1. **Key development issues and rationale for Bank involvement**

*Filling the Infrastructure Investment Gap:*  
In the early 1990’s, the Government of Chile took stock of its infrastructure needs and estimated its infrastructure deficit at US$11 billion with additional losses due to lack of competitiveness of US$1.7 billion annually.¹ In determining how to respond to this need for massive investments and significant improvements in service delivery, the Government also recognized that the public sector did not have the resources to carry out the major works required, nor could it commit its budgetary resources exclusively to infrastructure investments given the country’s social investment needs.

To face this challenge, the Government first called on the private sector to take part in the building, maintenance and operation of major road works. Thus, the Chilean Concessions System was born, allowing the private sector to finance economically profitable projects and recover their investment primarily through direct charges to users. In the years since its inception, the concession program has expanded both in terms of sectors and design. Sectorally, Chile now has what may be the world’s most extensive concession program encompassing roads, ports, railroads, bridges, tunnels, reservoirs and canals. In addition, the current list of projects to be concessioned includes hospitals, jails and even public plazas and sports stadiums. Structurally, Chile’s concession designs now includes bidding under least cost variables, least net present values and lowest cost subsidy requirements.

As the diagram below illustrates, Chile’s overall investment portfolio has risen from about 450 million pesos in 1995 to over 1 billion pesos in 2005 in real terms. More strikingly, the share of private sector participation in those yearly investment levels has risen from 9 percent to 65 percent over the course of the last decade.

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¹ See: Concesioneschile.com
The net result of these efforts—in tandem with electricity sector unbundling, telecommunications liberalization and municipal water and sanitation privatizations—has been a level of investment in infrastructure far beyond that of any other country in Latin America. At between 5 and 7 percent of GDP per year, Chile’s infrastructure investment levels are similar to the expenditure levels of East Asia’s higher performing economies such as China and Thailand. Partially as a result of the infrastructure investment commitment, Chile’s growth levels over the last 15 years have also paralleled those of East Asia.

Given that most of that expenditure has come from the private sector, the overall assessment of Chile’s concession program is generally positive. There is widespread agreement that a substantial part of the infrastructure deficit would not have been reduced over the past decade, concomitantly with the strengthening of public finances, without these public-private partnerships.

Improving a Strong Performer:
Even though public-private partnerships (PPPs) generally, and concessions in particular, have contributed to closing Chile’s infrastructure deficit, many economic analysts as well as the current Government believe that Chile’s leveraging of the private sector can be further improved as can the use of public resources for works projects. Concerns about bias and inefficiency in concession design and oversight have recently risen to the surface despite the outside world’s positive assessment of Chile’s concession program. In particular, the growing frequency and size of concession renegotiations through “complementary agreements” is attracting increasing coverage in the Chilean news media. These renegotiations are typically triggered by Government but result in unregulated or under-regulated works contracts, unknown profits captured by concessionaires and additional contingent liabilities for the Government generated by traffic or revenue guarantees.

From the new administration’s perspective, the focus of intervention should be in the areas of transparency and accountability in the concession process, more balanced risk-sharing arrangements and greater regulatory oversight of the private sector in terms of both quality of service and financial returns. On public works, the administration’s primary concerns revolve around the lack of planning, ineffectual project management and the subsequent inefficient use of public resources.

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2 See, for example: “Strengthening Regulation in Chile: The Case of Network Industries,” Alexander Galetovic and Luz de Mello, OECD, October 27, 2005
These interventions naturally fall to the Ministry of Public Works (MOP) as it is the primary agency responsible for planning, developing and constructing public infrastructure in support of the economic and social development of the country. At the same time, the MOP is in charge of the maintenance, operation and administration of these public works as well as the regulation of all concessions.

**Specific Shortcomings at the Ministry of Public Works:**

The MOP has identified specific constraints to its operating procedures and institutional structure that it believes will need to be addressed in order for Chile to reach a new level of efficiency and accountability in infrastructure investment and operations. According to the senior staff of the Ministry, those challenges include:

- Confusion in the roles and mechanisms of decision in the planning, management, oversight and regulation of roads, ports, airports and water resources.
- Lack of long-term planning with an integrated geographic perspective oriented to the competitiveness of Chile’s productive sectors.
- Low level of interaction with other relevant stakeholders in infrastructure sector.
- Works that are contract-driven rather than integrated along a supply chain, leading to coordination problems and inefficient expenditures.
- Lack of explicit commitments to service levels for either concessions or public works.
- Absence of ex-post evaluation and of integrated risk management.
- Insufficient management and financial information systems to support any of the needed reforms in planning, management or regulation.
- Lack of societal or consumer voice in the design of contracts or regulation of services.
- Incomplete projects and contracts that provoke claims and increase costs.

