Promote the development of competences in municipal administration and the use of a skill management framework and job profiling.
- Develop a performance evaluation.
- Invest in the management capability of municipalities at senior and middle management levels.

##### **3. Strengthening the HRM function**

- Delegate HRM responsibility to municipalities (gradual and asymmetric process).
- Establish an accountability mechanism to monitor the management of human resources at the municipal level.
- Promote municipal associations to manage HRM collectively.
- Professionalise the HRM function at the municipal level.

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## **5. Enhancing the quality and efficiency of municipal services**

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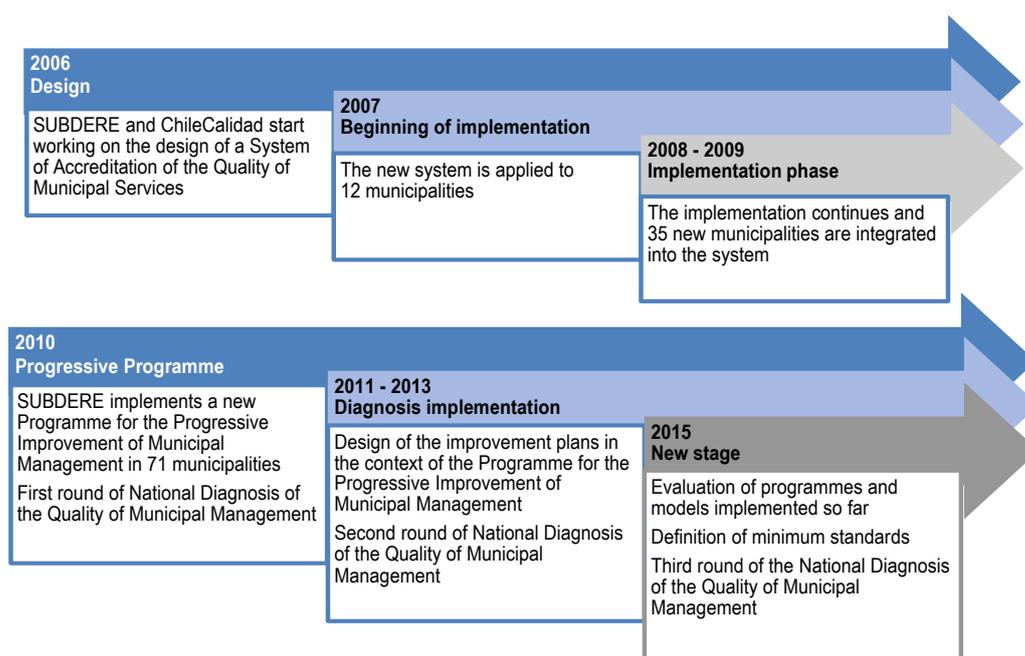
### ***The management framework of municipal services in Chile is complex and unclear***

The municipal landscape in Chile varies sharply across the country, and the differences in management and service provision between wealthier municipalities and poorer ones are large. These differences are not only due to weak financing or capacities but also result from the considerable fragmentation of responsibilities within the municipality and the lack of a comprehensive and “whole of government” management assessment. Chilean municipalities are responsible for a wide range of services at the local level. This engenders two major challenges: i) fragmentation in the provision of municipal services which is largely dependent on different and specific management strategies, especially for shared

responsibilities; ii) the heterogeneity of local capacities across the country, rendering uniform service delivery unrealistic and often impossible.

SUBDERE has developed a robust and complex framework for improving municipal services through management models, certification systems of the quality of municipal services, and the diagnosis of local management of service provision (Figure 28). Yet, municipal education and health services follow national guidelines defined by line ministries independently of the management model promoted by SUBDERE. Better co-ordinating service provision in a “whole of government” perspective does not mean that just one institution is responsible for assessing the delivery of all services provided by municipalities, but it means that co-ordination among the different institutions needs to be in place.

**Figure 28. Progress in management of municipal services**

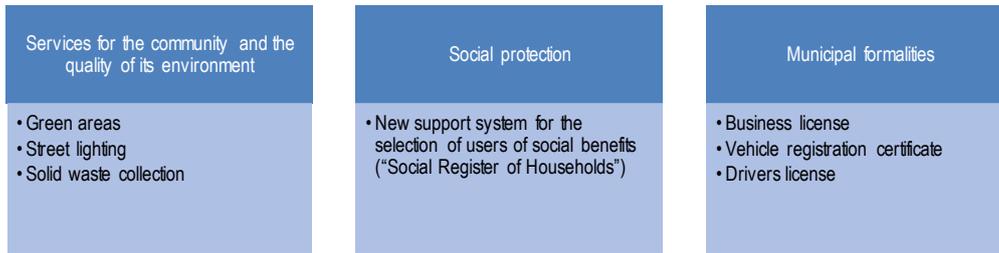


Source: created by OECD based on information provided by SUBDERE.

### ***Ensuring minimum standards of municipal services to reduce territorial disparities***

As part of the decentralisation reforms, SUBDERE is moving towards a new paradigm of performance management and service delivery at the local level and developing a system to define minimum service standards. This new system, called “System for Strengthening and Measuring the Quality of Municipal Services” (SEMUG), recognises that improving service delivery at the municipal level is crucial for the decentralisation process and can help reduce territorial disparities. Minimum standards can also potentially increase municipal accountability by making local governments more transparent and reactive to both, central government and citizens. Chile should pursue the efforts to define minimum service standards in order for all citizens to receive quality public service (Figure 29). Yet, this process should be seen as an intermediary step toward greater municipal autonomy.

**Figure 29. Basic services for minimum standards**



Source: SUBDERE

In this new system, however, the definition of minimum standards is rigid and can entail an excessive burden for municipalities. Service charters are suitable instruments to promote the continuous improvement of public services and to make clear commitments to the quality standards that citizens can expect. Chile could envision the implementation of service charters at the subnational level to ensure minimum standards while also ensuring flexibility and autonomy for municipalities to tailor their policies to local preferences.

