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**Regional Development and the Action of Public Investment:  
The FNDR and the ERDF, a Comparative Analysis**

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<sup>Ω</sup> Martín Alonso Urrea Barros was born in January 25, 2002, healthy and pretty

## Abstract

Regional economic growth and development is triggered by a combination of many factors such as public sector intervention, national and regional policies, and private sector investments.

Regional development funds, through the application of pertinent objectives, focusing, participation, and co-ordination can certainly make an important contribution on regional development.

In Chile one of the main public sector policy instruments for regional development are the Regional Investment Funds. The role of these funds in the economic and social development of regions in difficulty or whose development is lagging has significantly increased in recent years.

The country has had a regional development fund, the “Fondo Nacional de Desarrollo Regional” (FNDR) since the mid-1970s. This fund, modest in its beginning, was significantly increased starting in 1985 due to loans from the Inter American Development Bank. The FNDR has played an important role providing basic social infrastructure in regions.

However, despite the increasing amount of resources channelled to regions, twenty five-years of existence of the FNDR, and almost a decade since establishment of Regional Governments in Chile, few improvements can be recorded in the way the Regional Funds are being used or on their overall effect on regional development.

The main purpose of the study is to analyse the action of the regional development fund of Chile (the FNDR) and its relationship with the overall objective of regional development.

Two different empirical approaches evaluated specific effects of the FNDR. The first was concerned with the analysis of particular aspects of the fund labelled as the “key elements” in the running of the FNDR. The second presents and compares the

experience of a similar fund for regional development. The fund selected to carry out this comparison was the European Regional Development Fund (ERDF).

The specific questions to the 'key elements' address three different aspects of the existence and performance of the fund: questions 1 and 2 deal with the very existence or the overall aim of the fund; questions 3 and 4, with the way the fund is being allocated and used; and, question 5 is rather different as it tries to explore the possibility of finding other potentials for regional development, not exploited as such, due to the dominance and statutory primacy of the fund.

The analysis of the 'key elements' unveiled important features about operational aspects of the fund. It also set out the role the fund may play in regional development in terms of contemporary growth theory and policy making.

This study then compares these key aspects of the FNDR with those of the European Regional Development Fund (ERDF). The critical analysis of these features of the FNDR together with the comparison with those of the ERDF constitute the results of this study from which the conclusions and recommendations are drawn.

# Regional Development and the Action of Public Investment: The FNDR and the ERDF, a Comparative Analysis

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## Chapter 1

# Research Aim

### Introduction

Economic restructuring, state intervention and accelerated global changes are giving greater prominence to the nature and performance of local and regional economies. Regional economic growth and development is triggered by a combination of many factors, such as public sector intervention, through national and regional policies, and public and private sector investments.

In Chile one of the main public sector policy instruments for regional development are the Regional Investment Funds. The role of regional funds in the economic and social development of regions in difficulty or whose development is lagging has been widely recognised (Holtz-Eakin and A. E. Schawartz, 1995, the European Commission, 2001). Regional Funds, through the application of pertinent objectives, focusing, participation, co-ordination and suitable approaches to face local problems certainly may make an important contribution in this direction.

Chile has had a regional investment fund, the “Fondo Nacional de Desarrollo Regional” (FNDR) [regional development fund] since the mid-1970s. This fund, modest in its beginning, was significantly increased starting in 1985, due to loans from the Inter American Development Bank (IDB). Since then, the FNDR has played an important role providing basic social infrastructure in regions.

The creation of Regional Governments, in 1993, was supposed to have a significant impact in the way these funds were being used and allocated into and within regions. A presidential mandate in the mid-1990s established that regional investment funds were to double by the end of the decade. The FNDR thus came to be viewed as a powerful instrument for intervening in the regions’ economic and social performance.

Despite the increasing amount of resources channelled to regions, twenty five-years of existence of the FNDR, and almost a decade since establishment of Regional

Governments in Chile, few improvements can be recorded in the way the Regional Funds are being used or on their overall effect on regional development.

The expertise gained by the public institutions involved in FNDR administration and the resulting social infrastructure of the fund's action are said to be the main assets of the FNDR after twenty-five years of operation.

The starting point for this thesis is the question of whether the fund has managed to address many of the problems for which it was actually designed. Answering this question requires consideration of the way in which the different parts of the fund are being allocated, the nature of the objectives set and the kind of actions and projects financed by the FNDR.

## 1 Research question and objectives

### Purpose

The main purpose of the study is to analyse the action of the regional development fund of Chile (FNDR) and its relationship with the overall objective of regional development. For comparison, the FNDR is evaluated with reference to the European Regional Development Fund (ERDF).