**Role of the World Bank:**

In order to address these shortcomings, improve the use of public resources, increase efficiency of private sector participation, and strengthen regulation, the MOP has initiated an institutional strengthening program. The Government of Chile wishes this initiative to be supported by a Technical Assistant Loan (TAL) and Development Policy Loan (DPL) with the World Bank. As described in Sections 2 and 3, the linked loans focus on strategic interventions that are common to the Bank’s infrastructure and private sector lending and technical assistance throughout the developing world. Integrated planning, rational project management, appropriate public-private contract design, and regulatory structures that protect both consumers and investors are areas of core competence for the Bank.

By supporting the implementation of the plan, the TAL and DPL are in line with the goals and strategic approach set out in the 2002 Country Assistance Strategy (CAS) that focuses on sustaining economic growth and social progress, fostering inclusion, and modernizing the state through capacity building. The current CAS aims to support programs and activities which deepen and sustain Chile’s efforts at poverty reduction with a mix of technical and financial support. The proposed program epitomizes such a mixture. This project will be developed in parallel with the new CAS so as to maintain consistency of priorities and approach in the context of the new program for Bank support to Chile.

Although it does not require the financial resources of the World Bank per se, the Government of Chile has requested the Bank’s involvement in this initiative in order to leverage the Bank’s experience in the design of public-private contracts, regulatory frameworks, transport and logistics planning and institutional reform, including information systems and communications strategies. In addition, the Bank offers a comparative advantage in its ability to draw upon global knowledge, sustain a policy dialogue, and exploit synergies with other operations and past experiences including, but not limited to the Rural Territorial Development Project and Trans-Santiago Urban Transport Project.
The estimated project cost will be about US$5.5 million for the TAL and US$30 million for the related DPL, all of which would be funded by IBRD. A Project Preparation Facility of US$1.0 million has been requested by the Ministers of Finance and Public Works.
2. Proposed objective(s)

The purpose of the Technical Assistance Loan and the related Development Policy Loan is to support the process of institutional strengthening taking place at the MOP. The objectives will include improving planning, implementation, management and regulation of concessioned infrastructure projects as well as road maintenance and public works contracts.

The long-term expected project outcomes will be:

- More efficient use of public resources in the area of infrastructure investment;
- Higher level of efficiency returned to consumers and society at large in infrastructure services that are concessioned;
- Strengthening of regulation and of oversight arrangements to increase transparency and citizen participation; and
- More regionally equitable commitment of resources for development as a result of the inclusion of regional perspective in project planning.

During the course of supervision of the project, the task team will work with MOP to establish a methodology for the long-term measurement of improvements in the above outcomes. That impact analysis will be responsibility of the MOP and will form a basis of the new levels of accountability being sought by the current administration.

3. Preliminary description

After extensive discussions among the Bank team, the Ministry of Finance and the Ministry of Public Works, it has been agreed that the Bank’s assistance should come through a dual program of a Technical Assistance Loan and a Development Policy Loan. While the TAL will provide funding and Bank supervisory for the necessary consultancy, capacity building and training, the major expected outputs of that technical assistance will define the DPL. In order for the triggers of the DPL to provide real incentives for the delivery of the TAL, the Ministry of Finance is now in discussions with the MOP to identify linkages between the two loans. The two Ministries are preparing intra-ministerial agreements about the linkages and are exploring the possibility of Hacienda withholding MOP budget in line with the value of the expected DPL. Resources would in this way be transferred to MOP upon successful completion of the TAL tasks identified as DPL triggers.

**Development Policy Loan (DPL)**

The DPL under discussion with the Government of Chile would derive its triggers from the Task Objectives listed above under: Planning, Contract Design, Regulation, Project Management and, interconnectedly, Institutional Strengthening. The primary expected outcomes from each of the pillars of reform will translate into the triggers of a proposed *Development Policy Loan* (DPL). Realization of the triggers would result in the release of the resources assigned to each tranche which would, in turn, affect the resources made available from Hacienda to the Ministry of Public Works.