***Chile should integrate minimum standards into a comprehensive service management model***

Service provision is crucial, but it is only one piece of municipal management. To ensure that the minimum standards are achieved, they should be part of a more comprehensive assessment of municipal performance, one that integrates elements such as governance, citizen participation, resource management, planning, etc. A comprehensive performance measurement based on an integrated management model can support Chile in the process of quantifying the output and outcomes of government policies. It can also help municipalities and their staff set goals and support incentive mechanisms. Performance measurement, however, requires the capacity and will to set and monitor objectives by all levels of government, and to communicate performance openly and in a way that is relevant to citizens.

Adequately defined performance indicators, ones that can promote learning and orient stakeholders towards results, are a key piece of the management model. The set of indicators needs to be clear and measurable. Chile could envision integrating the system of indicators into the current Municipal Information System (SINIM) that could provide a platform or starting point for a tool of this type. In the long run, to complete a comprehensive system of municipal services Chile could create a new independent platform dedicated to this effort.

***Reinforced local capacities and multi-level governance tools are necessary to improve municipal services***

To develop an efficient system of management performance at the local level requires effort from the central government to provide municipalities with the financial, human and technical means to effectively use the system. Otherwise, requirements can rapidly become a burden for a number of municipalities, particularly small ones. To ensure that minimum standards are met, the central level should reallocate resources, potentially tying the continuation of such reallocation to improvement on indicators associated with the standards, thus providing the financial incentives for municipalities to improve service delivery.

Greater financial resources need to be accompanied by adequate human resources to manage the additional resources. Having enough capacity is crucial both at the municipal level but also at the central level to define standards, manage, monitor and evaluate performance. Municipalities should take advantage of law No. 20.922 that gives more flexibility in hiring professional staff that will help municipalities meet minimum standards and improve the overall performance of the municipality.

Overlapping mandates and weak vertical co-ordination among the institutions involved in service delivery and performance evaluation can undermine the effectiveness of Chile's institutional landscape. Improving the effectiveness of service delivery requires appropriate multi-level governance arrangements and institutional and legal frameworks that clearly define the roles and responsibilities of all relevant levels of government.

### ***Towards the institutionalisation of public service management***

The decentralisation process implies an adjustment of the institutional landscape that should be made gradually. To reduce the potential risks inherent in a comprehensive service delivery management model, Chile needs to ensure institutional arrangements and conditions that will help the country efficiently improve public service provision at the local level. In Chile, service management depends to a large extent on political priorities, and programmes are often discontinued or replaced as these priorities shift. An appropriate institutional framework can make service management less dependent on political vagaries. In the long run, a re-allocation of responsibilities in a new institutional landscape is necessary. This can imply the creation of a Guaranteed Municipal Services National Commission for the Certification of Subnational Governments.

#### **Box 6. Key Recommendations for Enhancing the quality and efficiency of municipal services**

##### **1. Strengthening municipal services management in Chile**

- Develop a municipal services management model (“System of Municipal Services”) integrating all municipal services (education, health and municipal sectors)
- Favour co-ordination and coherence across levels of governments.

##### **2. Ensuring minimum standards for municipal services to reduce territorial disparities**

- Develop the SEMUG programme, which make municipalities more transparent and accountable.
- SEMUG should be seen as an intermediary step towards a more flexible and autonomous tool for service provision management. The promotion of service charters could be envisioned.

##### **3. Integrating standards into a comprehensive management model going beyond SEMUG**

- Integrate elements such as governance, citizen participation, resources management, planning, etc. in the management model.
- Design, in co-ordination with others stakeholders, a suitable indicators system that is both clear and measurable. SINIM could be a good starting point but a new independent platform could also be established in the longer term.

##### **4. Creating the conditions to improve municipal services**

- Provide municipalities with sufficient financial, technical and human means and training/capacity building activities to effectively implement a comprehensive municipal service management system as well as incentive mechanisms (tied to improvement and results).
- Complement improved service delivery with other activities such as digital governance, innovation or administrative simplification.

##### **5. Towards the institutionalisation of public service management**

- Reinforce co-ordination mechanisms across sectors (education, health, municipal activities).
- Strengthen SUBDERE's role: it is the institution with the expertise to support municipalities in defining standards/indicators and to support performance management improvements.
- Set up an independent body – in the form of superintendence or a national commission – that would oversee municipal management performance, as a future step.

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## 6. Building transparency, accountability and citizen participation practices at municipal level

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Chile's government has a clear objective: to use participatory governance as a means to build a more inclusive and more democratic society. It is actively doing so by boosting transparency practices and introducing tools to promote greater citizen participation. Chile has the legal frameworks in place to accomplish this, however it is falling short with respect to two other enabling factors for stronger public engagement: political will, particularly at the local level; and a vibrant civil society, which despite a strong presence in numbers appears to have limited ability to influence decision makers and be a partner with government. In addition, Chile's multi-level governance practices and the managerial typology characterising municipal administration contribute to the apparent deficit in participatory governance.

### *Institutions, frameworks and actors to support greater participation are in place but there is a lack of incentive to engage*

Chile's approach to promoting transparency is relatively streamlined and flexible: a national council was established with oversight and sanctioning capacities; government bodies together with local authorities were clearly tasked with the how, where, and what of making information available; and, while the channels for access may not fully align with citizen preferences or capacity, there has been significant investment in ensuring that information is available and accessible. This is in contrast to the frameworks established to institutionalise citizen engagement, which are top-down, fragmented, and sometimes unclear, or contextually not appropriate.