### Specific objectives

The specific objectives of the study are presented as five questions. These questions address three different aspects of the existence of the fund: questions 1 and 2 deal with the very existence or the overall aim of the fund; questions 3 and 4, with the way the fund is being allocated and used; and, question 5 is rather different as it tries to explore the possibility of finding other potentials for regional development, not exploited as such, due to the dominance and statutory primacy of the fund.

Question 1: *What is the overall aim or concept underpinning the operation of the FNDR and how has this concept evolved during its twenty-five years of existence?* This sets the

context under which the fund was created and its adaptability to the new social and economic realities undergone in the country.

Question 2: *What are the objectives of the FNDR and how they are linked with regional development?* An analysis and critical discussion of the specific objectives of the FNDR and the way the fund has actually been used to stimulate regional development.

Question 3: *Do the methods of allocation of FNDR funds all serve the specific objectives set up for the fund?* This question explores the different methods, variables and indicators employed for the allocation of the various parts of the fund to the regions of Chile. These results will be then compared with the specific objectives of the fund.

Question 4: *What are the types of action and the sectors of investment financed by the FNDR?* A detailed account of the type of action and sectors (Education, Health, Roads, etc) financed by the FNDR. It also discusses their relevance for regional development.

Question 5: *What kind of actions, beyond the mere physical investment, are being pursued by the FNDR that may contribute to regional development?* This question examines whether unanticipated actions and results of FNDR action leverage investment and builds institutional and social capacity.

This study compares these key aspects of the FNDR with those of the European Regional Development Fund (ERDF). The critical analysis of these features of the FNDR together with the comparison with those of the ERDF constitute the results of this study from which the conclusions are drawn.

The rationale of the thesis is that despite the significant contribution of the fund in the provision of social infrastructure in regions, the FNDR action appears to be very limited and of low impact on regional development. This view is shared by the results of three studies that have analysed the performance of the fund in recent years. Evidence of the differentiated performance of region on the variation of social indicators during the last ten years is also used to sustain this argument.

## 2 Main contents and methodology

The thesis has been structured in 8 chapters, exclusive of the bibliography and the appendixes. The main contents of each chapter and the specific aspects of its methodology, when it corresponds, are presented below.

\* Chapter 1, *Introduction*, presents the rationale, purpose of the study and the specific objectives, as well as a summary of the main contents and the methodology used in each case.

\* Chapter 2, *Economic Growth and Development: Global and Regional Scale*, corresponds to the presentation of the main theoretical approaches used in this study. This section also provides the definitions for the principal concepts relevant to the thesis such as those of development, economic growth, region, decentralisation, public infrastructure, and others that set the basis for the discussion of the following sections.

\* Chapter 3, *Chile's Regional Development Experience*, gives account of the experience in regional development in Chile with emphasis in three aspects: firstly, the process of decentralisation in the country since its origin and manifestations in recent years; secondly, it describes the newly created institution of 'Regional Governments' in Chile, its main tasks and importance for the development of regions; thirdly, it provides a summary of Chile's recent economic evolution, problems and achievements. The chapter ends with a presentation of the economic and social disparities that exist among regions.

Section 4 of this chapter introduces the concept of "winner" and "loser" regions that is used to group territorial units that have performed well or badly under Chile's present strategy of development. Regions grouped under the different categories do not necessarily present geographical continuity.

Economic and social indicators are used to group regions under 3 categories depending on whether they performed above or below the average in one, two or more indicators. The resulting grouping of regions under each of these categories, economic or social,

was then combined to produce a final grouping of regions that permitted to conclude whether they belonged to the winner or loser regions of the current strategy of development of the country. The results of this analysis are later correlated to the allocation of FNDR funds (chapter 5).

\* Chapter 4, *The Regional Development Fund of Chile (FNDR)*, concentrates in the FNDR fund, the subject matter of this research. The first part of the chapter provides a general description of the fund. There follows a detailed account of the fund's purpose, its objectives, areas of action, budgetary procedures, and method of allocation of resources. This presentation illustrates the fund's main aim, its importance within the total Chilean's public investment as well as its importance for particular regions.

The second part introduces three recent studies about the performance of the FNDR. These studies are critically analysed and some of their findings are later used to reinforce some of this research's own arguments. Each of the studies is presented in terms of its main purpose, main contents, methodology used and conclusions.

\* Chapter 5, *Key elements of a well/badly working system: The action of the FNDR*, deals with the five questions that lead the research. These five questions refer to: the concept of the FNDR, the specific objectives of the fund, the method of allocation of resources, the type of action and sectors of investment, and the poor utilisation of the fund's existence to stimulate other actions for regional development. These five aspects of the fund, it is argued, are not functioning well for the overall performance of the FNDR.

This chapter discusses whether the five aspects of the FNDR are functioning appropriately given the objectives of the fund. Data used for this purpose came basically from three sources: a) official publications and studies about de FNDR, b) the methodologies used for allocation of the different FNDR parts<sup>1</sup>, and c) first hand information from interviews conducted in Chile with relevant informers.