Triggers that are in discussion with the Ministries of Finance and Public Works are presented below in chronological order of when they are likely to be achieved. Phase 1 achievements are likely to occur over the next one to 2 years. Phase 2 achievements will require 2 to 4 years.

**Planning:**
- Implementation of new methodology for integrated territorial planning (Phase 2)

**Contract Parameter Design (Concessions and Public Works/Road Contracts):**
- Presentation of the amended Concession Law (Phase 1)
Determination of the quality of service parameters being utilized in contract or concession design in each area of infrastructure (Phase 2)

Analysis of public bidding documents for the pilot contracts for multi-annual performance-based road maintenance. (Phase 2)

Project Management:

Naming of project managers with responsibility for the life cycle of the Ministry’s largest and highest impact projects. (Phase 1)

Fully reorganization according to project lifecycle management processes (Phase 2)

Regulation/Oversight (Fiscalización):

Presentation to Congress of the new Regulatory Law (Ley de Fiscalización) (Phase 1)

Creation of the new Regulatory entity (Phase 1)

Definition of all new quality of service standards for the design, oversight and regulation of contracts and concessions. (Phase 1)

Utilization by the Superintendencia of the information management system to access data on concessionaires’ performance against contractual financial and quality of service targets. (Phase 2)

Institutional Strengthening:

Implementation of the integrated information system. (Phase 2)

Technical Assistance Loan (TAL)

The TAL will be used to support the achievement of each of the DPL’s triggers. It will comprise a series of technical consultancies, capacity building initiatives, training programs, and information development tasks as described below.

### Technical Assistance Loan

<table>
<thead>
<tr>
<th>Component</th>
<th>Tasks</th>
<th>Period of Execution</th>
<th>Indicative Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Planning</td>
<td>Integration of the information from the National Innovation and Competitiveness Council into the logistical analysis of “key clusters” and their bottlenecks to productivity and market access.</td>
<td>Years 1 to 3</td>
<td>US$1.0million</td>
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<td>Implementation of planning systems, including: database of, manual of procedures</td>
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<td></td>
<td>Training in and adoption of ex-post evaluation methodology in order to reduce complementary works requirements and for project delays</td>
<td>Years 2 and 3</td>
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<td></td>
<td>Regional capacity building for ex-post evaluation</td>
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<tr>
<td>Contract Parameters: Design and Concessions and Road Performance-Based Contracts</td>
<td>Study of the market of service providers, developers and concessionaires their capacity to bid and offer services by type and size of contract and the potential impact on competition as derived form the size of the contract.</td>
<td>First Year</td>
<td>US$1.0million</td>
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<td>Design of the standard contract model to be utilized for road maintenance and rehabilitation long-term contracts</td>
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<td></td>
<td>Implementation of long term contracts</td>
<td>Years 1 to 3</td>
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<td></td>
<td>Study of the budgetary impact of moving from short-term contracts to multi-annual contracts.</td>
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<td>Training of staff for pilot projects.</td>
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<tr>
<td>Institutional Strengthening and Regulation of Concessions and Public Works</td>
<td>Design of the new agency and its internal rules and regulations and implementation</td>
<td>Years 1 to 3</td>
<td>US$2.5million</td>
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<td></td>
<td>Capacity building and training</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Implementation of information systems</td>
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<td></td>
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<tr>
<td>Project Management</td>
<td>Human resource review to evaluate the capacity of current managers and technical staff to work across lifecycle of projects.</td>
<td>First 2 Years</td>
<td>US$1.0million</td>
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<td></td>
<td>Training in the use of management tools derived by private sector and OECD best practice agencies for lifecycle management.</td>
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</table>
4. Environment Aspects
DPL funds will not support the design or implementation of infrastructure investments. However, and given the types of infrastructure under MOP’s mandate, project preparation activities will include the analysis of potential environmental and social effects of the proposed reforms as well as the mechanisms in place to handle them or the measures to strengthen institutional capacities to deal with them.

5. Tentative financing
Source: ($m.)
BORROWER 0
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT 30
Total 30

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