The top-down approach to participatory practices, grounded in legally required compliance, is insufficient to ensure implementation, particularly at the subnational level. Non-compliance with the Transparency Law can be sanctioned by the National Transparency Council, however there is no such sanctioning mechanism associated with mechanisms designed to promote greater participation, specifically law No. 20.500 and the Presidential Instruction 007/2014. Research suggests that when participatory governance is promoted in a heavily top-down manner, it can generate a "self-interested" or short-term approach to participation, wherein local officials "go-along" with whatever programme is on offer in order to secure funds, but there is little associated incentive for them to adopt a long-term approach to participatory governance. Introducing incentive mechanisms to make compliance more appealing or non-compliance more risky, particularly with respect to engagement practices, could be of value. Financial incentives or fiscal sanctions are often the most effective. However, it would be important to ensure that incentive mechanisms do not limit results by rewarding municipalities that only superficially apply the law – i.e. take a short-term or self-interested approach in order to access funding or to "box-tick" citizen participation. In addition, it is important to understand what is really behind a lack of compliance. Resource limitations could be one factor, but there is evidence to suggest that other factors play a role as well, including: a lack of citizen awareness with respect to law No. 20.500 and the right to participate; a poor understanding of the long-term advantages of participatory governance on the part of officials and citizens; a perceived threat to established power contributing to limited political will; and/or a lack of human resource capacity.

Another limitation may be the government's institutional approach. There appears to be a large bureaucratic and administrative structure dedicated to implementing law No. 20.500 and it seems that the government is placing oversight units to oversee oversight units. This risks creating administrative burden, confusion, overlap, and significant fragmentation, which can impact the law's effectiveness. The entities are also inward looking and can fragment citizen participation by sector, rather than promoting a broader, cross-sector, society-wide approach to participation at all levels of government.

Local level actors – citizens, elected and representative officials, and civil society organisations (CSOs) – are pivotal to successful participatory governance. In Chile, the degree of citizen engagement seen in a municipality will depend considerably on the mayor, and could conceivably shift – for better or

worse – if a new mayor takes office. Thus, ensuring that engagement practices are properly institutionalised is important. Municipal councils could be more influential in participatory governance, particularly as one of their responsibilities is to ensure community participation. Currently, they serve as an advisory body to the mayor rather than being an active partner in municipal development, and through this bringing forward the voice of the community and individual constituencies. Their actual ability to ensure participatory practices is limited, as is their ability to check and balance the local executive. The relative impact of each municipality’s Council of Civil Society Organisations (*Consejo Comunal de Organizaciones de la Sociedad Civil* – COSOC), depends on the municipality itself. In some localities they are highly relevant, giving opinions and conclusions; in others, especially poorer municipalities, this is more difficult, and room to directly (or indirectly) influence critical issues is limited. Overall, and in keeping with the managerial typology of municipal management in Chile, it appears that the majority of CSOs are neighbourhood groups (*juntas vecinales*) that have little capacity or space to influence local decisions, policy or programming – instead they concentrate on projects within their communities and are supported financially for initiatives that focus primarily on infrastructure and social activities. The result is CSO activity concentrated within the confines of a neighbourhood boundary, rather than at a municipality-wide level, further fragmenting networks and network activity. It can also impede building the “strength in numbers” required to advocate on the behalf of citizens and ensure accountability on the part of government.

### ***Transparency techniques are strong but could better support building accountability***

Greater transparency can contribute to citizen confidence in government. However, it seems that Chileans are significantly less concerned with their government’s transparency, and more concerned with real or perceived corruption. In order to meet participatory governance and government objectives, speak more directly to citizen concerns, and build confidence in government, attention may need to shift from strengthening transparency mechanisms to actively building accountability. Such a shift would require reassessing how the government is being transparent: the way it provides information; the type of information provided and to whom; and the links it makes between transparency mechanisms and accountability techniques, particularly since greater transparency does not automatically translate into greater accountability.

Compliance with access to information laws is improving significantly at the local level, and recent data indicates that, in 2015, 76.9% of Chile’s municipalities were in compliance with “active transparency” requirements – representing a 12.2% increase over 2012. Despite these improvements, there are three concerns with how information is being provided and the nature of the information itself. First, the multiplicity of transparency portals creates fragmentation and could cause confusion for users. Second, the information available – often a link to a specific law – is dense and not necessarily user friendly. Finally, there is little attempt to increase accountability through greater transparency, especially when the information provided is dense and/or difficult to understand.

There are two additional concerns with Chile’s approach. One is the high level of emphasis and investment directed to making information electronically available when it is a) not how people tend to access information; b) not considered reliable information by users; and c) not within the practical reach of many Chileans. Thus, the government may not be meeting citizen needs, and it begs a question of inclusiveness. The second concern focuses on municipal implementation capacity. Despite improved compliance, on average, nationwide, there are issues of information not being current, or simply not made available at the local level. This can point to a shortfall in the municipal resources necessary to maintain data up-to-date as it requires staff time, just as it may reflect a lack of political will. The government may need to reconsider how it is spending transparency resources and strike a better balance between providing the qualitative and quantitative information that citizens demand the right to access, with greater openness in communicating information that citizens want to know, and how they want to know it. This could result in a more effective and more efficient approach to transparency, and help support greater accountability.

To this effect, COSOC could play a valuable role at the local level, as could creating a more inclusive dimension to the transparency framework. Greater consideration could be given to open government data as a means to enhance transparency and accountability, particularly at the subnational level. This could help municipalities grow in their partnership capacity vis-à-vis higher government levels, contribute to performance measurement and build accountability, but would require improving subnational data gathering and management capacity.

Current transparency practices will need to be complemented with stronger accountability mechanisms, particularly at the local level. This is especially important if Chile wishes to meet its objective of boosting citizen oversight of local authorities as a means to support accountability, strengthen the social fabric and build inclusiveness. It involves promoting accountability frameworks, building stronger performance measurement systems, and encouraging local government to publish municipal service and quality of life objectives, ideally after involving citizens in their identification, establishment and achievement. Greater effort could be directed to ensuring citizen input early in the policy or planning cycle, and using performance measurement as an accountability tool.

### ***Participatory capacity needs to be strengthened among all actors, especially at the local level***

Chile's ambitions with respect to citizen engagement – i.e. processes that create a stronger partnership between all levels of government and citizens – are not aligned with its multi-level governance framework, one that limits municipal autonomy in decision making, programming prioritisation, and resource management. Nor is its top-down approach fully aligned with the more bottom-up, fluid character of citizen participation, which by its very nature requires decentralised activity and a degree of flexibility to choose and adjust the participatory method applied based on objectives, on circumstance, and on capacity.