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<sup>1</sup> The FNDR is not just one fund, but includes several parts that will be described in chapter 4.

In February 2000 a three weeks fieldwork was conducted in Chile. This consisted of interviews with public officials in charge of the different areas of the administration of the fund, both at the national and regional level. The instrument was a semi-structured interview whose main purpose was to find out the view of these key informers about three particular aspects of the operation of the fund. These aspects were: a) the overall concept and specific objectives of the fund, and to what extent they thought these objectives had changed through time; b) the rationale of the methods of allocation of funds face to face with the specific objectives currently in operation; c) the relationship, in their view, between the actual action of the FNDR and regional development in Chile.

The concept of the FNDR (or the overall objective of the fund) and the type of action and sectors of investment are also tested against theoretical arguments about what should be appropriate/rational for public funds designed for regional development.

During the correction period of the thesis (November 2001-April 2002) a second set of interviews were applied to number of key informers (politicians and public servants) in Santiago and the Biobío Region. This time, to find out about the expected changes that the concept and specific objectives of the FNDR might had suffered, in their view, when transiting from a dictatorship government (1970s and 1980s) to a democratic regime.

The instrument for gathering information was a semi-structured questionnaire that included 3 parts and 8 questions in total. The first part was designed to identify the interviewed and his/her relationship with the FNDR by the period 1989/1990. The second part asked for the role that these key informers saw for the FNDR under a democratic government (in different aspects such as the role of the fund in the process of decentralisation, the type of investment to finance, etc). The last part was one open question to give the opportunity to informers to refer to other aspects no considered in the previous section.

The specific objectives and the method of allocation of resources (section 2 and 3 of this chapter) are tested in term of their congruence with each other. This correlates the actual allocation of funds to the regions (FNDR per capita) with the regional indicators of

poverty and income distribution. The resulting tables identify the most and the least favoured regions with respect to these indicators. The results of this information is presented and discussed in the first two sections of chapter 5.

\* Chapter 6, *The European Regional Development Fund (ERDF)*. After analysing in detail the five aspects identified as the key elements for the functioning of the FNDR, this chapter presents the 'reference fund' that will be used for comparison with the FNDR of Chile. The fund selected is the European Regional Development Fund (ERDF). Although the ERDF and the FNDR differ greatly in terms of their magnitude (territories they cover and amount of resources involved) and scope (number and quality of actions with respect to their objectives), both funds, set up more or less at the same time, by the mid-1970s, present significant differences and similarities that are worth exploring.

This section begins with an introduction to the European Union's institutions and the main aspects of regional policy in the Union, followed with the presentation of the Structural Funds, and within them, the ERDF, the main component of the Structural Funds. Finally, it presents the ERDF's main and specific objectives, its tasks, method of allocation of funds, and the type of action and areas of investment as well as the main aspects of its administrative procedures.

ERDF analysis relies mainly on official documentation, although some analytical studies on the fund's functioning have been used for a critical view on the performance of the fund. Structural Funds' regulations, data on the amount of resources allocated to objectives and countries and the periodic evaluations carried out by the Commission were also used.

\* Chapter 7, *Main Similarities and Differences between the FNDR and the ERDF*, is one of the main outcomes of this study. It presents and discusses the main similarities and differences highlighted by the comparison between the two funds. This section introduces a two-column table for presenting the characteristic elements of each fund that account for the five aspects selected for comparison. This two-column feature provides a rapid and clear visualisation of these similarities and differences. The graphic presentation is followed by a discussion of the causes that may explain these similarities

and differences and their relevance for the functioning of the fund and its capability to achieve the stated objectives.

Particular examples are used to further develop some of the main points of discussion, i.e. the case of the Regional Development Fund of Spain (FCI), the Electric Projects and the Programming Documents in the case of Chile, and the management of budgetary procedures in the case of the Scottish Executive.

\* Chapter 8, *Conclusions and Considerations for Further Research*. This chapter presents some conclusions and considerations for further research. Conclusions are basically drawn up from chapter 5, the analysis of the functioning of the key elements of the FNDR, and from chapter 7, the comparison between the FNDR and the ERDF.

### 3 Final remarks

#### Opportunity of the study

\* The study took place from 1998 to 2001. In the year 2000 a new programming period began for the Structural Funds. The transit from one period to another implied a structural reform of the ERDF, which provided valuable information with respect to the evaluation of the final programming period as well as a great deal of discussion on the theoretical and practical aspects of regional planning and public policy in Europe.

\* The year 2000 was also the beginning of another programming period for the FNDR fund. This new programme' features were not included in this study, but a summary of its main contents are presented in [Appendix 4](#). As it will be seen in this appendix, and contrary to what happened in the case of the ERDF, no major transformations were introduced to the FNDR in this opportunity. As it will be shown, the fund will basically continue to operate in the same way and it will be financing the same kind of projects as in previous periods.