Chile's participatory practices tend to reinforce the “inform” and “consult” forms of interaction or engagement (Figure 30). While this can be beneficial, it has limited public impact since communication is generally a ‘one-way’ exchange, either from government to citizens (inform) or from citizens to government (consult), rather than a two-way dialogue. It also tends to occur once a decision has been made, rather than in order to take a decision. Chile's emphasis on such mechanisms limits active citizen involvement, collaboration and empowerment in the policy process; and is in keeping with the managerial typology of municipal administration and the associated multi-level governance approach. The tendency of Chilean officials to position engagement as a tool to improve service delivery rather than to support strategy, policy and planning processes is also reflective of this managerial typology. It is top-down and inward looking, emphasising formal councils and oversight units at the national and local levels, as well as government programmes and government training, rather than outward looking, anticipating and responding to when and how citizens want to participate and ensuring their capacity to do so. This may be one reason why there appears to be little room for citizen “voice” in policy or programme design and implementation. It can also link to a governance and management system where strategic development planning is not a strong component of the municipal portfolio and may at least partially explain why consultation often comes too late in the planning process.

More effort is needed to create room for citizen voice. This can mean improving communication at the early stages of planning so that its expression does not reach the “threat” stage. One way to do so is by bringing relevant stakeholders into the process early on. This is certainly antithetical to the current multi-level governance structure as it can put government plans at risk. However, it can also better support trust and avoid incurring the unnecessary costs of “undoing” a project very late in the process if citizen influence is strong enough. The comprehensive use of citizen engagement requires that government organisations be transparent about what they do and responsive to what citizens tell them.

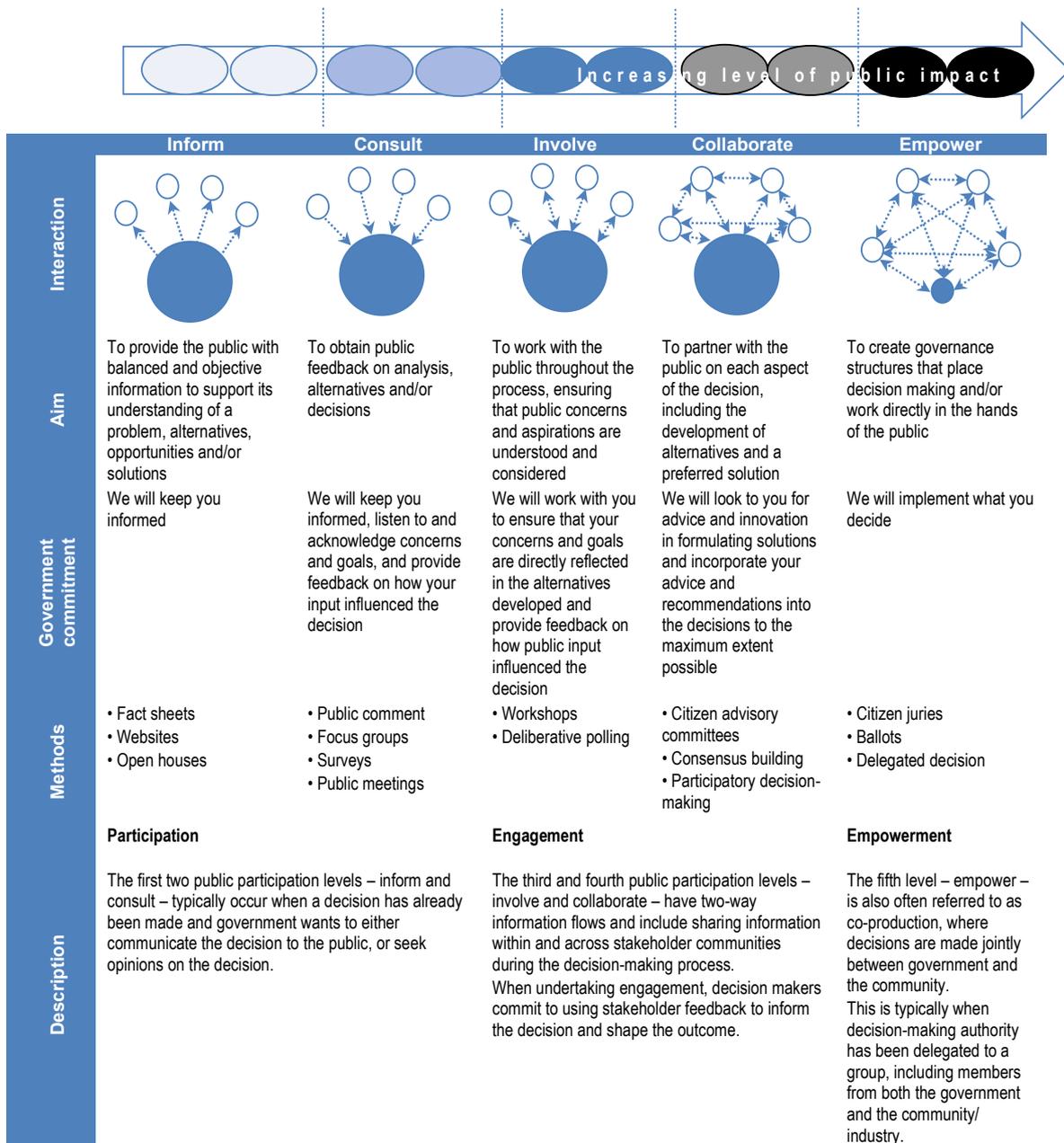
For Chile to progress in its engagement practices, it will need to consider a broad approach to capacity building, and target all primary actors – i.e. civil servants and citizens, including CSOs, and also politicians. The result could be a stronger, more “partnership” oriented relationship between government

and non-government actors. Moving forward, it would be important for Chile to continue building capacity in innovative manners, as well as to build incentives that address any reticence to implementing participatory mechanisms. Continued opportunities to learn, for example in regular fora for the exchange of best practices, are one way to address this.