## Limitations

\* Several limitations are imposed by the availability and opportunity of data. There is a lack on information regarding the FNDR. Few studies have analysed critically the functioning and performance of the fund. No systematic data about the fund is produced by any of the instances that have the responsibility for its administration. The most recent data available are figures of 1998 for the allocation of FNDR funds.

\* Although the way the FNDR fund is being allocated within regions may be very important for the analysis of the way the fund actually impacts local development, this study concentrated mainly on the regional scale. The reason for this is that information for the local level simply does not exist and therefore would have to be generated.

\* This study concentrated mainly in the processes rather than in the products. Therefore, whenever opinions or conclusions are drawn at this respect, they have to be considered suggestive rather than conclusive.

## Chapter 2

# Economic Growth and Development

### Introduction

This chapter presents and discusses on the main theoretical concepts and theories associated with economic growth and regional development. Theory plays a fundamental role providing the basic framework for understanding the concept of growth and development in their many dimensions. Theory underpins the concept of the region.

The chapter has five parts. The first part introduces the linked concept of economic growth, development, and regional development. This part defines the main concepts to be used in this work and explores different theories of development and regional development with emphasis on the most recent explanation of the so called 'new growth theory'. This focus acknowledges increasing interest among theorists to apply this analysis to explain current regional divergence throughout the industrialised and developing world.

Development, for the purpose of this work, has to be understood not only as economic development but also as incorporating its social and cultural dimensions. Thus, whenever utilised from now on in its two variations i.e. national development (or development) and regional development, the concepts of development should be understood as including these other dimensions. The way these concepts have been defined and utilised in the literature is extensively presented in this chapter.

As the main concern of this work have to do with 'development' within the 'regional' context, the first part also discusses on the main definitions of 'regional theory and development'.

Part 2 of the chapter discusses about the concept of 'region', and about the types of regions which this work deals with..

Because of its special importance for the case of regional development in Chile's recent history, the third part of this chapter discusses the concept of 'decentralisation' and its influence on the country's present administrative structure and strategy of development. The historical evolution that the concept has experienced in Chile as well as the most recent steps toward decentralisation taken by the Chilean Government are presented.

The fourth part of this chapter is devoted to the role of infrastructure investment in economic growth. As infrastructure represents, and it will continue to do so, the principal component of the regional funds in Chile, this part concentrates on the discussion of the role that public infrastructure investment may have on the regions economic growth and development.

Finally, part fifth, Conclusions, is devoted to link the concepts of economic growth, regional theory, decentralisation and public infrastructure investment to provide a theoretical framework for analysing the role regional funds may play in regional development.

## 1 Economic growth and development: Global and Regional scale

*"Throughout the industrialised world, widespread economic restructuring, rapid technological change, the configuration of State intervention, and increasing globalisation are giving greater prominence to the nature and performance of individual and local economies within nations. The old patterns and processes of regional development that characterised the post-war period are being fundamentally redrawn, creating new problems of uneven development and new theoretical and policy changes. What ever interpretation of this contemporary transformation is adopted, regions and localities are back on the academic and political agenda"* (Forewords of the Regional Policy and Development Series of the Regional Studies Association. London, 1997).

Economic and social development issues are not unique to the "industrialised world". The significant problems of economic growth, resource allocation, investment co-ordination and the effects that the driving forces of democratisation and decentralisation may have on local development have put the 'regional question' on the agenda of many developing nations.

Many authors have studied how economic growth and development occur and how it spreads through space. The earliest works of Von Thunen and Weber in the 1800s, and afterward, during the 1930s and 1940s, the studies of Christaller (1933) and Losch (1940); and during the 1950s and 1960s, Perroux (1954), North (1955), Hirshman (1958), Isard (1956), Myrdal (1957), Friedmann (1966), Siebert (1969) among others, and most recently, the works of Lisk (1983), Sala-i-Martin (1994), Barro (1995), Rodriguez-Pose (1998), Todaro (1989 and 2000).

Theories of economic growth have focused in both the national and the regional level. Theories of growth at a national scale have not paid much attention to the differences generated among different regions within a country. Regional level theories, on the contrary, have emphasised the economic and social differences generated among the different territorial units of a country and in particular have concentrated on regions lagging behind.

### 1.1 Economic growth and development: the global scale

Concepts definition: development, development economics and economic growth

In order to understand the difference between the concepts of traditional economics and development economics it is worth looking at the analysis of Todaro (2000). He argues that “‘traditional economic’<sup>2</sup> is concerned primarily with the efficient, least-cost allocation of scarce productive resources and with the optimal growth of these resources over time so as to produce and over-expanding range of goods and services”. ‘Development economics’, continues Todaro “has a greater scope. In addition to being concerned with the efficient allocation of existing scarce (or idle) productive resources and with their sustained growth over time, it must also deal with the economic, social, political, and institutional mechanisms, both public and private, necessary to bring about rapid (at least by historical standards) and large scale improvements in levels of living for the masses of poverty-stricken, malnourished and illiterate people of Africa, Asia, and Latin America” (p. 8).

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<sup>2</sup> Todaro makes clear that by ‘traditional economics’ he means the classical and neo-classical economics taught in mostly American and British literature.

‘Development economics’, according to Todaro, had nothing to do with the economies of European countries or other ‘developed’ countries, with their industrial areas in decline, with their deprived urban centres or their malfunctioning rural systems. Although incomplete, Todaro’s definition includes, along with the economic, the social, political and institutional dimensions of development.

Glasson (1978) points out that, no matter the kind of development, this always involves implicit and explicit value judgements about the direction and speed of change. Although economic factors are of fundamental importance, development is much more than economic development or economic growth.

This author argues that development can be seen as a multi-dimensional process, including, in addition to the economic development process, social development processes concerned with the distributive aspects of development; and political-administrative development processes concerned with the shift in the influence and power of groups and individuals. All the processes are complexly interrelated and interdependent.

Glasson also mentions the political-administrative development processes related to the shift in the influence and power of groups. These will be more extensively covered when analysing the motion force of ‘decentralisation’ later in this chapter, as one of the main reasons for the definition of regions and regional development in Chile.

Economic growth, on the other hand, is an essential component of economic development, although not the only component. According to Gupta (1983), certain elements play a pivotal role in the growth process. Gupta takes growth as the rising of the standard of living for the average family, that is, raising their per capita income. He suggests that considerable confusion has been caused by mixing up ‘growth theory’ and ‘planning theory’. He claims that what we have become accustomed to call national ‘development plans’ are in truth, little more than co-ordination and budget exercises.

### 1.1.1 Theories of economic development and growth

Two ways of understanding economic growth, suggests Gupta, were developed separately by Rostow and Schumpeter<sup>3</sup>: First, the work of Rostow “contained an implied suggestion that once an economy reached a certain minimum level of saving and investment, it would be ready for take-off into self-sustained growth. The widely accepted Harrod-Domar model of growth places capital formation at the centre of the stage. The strength of this belief is evident from the fact that policy measures in most developing countries are even today concentrated on raising the rates of saving and investment. An associated belief that growth was brought about by industrialisation. This belief arose from the oft-cited fact that all the developed countries were also the industrialised ones...” (Gupta, 1983 p. 2).

The five stages of growth, that according to Rostow (1990) it is possible to identify in all societies, are:

- a) The traditional society. This is one whose structure is developed within limited production functions, based on pre-Newtonian science and technology, and on pre-Newtonian attitudes towards the physical world;
- b) The precondition to take-off. This refers to societies in the process of transition. This is the period when the preconditions for take-off are developed;
- c) The take-off. This is the interval when the old blocks and resistances to steady growth are finally overcome. The forces making for economic progress expand and come to dominate the society;
- d) The drive to maturity. This is the long interval that follows the take-off period. It corresponds to a long interval of sustained although fluctuating progress, as the now regularly growing economy drives to extend modern technology over the whole front of its economic activity;
- e) The age of high mass-consumption. In this, the leading sectors shift toward durable consumers' goods and services. According to Rostow, this is “a phase from which Americans are beginning to emerge; whose not unequivocal joys Western Europe and Japan are beginning energetically to

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<sup>3</sup> See Gupta, 1983 for Rostow and Schumpeter references.

probe; and with which Soviet society is engaged in an uneasy flirtation” (Rostow, 1990 p. 10).

Based on what has been known as the “sector theory” and the “development-stages theory”, and the subsequent critic on these theories, Parr (1999) proposes a modified version of the development-states theory called the “export-stages framework”.

The framework is based on two propositions. The first states that “regional development over the long run is primarily dependent on the growth of the region’s export base”, the second that “if the export base of a region undergoes a structural change, it is likely to do so in a systematic (and thus predictable) manner, involving a well-defined sequence of stages” (p. 98). Parr argues that in the resulting framework, development is viewed as resulting largely from growth of the export base. He emphasises that over the long run the export base may well undergo a major structural change.

Conversely, Schumpeter, “associated the process of development neither with capital accumulation nor with industrialisation but with ‘doing things better’ or technical progress. Lately, this has gained a reluctant recognition among economists in the form of the ‘residual factor’ in growth”. The so called ‘residual factor’ has to do with the proportion of growth rate that remains unexplained by the additions to productive resources of capital and labour.