Chile has done a good job identifying and promoting the development of key participatory tools such as transparency websites, improved access to information, participatory budgets, citizen councils, etc. However, in practice there appears to be greater emphasis on applying such tools to a specific project or programme rather than considering citizen participation as a powerful policy lever to identify, prioritise and support the realisation of broader municipal development ambitions. Evidence suggests that municipalities that consider citizen participation as a transversal activity and apply a more policy-oriented perspective – in other words, taking a consistent approach to engaging with citizens – are more successful in their engagement practices. For participatory governance to become more firmly embedded in local governance, municipalities will either need more support or greater incentive to use participatory practices as a policy lever in a transversal, integrated fashion rather than as a project implementation tool. Participatory practices, however, need to be supported by multi-level governance practices. This might be one of Chile's greatest challenges. If local governments are weak, it is less likely they will be able to produce strong participatory outcomes, especially if they are expected to use complex and costly mechanisms.

At a local level, there is a heavy reliance on normative (legally mandated) participatory mechanisms. This raises several concerns. First, local officials can hide behind the law and legal requirements, including them in ordinances but not actively promoting or supporting their use. Second, the mechanisms stipulated as obligatory may be beyond the resource capacity of some municipalities and thus are limited in their inclusiveness. Finally, the array of participatory mechanisms available to governments and CSOs is extremely broad, and while identifying key practices through the law can indicate which practices the government perceives to be most important or relevant, it leaves little room for innovation, experimentation or adaptation to specific circumstances or contexts. Specifically with respect to participatory mechanisms, Chile's municipalities seem to face two challenges. First, they have difficulty implementing the participatory mechanisms required by law. Second, and perhaps even more fundamentally, there is difficulty in clearly articulating what constitutes a participatory mechanism and what does not. Thus, some additional "soft" guidance may be necessary. This could help streamline the extensive list of mechanisms that municipalities include as participatory (currently over 40), help limit "consultation fatigue", and prevent a box ticking exercise whereby municipalities include mechanisms because they are required (e.g. plebiscites) or suggested (e.g. participatory budgets) without having sufficient capacity to implement them.

**Figure 30. The spectrum of public engagement**



Source: Adapted from IAP2 (2007), IAP2 Spectrum of Public Participation, International Association for Public Participation, Louisville, CO, available at: [http://c.ymcdn.com/sites/www.iap2.org/resource/resmgr/imported/IAP2%20Spectrum\\_vertical.pdf](http://c.ymcdn.com/sites/www.iap2.org/resource/resmgr/imported/IAP2%20Spectrum_vertical.pdf)

Source: Adapted from IAP2 (2007), IAP2 Spectrum of Public Participation, International Association for Public Participation, Louisville, CO, available at: [http://c.ymcdn.com/sites/www.iap2.org/resource/resmgr/imported/IAP2%20Spectrum\\_vertical.pdf](http://c.ymcdn.com/sites/www.iap2.org/resource/resmgr/imported/IAP2%20Spectrum_vertical.pdf) (accessed 4 August 2016); Victorian Auditor-General’s Office (VAGO) (2015), Public Participation in Government Decision-Making: Better practice guide, Victorian Auditor-General’s Office, Melbourne, Victoria, Australia, <http://www.audit.vic.gov.au/publications/20150130-Public-Participation-BPG/20150130-Public-Participation-BPG.pdf> (accessed 11 August 2016).

To move forward, Chile may need to reconsider how it wants to proceed in strengthening participatory governance. It has already developed a myriad of tools and institutions to support such an effort, and does not necessarily need any more. However, it may need to use what it has more effectively.

Because strong engagement depend on trust in government, an approach focused initially on building trust could be helpful. This means first concentrating on mechanisms that support greater accountability (i.e., those that inform, consult and involve citizens in decision-making processes) and then proceeding to more complex forms of engagement (i.e., those involving greater collaboration and empowerment). In addition, it may be valuable to take a more nuanced or tailored approach to promoting participatory practices – one that is based on municipal capacity rather than an overly general law. In such a case, municipalities with the resources (financial, human and infrastructure) and capability to undertake more complex forms of engagement would be encouraged and supported to do so, and those with less capacity would be supported in their progress up the participatory learning curve.

#### **Box 7. Key Recommendations for building transparency, accountability and citizen participatory practices**

##### **1. Further strengthening participatory governance institutions, frameworks and actors**

- Streamline the number of institutional oversight bodies and make their activities and purpose clearer, including by promoting an integrated cross-sector approach to citizen participation at the national level and streamlining the number of required participatory councils in line ministries and sector agencies.
- Strengthen participatory governance at the local level through elected officials and representative organisations, including by strengthening the capacity of municipal councils; strengthening the role of COSOC; reducing the fragmentation of civil society networks and supporting their capacity to become advocates for their communities, and partners with local governments.

##### **2. Adjust transparency techniques and build stronger accountability mechanisms**

- Make accessing information easier and more relevant to all citizens and better align transparency mechanisms with citizen preferences and behaviour, ensuring that the information provided is the information sought.
- Enhance Open Government Data practices for example by regularly consulting user needs for data release, sending notifications to users when new data sets are made available, supporting municipal capacity in open government data by helping them build data availability.
- Support greater local level accountability on the part of elected officials, including by supporting municipalities in the design and implementation of indicator systems and the use of performance information; bringing citizens into the local level planning process early on in the cycle, and consider a pilot initiative where citizens identify objectives for their municipality and present these to the mayor at the beginning of the mayor's term.

##### **3. Improve the use of citizen engagement practices at the local level**

- Give government officials at all levels a stronger understanding of participatory frameworks and the aims and implications of diverse engagement mechanisms.
- Strengthen the voice of the next generation through municipal youth councils, candidate youth fora, etc.
- Better communicate plans that will affect a community before plans are finalized, creating room for citizen voice, identifying potential problems and developing solutions agreeable to all parties.
- Support citizen participation capacity, matching resource and community needs, focusing on “upskilling” and sharing with citizens when and why their input is used and not used.
- Include a citizen participation module in the training provided by the Academy for Municipal and Regional Capacitation (*Academia de Capacitación Municipal y Regional*), teaching practical skills on participatory mechanisms including costs and benefits.