Back in the 1960s, Friedmann<sup>4</sup> argued that there were four states of development:

- a) pre-industrial;
- b) transitional;
- c) industrial; and,
- d) post-industrial.

According to Friedmann (1966), in pre-industrial societies, such as Bolivia and Afghanistan, the policy emphasis was on the creation of preconditions for economic ‘take-off’ and regional policy was inappropriate. In transitional societies, such as Venezuela and Brazil, there was a need to create a spatial framework suitable for

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<sup>4</sup> Quoted by Glasson, 1978.

sustaining economic growth, and here regional policies become critical. The third stage, the industrial society, typical of much of Western Europe, including the UK, often reaps the cost of industrialisation, especially in the form of depressed regions resulting from overspecialisation. The final stage, the post-industrial society, typified by the USA, there is a shift to a new focus with the emphasis on urban and metropolitan problems.

Similarly, Kaldor typified economic growth processes as follows: (cited by Barro and Sala-i-Martin, 1995 p. 5).

- a) per capita output grows over time, and its growth rate does not tend to diminish,
- b) physical capital per worker grows over time,
- c) the rate of return to capital is nearly constant,
- d) the ratio of physical capital to output is nearly constant,
- e) the shares of labour and physical capital in national income are nearly constant,
- f) the growth rate of output per worker differs substantially across countries

Another approach on how the economy of a country grows was presented by Kuznets (1983)<sup>5</sup>. For the case of a developed country, this author defines economic growth as “a long term rise in capacity to supply increasingly diverse economic goods to its population, this growing capacity based on advancing technology and the institutional and ideological adjustments that it demands” (p.56).

Kuznets identifies six characteristic features manifested in the growth process of almost every developed nation. These are:

- a) high rates of growth of per capita output and population,
- b) high rates of increase in total factor productivity,
- c) high rates of structural transformation of the economy,
- d) high rates of social and ideological transformation,
- e) the propensity of economically developed countries to reach out to the rest of the world for markets and raw materials
- f) the limited spread of this economic growth to only a third of the world's population.

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<sup>5</sup> The Nobel Prize-winning Harvard economist Simon Kuznets. From his work that appears in the *American Economic Review* 63, N.3 (June 1973), pp 247-258; and reproduced in Todaro, 1983, pp 56-67.

Todaro (2000) states that these six characteristics can be grouped into three categories, the first two as aggregated economic variables, 3 and 4 as structural-transformation variables, and the 5 and 6 as affecting the international spread of growth. These categories, more or less common in the experience of most developed countries do not explain why economic growth does not spread to less developed nations. Todaro argues that the answer to this come from the internal condition of most Third World countries, and from the contemporary nature of international economic and political relationships between rich and poor nations.

Lisk (1983), based on the differences and similarities in objectives and policy emphasis, distinguishes four approaches to development:

- a) growth-oriented;
- b) employment-oriented;
- c) poverty-oriented; and,
- d) the Basic-needs approach.

What is common to these four views is that all of them recognise the need for economic growth. Because several features of these strategies are observed in the development model followed by Chile during the last two decades, Lisk' strategies are presented below in detail.

#### a) Growth-oriented strategy of development

Main facts:

- the primary objective is to increase the rate of output within the economy over a period of time, mainly by increasing the rate of capital formation,
- the growth rate is presented as a function of increase in capital stock, and emphasis is placed on the mobilisation of saving and investment,
- it is assumed that rapid growth of GNP suffices to bring about higher standards of living through its beneficial influence on other economic and social parameters.

Lisk points out that there are two major theoretical variants among growth-oriented strategies: a) *balanced growth*, which calls for massive capital investment on all fronts simultaneously. This theory assumes that technical and commercial complementarities exist between the new industries at different stages of production and in different

sectors of the economy. Lisk emphasises that this corresponds, in some ways, to the external economies of large-scale production; b) *unbalanced growth theory*. This places similar reliance on forward and backward linkage effects between industries at different stages of production to provide the impetus for growth. Lisk argues that, while the capital accumulation concept may be valid in relatively developed countries, it is certainly not clear so in countries with structural constraints such as scarcity of managerial and technical skills, insufficient capacity to absorb new knowledge.

The development assumption of these theories is that rapid growth rates over a period of time will result in an overall improvement in quality of life of people.

This argument that rapid growth necessarily improves the standard of living in developing countries can be disputed by looking at the recent experience of South American countries. The rapid growth achieved in the 1990s has actually resulted in the worsening of income distribution, increases in the number of poor and higher unemployment (see Riveros, 1997 and Meller, 2000 for the case of Chile).

#### b) Employment-oriented strategy of development

Main facts:

Lisk states that the objectives of this strategy reflect a wider definition of development that includes improvement in the living conditions of individuals in addition to economic growth, like the previous strategy (Lisk, 1983).

- employment promotion is viewed as the principal means of spreading the benefits of economic growth more evenly throughout the economy,
- the growth objective is modified so as to maximise not only output but also the rate of labour absorption,
- there is an emphasis in the reallocation of resources in favour of disadvantaged sectors and groups,
- emphasis is put on the central objective of reducing unemployment and under-employment,
- redistribution of incomes and productive assets receive some attention.

Lisk argues that there exists the possibility of conflict between the output and employment objectives. The theory stresses, however, that simultaneous increases in

output and employment can be achieved through direct substitution of labour for capital in the production process. This author draws attention to the fact that due to structural constraints many developing countries may find difficult to achieve gains in both output and employment.

#### c) Anti-poverty strategy of development

One of the main reasons for the adoption of this strategy is that, after several examples of the application of the two other strategies presented above, it was seen that the effects on the redistribution of income, through access to productive employment, still excluded the principal poverty groups.

An important constraint on adopting this kind of strategy is that a redirection of consumption and investment in favour of the poor may probably lead to some reduction in saving and investment by the rich. This implies a lower rate of capital accumulation during the transitional period. Growth of GNP is abandoned as an objective, but it is pursued only to the extent that it is complementary to the reduction of economic and social inequalities, which may have been accentuated by the growth process itself.

The poor, in both the rural and urban areas are among the less qualified groups in society and for this reason they are usually outside the organised sectors of the economy. As most development strategies are concentrated in the most advanced sectors of the economy the poor cannot easily find employment for their low skill levels. This has led to a reorientation of the development policies towards the eradication of poverty, setting the basis for the emergence of 'anti-poverty strategies'.

According to Lisk, the main objective of poverty-oriented development strategies of development is to raise per capita incomes above a predetermined 'poverty line' as quickly as possible, with the related aim of reducing income distribution and social inequalities.

This can be well illustrated by the case of Chile where the high growth rate achieved during the 1980s actually worsened the country's income distribution. This situation started to be reversed during the 1990s where, although keeping the high rate of the increase of the economy (over 6% annually from 1990 to 1998), income distribution

started to improve slightly. For example, poverty in Chile amounted to a 38.0% of the total population by the year 1990. This figure dropped drastically under the democratic government, reaching 21.7% by 1998 (MIDEPLAN, 1998). Income distribution, however, moved much more slowly toward in the direction of reducing the high disparities in the same period.

#### d) The Basic-needs strategy of development

Lisk (1983), points out that the main objective of this approach is to satisfy the essential requirements of each country's population within the time horizon of one generation. Two complementary sets of target are laid down for this purpose. The first is concerned with personal consumption needs such as food, shelter and clothing; the second has to do with the provision of public services such as health, sanitation, the provision of safe drinking water, education, transport and cultural facilities.

This strategy is similar to the poverty-oriented strategy, although they present important conceptual differences. For example, an anti-poverty programme would be directed to target specific poverty groups within the economy. The basic-needs approach is based on the premise that poverty in most developing countries is widespread and that action, as a consequence, should be directed at the population as a whole.

#### 1.1.2 The new growth theory

The theory of 'endogenous growth' or the 'new growth theory' started to be developed at the end of the 1980s. It was the answer of few neo-classical and institutional economists who began to look for a new growth theory (Todaro, 2000).

This theory provides a theoretical framework for analysing endogenous growth, persistent GDP growth that is determined by the system governing the production process rather than by forces outside the system. The principal motivations of the 'new growth theory, argues Todaro (2000), are to explain both growth differentials across countries and a greater proportion of the growth observed. To complement Todaro's statement, it is worth saying that growth differentials are not only observed at the national level, in fact, regional differences, within countries, are a major preoccupation in 'endogenous growth' theories.

According to Cypher and Dietz (1997), the Solow-type neo-classical economic growth model, one of the most influential neo-classical growth models, and one that has shaped much modern thinking about the process of economic growth since the 1950s, has been interpreted as predicting that the per capita incomes of economies would tend to converge to the same level over time, as lower income nations grew faster than higher income nations, assuming they all have access to the same technology and shared similar saving and investment rates.

Cypher and Dietz suggest that “the relatively slow progress of many African and South Asian economies, as well as the decline in per capita incomes brought on by severe crisis in many less developed nations that had been successful for a time until the early 1980s, have caused quite a number of economists to question the validity of any growth model which predicts eventual income convergence, conditional or unconditional” (p. 243).

As a consequence, “in the late 1980s, a spate of endogenous growth models began to appear in the economic literature. Endogenous growth theories do not assume, nor do they find, physical capital accumulation to be the dominant determining factor in spurring economic growth, nor in explaining differences in income levels amongst nations”. “In the endogenous growth models, a higher level of investment, properly defined, not only can get a country to a higher level of per capita income, as in the neoclassical view, but higher investment rates, again properly understood, also can sustain higher rates of growth of per capita income in the future” (Cypher and Dietz, 1997 p. 424).