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## 7. Strengthening strategic co-ordination within and across levels of government

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### ***Institutional fragmentation represents an important challenge at the national and subnational levels***

In Chile, territorial strategies, policies, and investments tend to be centrally defined and fragmented across sectors. At the national level, different ministries are responsible for urban, rural and regional issues. In particular, while the Secretariat for Regional Development and Administration within the Ministry of Interior (SUBDERE) supervises regional and rural development, the Ministry of Housing and Urbanism (MINVU) spearheads urban development. This results in a strict separation of urban management from rural and regional affairs, which risks creating a “Swiss cheese” effect in territorial development, co-ordination and management.

The impact of institutional fragmentation at the central level is often played out at the subnational level, bringing with it responsibility overlap and complex accountability lines. The *intendente*, the Regional Government (GORE), the regional-level representatives of line ministries (SEREMI), the Regional Agencies (*Servicios Públicos Regionales*) and the Regional Councils tend to work separately with no incentive to co-operate. The co-existing mandate of the *intendente* (who is both a representative of the state and the head of the regional government, GORE) generates a problem of divided loyalty (to the central and to the regional levels) and undermines accountability. Collaboration is often fragile because of a combination of ad hoc initiatives and informal relationships. The absence of a formalised inter-institutional co-ordination platform renders collaboration the exception rather than the rule.

Improved co-ordination across sectors at both the national and subnational levels can help address institutional fragmentation ensuring that regional policies contribute to the pursuit of common development goals. Improved co-ordination can also limit overlapping projects, help promote synergies between policies and investments, and ensure that projects and local investments are mutually reinforcing. Building greater coherence could involve placing the responsibility for territorial development – regional, urban and rural – under SUBDERE to facilitate the interaction between different ministries and institutions.

The ongoing decentralisation reform could be a good opportunity to re-think and map the distribution of responsibilities at the central level and across the different levels of government. While decentralisation reforms are often associated with increased duplication and overlap of responsibilities and services, thereby generating administrative overhead, Chile could take advantage of this opportunity to reduce the scope of these duplications

### ***Reinforcing the role of regions to enable more efficient and stronger municipalities***

Regional governments are in a key strategic position to co-ordinate policy priorities vertically with the central and municipal governments, and horizontally among municipalities within their jurisdiction. However, given the current institutional framework, regional governments have limited autonomy and act mainly as vehicles of central transfer to municipalities. Their role as brokers to effectively channel local demands and better communicate local priorities to the central level needs to be reinforced. In a scenario where regions have more autonomy to plan, design and implement regional policies, it is however crucial to avoid making decentralisation happen by centralising decisions at the regional level. Co-ordination tools are thus fundamental to attenuate these risks.

The role of regions can be reinforced as key partners for municipalities to provide technical, administrative and financial support that better suits local challenges. Regions could also be more proactive in supporting projects that require cross-jurisdictional co-operation, having an integrating role particularly vis-à-vis weaker and rural municipalities at regional level.

### ***The planning framework for regional and local development needs to be better aligned and streamlined***

The planning framework that guides development and investment strategies at the national and subnational levels in Chile is complex. For regional, urban and rural development, co-ordination and collaboration in policy planning are infrequent, and approaches to territorial development and management remain siloed and with limited cross-sector dialogue and local consultation.

The Regional Development Strategies (*Estrategia Regional de Desarrollo*, ERD) and the Municipal Development Plan, (*Plan de Desarrollo Comunal*, PLADECO), provide a basis for community deliberation, discussion, and planning, but their non-binding and unfunded nature appears to limit their usefulness – particularly given the annual, project-by-project approval process. The development strategies have not yet achieved a level of maturity to be the main umbrella guiding regional and local development. The lack of a national-level territorial strategy also leaves them without an anchor in higher-level objectives. The challenges linked to the design and implementation of strategic planning in regions and municipalities vary depending on the municipality, as capacities differ greatly.

For planning instruments to be effective co-ordination instruments, Chile should streamline its planning tools and institutionalise dialogue among the different levels of government. This will also benefit the development of the appropriate capacities, especially at the local level. However, if co-ordination is not rewarded by effective development and investment policies that benefit local governments, dialogue is unlikely to happen.

### ***An improved connection between planning and budgeting is needed to encourage co-ordination***

Co-ordinated planning is limited by a budget process and funding mechanisms that do not favour coherence among planning instruments. Regional and local strategies are not directly linked to funding streams; their implementation is tied to annual regional budget capacity, which depends on central-level grants. Subnational funding follows a sector-based logic, and the various projects that form an integrated initiative risk being evaluated independently of a master plan. Chile should move away from a pure project-based approach to a more strategic/programme-based approach to assign funds.

The capability to overcome a lack of co-ordinated planning instruments is limited by political cycles that create incentives for national and local actors to prioritise a short-term agenda. In Chile, the challenge is particularly relevant because of the four-year electoral cycle combined with the single presidential terms. At the local level the problem is even more acute: municipal elections take place in the middle of the Regional Council mandate (elected at the same time as the president) and the 4-year designation of an *Intendente*.

### ***Platforms for dialogue should involve actors at all levels of government and sectors***

Chile has a long tradition of *ad hoc* or permanent inter-ministerial and/or advisory committees to address short- or long-term challenges. Recently, Chile has set up a new dialogue forum, the Interministerial Committee for City, Housing and Territory (*Comisión Interministerial Ciudad, Vivienda y Territorio*, COMICIVYT) to co-ordinate and validate land use and infrastructure planning across ministries. This forum can help to clarify the main capacity challenges and bottlenecks impeding the effective management of subnational policies and/or investments. However, municipalities and local actors are often under-represented in these fora; inter-sectoral dialogues stop at the regional level. To avoid co-ordination fatigue, the long tradition of inter-ministerial committees in Chile could legitimise and reinforce the institutional foundation of the COMICIVYT and CORECIVYT – the regional expressions of the COMICIVYT – as the main co-ordination platform for regional and local issues. The CORECIVYT could be the unique legitimate platform to co-ordinate policies and investment with regional or local impact. For this, municipalities or municipal representatives need to have a seat on the Committee. The exact

associations or municipal representatives that will be represented on the committee will depend on the particularities of each region.

### ***Programming contracts in Chile should be encouraged***

Contractual agreements in Chile can help address multi-level governance challenges, ensuring that national policies and regional and local priorities are consistent. Programming contracts (*Convenios de programación*, CP) have mostly been used for shared planning and financing of large infrastructure projects. However, limited compliance by the parties involved has delegitimised its scope; central government entities have sometimes been reluctant to enter into CPs; and investments financed through these contracts have not increased in recent years.

The role of municipalities in CPs has been very limited and more marginal than systematic. The vast majority of contracts have been signed between line ministries and regional governments mostly to leverage regional resources for activities already in their sector plans. As municipalities do not have the necessary resources to co-finance large investments nor the capacities to design a contract, these are often neglected in such arrangements.

Chile should further develop and support CPs as key instruments to boost co-ordination both across levels of government and across sectors, moving towards “territorial contracts” with particular territorial goals and regional development priorities. Several OECD countries have developed such tools, including France. The next step is to rebalance the top-down approach that has been dominant in the current framework with a stronger bottom-up component.

### ***Collaboration for local development and investments among municipalities in Chile is in its early stages***

While collaboration among municipalities has taken a long time to be integrated into local management, Chile has made substantial progress fostering inter-municipal co-ordination on a voluntary basis. Since 2009, municipalities can form not-for-profit organisations with their own capital, allowing them to enter into financial commitments, compete for funding and receive grants or subsidies from the central government. For investment purposes, municipal associations have had a positive impact. Compared with non-member municipalities, those municipalities that are part of associations have seen their volume of initiatives with a favourable recommendation (RS from the National System of Investments) increase by 46.6%. Municipal associations also seem to positively impact local capacities.

However, the experiences of municipal associations vary greatly throughout the country and the scope of the initiative remains limited so far. Several reasons explain this. First, the main driver for municipal associations so far has been political; municipal associations result from a common political willingness to tackle issues or projects that are not necessarily high on the agenda of local priorities. Their strength often depends on personal links among local authorities, which are fragile and may disappear at each election. The lack of financial incentive may, to some extent, explain why associations have not flourished as expected.

### ***Chile should design specific incentives supporting municipal associations***

Financial incentives and non-financial incentives to encourage municipal associations are very limited in Chile. As private organisations, municipal associations depend on the willingness of their members to pay their fees, rendering associations extremely dependent on competitive funds from the central government.

In the long run, Chile could envision giving public status to associations in order to ensure their functioning and sustainability in the long term, at least for some critical services (such as waste collection and disposal) and for lagging areas.

Improving the incentive framework could also include better promoting information sharing, consulting and technical assistance, and offering specific guidelines on how to manage such collaboration. The Chilean government might also consider providing financial incentives to support horizontal associative schemes across municipalities, for example by defining specific budget lines, through the FNDR or other funding dedicated exclusively to finance municipal association projects or joint investments.

Given the strong heterogeneity of the municipal landscape in Chile, the government could also encourage associations between municipalities with different capacities. Small municipalities can greatly benefit from such arrangements, and promoting associations among municipalities with different capacities can ultimately translate into greater productive development for lagging territories.

### ***Chile still has a significant metropolitan governance gap***

The metropolitan governance gap in Chile is twofold: on the one hand, metropolitan municipalities are not especially encouraged to collaborate on metropolitan issues; on the other, urban management at the central level is highly fragmented. The sector-driven logic of the different ministries and institutions, combined with co-ordination deficiencies among them, and the lack of an urban governance framework, makes it extremely complex to achieve territorial coherence and synergies between the different policies and actors in a given urban area.

Chile is aware of the need to design a metropolitan governance framework in order to foster the more cohesive and harmonious development of metropolitan areas. However, strong political barriers have impeded the government to move forward on this. Metropolitan governance, regardless of the form it takes, implies a rebalance of power among public servants, line ministries, and elected representatives, which also slows down the implementation of such reforms. Yet, the recently approved Law on Contributions to Public Space is an important milestone towards improving the administration and management of urban spaces in Chile. Pilot projects on metropolitan management by GORE also represent an important step forward.

### ***Chile should develop flexible and adequate metropolitan governance bodies adapted to local specificities***

The urban governance model implemented in Chile should respond effectively to a heterogeneous urban landscape. Challenges faced by Santiago, a large metropolitan area, are different from those of single-municipality urban areas such as Puerto Montt. Chile could thus consider adopting a flexible (and not a “one-size-fits-all”) metropolitan governance model that responds appropriately to the structure of the different functional urban areas. Independent of its form, the effectiveness of any metropolitan institution will rely heavily on its responsibilities and how its financial and administrative resources are provided. Without decision-making authority over resources, any new authority for urban governance will encounter severe restrictions and its effectiveness will be limited. Deciding which governance model is most suitable needs to follow a bottom-up approach to limit local resistance by building legitimacy by all levels of government.

Strengthening GORE by reconsidering their role in urban and metropolitan governance, as is foreseen in the current bill on regional responsibilities, can provide a mechanism to manage the impact of institutional fragmentation, the poor alignment between resources and competences, and the low capacity of some functional urban areas comprised by a single municipality. While for certain urban areas empowering the GORE with metropolitan governance responsibilities might be an effective solution, for other urban areas the creation of a new and independent institution might be necessary.

Metropolitan areas in Chile are typically hindered by internal disparities in terms of revenue raising potential, expenditure needs and investment capacity. To attenuate disparities, a new equalisation mechanism could be developed within metropolitan areas to promote solidarity based on a new tax that

could be linked to a metropolitan competence. In the meantime, Chile could promote contractual arrangements specifically targeting metropolitan areas committed to improving their governance. City contracts can help assign clarify roles for the different institutions that participate in urban development and management over a precise territory and could help in further addressing fragmentation issues.

**Box 8. Key recommendations on strengthening strategic co-ordination within and across levels of governments**

**1. Building a coherent multi-level institutional framework**

- Manage institutional fragmentation at the national level: stronger inter-ministerial co-ordination, strengthening SUBDERE's co-ordination role, further reflecting on the assignment of responsibilities within and across levels of government. Reinforce the institutional foundation of the COMICIVYT and its decision-making authority. A crucial first step would be to improve communication about its role and scope.
- Manage institutional fragmentation at the subnational level: strengthen the role of the elected regional governor as co-ordinator of regional policies; better define the role of the future regional presidential delegate; institutionalise co-ordination instances with municipalities at the regional level through an institutionalised platform for dialogue.
- Reinforce regions (responsibilities and resources) for more efficient and stronger municipalities: stronger role of regions to better co-ordinate regional and municipal planning, and to support municipalities (technical and financial support, capacity-building) and inter-municipal co-operation, while preserving municipal autonomy.

**2. Reinforcing multi-level co-ordination and dialogue**

- Ensure co-ordination through more coherent planning instruments at regional and local levels: streamline strategic planning, strengthen and align regional and municipal development strategies, improve links between planning and budgeting.
- Integrate subnational governments into co-ordination platforms and forums (e.g. CORECIVYT) and permanent mechanisms of participation, as well as consulting associations of subnational governments at national and regional levels.
- Foster dialogue with key non-government stakeholders (companies, citizens, universities, etc.) and integrate them in the definition and execution of the municipal agenda in order to manage inter-dependencies and shared responsibilities.
- Enhance the role of municipalities in co-financing instruments, in particular by further developing the Programming Contracts (*Convenios de Programación*) as key instruments to boost co-ordination among levels of government and across government sectors.

**3. Supporting collaboration among municipalities**

- Encourage inter-municipal co-operation: give public status to municipal associations to ensure their financing and sustainability in the long run (at least for some critical services and lagging areas); develop incentives for municipal associations, either financial or non-financial.
- Improve governance of metropolitan areas through flexible pilot projects, appropriate funding and equalisation mechanisms, and contractual arrangements.

## ACKNOWLEDGEMENTS

The report was produced by the Centre for Entrepreneurship, SMEs, Local Development and Tourism of the OECD under the direction of Lamia Kamal-Chaoui. It was elaborated by a team, coordinated by Isabelle Chatry, in the Regional Development Policy Division led by Joaquim Oliveira Martins. The report was written by Isabelle Chatry, Oscar Huerta Melchor, Maria Varinia Michalun, Ana Maria Ruiz and Isidora Zapata from the OECD Secretariat. It also benefited from the support of an external international expert on local finance in the name of Jean-Michel Uhaldeborde, Emeritus professor of economics at the University of Pau and Pays de l'Adour (France).

The OECD secretariat is also grateful to France for the involvement of its peer reviewer, Ms Marie-Christine Bernard-Gélabert, Deputy Chief of Staff at the Cabinet of the Ministry of Spatial Planning, rurality and local governments at the time of the study mission.

Valuable comments and inputs on the report were received from Dorothée Allain-Dupré, Chris Mac Donald and Karen Maguire from the OECD Regional Development Policy Division (RDP) as well as from Diana Figueroa Toledo and Paulo Santiago from the OECD Education Directorate. The team is also grateful to Claire Charbit from the RDP for her support during the first phase of the project, to Eric Gonnard, from the RDP Statistical Unit, for his valuable help in preparing maps and graphs as well as to Noëlle Bru, Senior Lecturer in statistics at the University of Pau and Pays de l'Adour for her technical support in data processing.

The OECD would like to thank the Chilean authorities at both national and subnational level for their co-operation and support during the study process. Special thanks are given to the Sub-secretariat for Regional and Administrative Development (SUBDERE), in particular to Ricardo Cifuentes Lillo, Sub-Secretary of SUBDERE, Nemesio Arancibia Torres, Director of the Division of Municipalities, Viviana Betancourt, Director of the Division of Regional Development, Rodrigo Suazo Chávez and Gastón Collao Tapia, Head of the Municipal Finance Department and coordinator of the local team, which also includes Marcelo Catoni Contreras and Ruth Novoa Figueroa.

The OECD is also grateful to the people within SUBDERE for responding to the OECD questionnaire, commenting on the report and participating in the various meetings which took place during the two missions of the OECD team in Chile. The OECD also thanks the other ministries that offered their comments on the report, in particular the Ministry General Secretariat of Government and the Budget Directorate (DIPRES) of the Ministry of Finance.

Special mention is given to Mr. Felipe Delpin Aguilar, Mayor of La Granja Municipality and President of the Chilean Association of Municipalities, who accompanied the Director of the Division of Municipalities to Paris to present the main findings and recommendations of the study to the Regional Development Policy Committee.

The Secretariat is also thankful to Ms Claudia Serrano, Ambassador of Chile to the OECD as well as Ms Consuelo Herrera, legal counsellor at the Permanent Mission of Chile to the OECD for their support, comments and guidance throughout the project.

The OECD extends warm thanks to the more than 170 stakeholders from central ministries and agencies at national and territorial levels and from regional and municipal governments, associations of municipalities, academia and civil society organisations met during the two missions organised in July 2016 (regions of Metropolitan Santiago and Valparaíso) and December 2016 (regions of Bio Bio and Los Lagos, including the municipalities of Concepción, Puerto Montt, Quillota and Calbuco).

The report was approved by Delegates of the RDPC in May 2017.

Finally, the team is thankful to the RDP administrative team for the support in organising missions, to Pilar Philip and Joanne Dundon who provided guidance to prepare the publication, Andrew Brenner who translated several parts of the report as well as providing editorial support (English version), Ernesto Vásquez Escribar and Erin Walton who translated the main findings & recommendations into Spanish and, finally, Elizabeth Zachary and Jennifer Allain who prepared the manuscript for publication.



**This document summarises the key findings and recommendations of the publication OECD(2017), "Making decentralisation work in Chile: Towards stronger municipalities" (forthcoming).**