Setting the birth of the ‘endogenous growth models’, Barro and Sala-i-Martin (1995) state that “In the mid-1980s, a group of growth theorists led by Paul Romer (1986) became increasingly dissatisfied with exogenous driven explanations of long-run productivity growth. This dissatisfaction motivated the construction of a class of growth model in which the key determinants of growth were endogenous to the model” (p. 38). According to these authors, the reason for the name ‘endogenous growth’ comes from the determination of long-run growth within the model, rather than by some exogenous growing variables like unexplained technological progress.

Barro (1997), points out that “recent works on endogenous growth theory have sought to supply the missing explanation on long-run growth. In the main, this approach provides a theory of technical progress, one of the central missing elements of the neoclassical model” (p. 4).

Barro and Sala-i-Martin (1995), emphasise the importance of the concept of technical progress, widely discussed in the ‘endogenous-growth’ literature of recent years. They argue that “the level of the technology can be advanced by purposeful activity, such as R&D expenditure. This potential for endogenous technological progress may allow an escape from diminishing returns at the aggregate level, especially if the improvements in technique can be shared in a nonrival manner by all producers” (p. 41).

According to a European Commission study (1997): “The failure of the basic neo-classical model to provide a satisfactory model of long-term per capita output growth has been addressed by the ‘new’ endogenous growth theories which seek to endogenize the sustained accumulation of factors, among which they include human capital and knowledge capital” (p. 8). This study states that endogenous growth models focus attention on the micro-foundations of the accumulation process, that is, on the private and social costs and benefits of investing in capital (infrastructure capital), skill (human capital) or technological progress (knowledge capital).

This study notes two strands of endogenous growth theories:

The first stresses the importance of the accumulation of human capital, defined as the quality of labour an individual is able to supply, i.e. their general skill capital; the second highlights the importance of sustained innovation.

In ‘endogenous growth model focusing on human capital’, the engine of growth is the accumulation of human capital. Introducing human capital into the production function implies the need to investigate both how current human capital affects the same period production, and how the current allocation of time by the individual affects the accumulation of human capital.

The ‘endogenous growth model focusing on the accumulation of knowledge’ tries to endogenise technological progress, that is, the process by which the same input of

labour and capital can produce more output. Technological progress, this study argues, is nothing other than knowledge creation, and sustained technical knowledge creations leads to a continually rising stock of knowledge.

Aghion and Howitt (1998) point out that “a great deal of evidence has been produced in recent years casting doubt on endogenous growth theory”. They argue that “the neo-classical growth model of Slow and Swan, with exogenous technological progress and diminishing returns to capital, explain most of the cross-country variation in output per person” (p. 403). They also point out that, contrary to what ‘endogenous growth’ models predict, cross-country evidence suggests that countries are converging toward a common growth rate in the long-run.

Finally, they cite Jones (1995), who “has challenged endogenous growth theory by pointing out that the input to R&D, as proxied by the number of scientists and engineers engaged in R&D, has risen dramatically over the past half century, with no visible tendency for growth in output per person or in productivity to increase” (p. 417).

### Summary

As presented by Todaro (2000) five theories of development “explore the recent historical and intellectual evolution in scholarly thinking about how and why development does or does not take place” (p. 77). These are:

- a) the linear-stages-of-growth model;
- b) theories and patterns of structural change;
- c) the international dependence revolution;
- d) the neo-classical, free market counterrevolution; and,
- e) the new or endogenous theory of economic growth.

Of these, the first prevailed during the 1950s and 1960s. Todaro (2000) points out that the theorists of these period viewed the process of development as a series of successive stages of economic growth through which all countries must pass in order to follow the path that historically had been followed by the more developed nations. Friedmann’s model is one of the most-cited illustration of this theory.

This linear-stage approach was replaced in the 1970s by two competing ideological schools of thought. The first focused on theories and patterns of structural change (again using modern economic theory and statistical tools). The second was more radical and political in orientation. In the latter, Latin American theorists played a determinant role. Its development and abundant literature explained the many ways by which the 'centre' managed to keep the 'periphery' underdeveloped, or how the two faces of development and underdevelopment were both part of the same system. According to Todaro (2000), dependence theories tended to emphasise external and internal institutions and political constraints on economic development.

Throughout the 1980s the neo-classical (neo-liberal) approach prevailed. This theory emphasised the 'beneficial role' of free markets, open economies, and the privatisation of inefficient and wasteful public enterprises. Rejecting dependence theory, it asserted that failure to is not due to exploitative external and internal forces. Rather, it is primarily the result of too much government intervention and regulation of the economy.

Based on this theory is that the profound transformations of Chilean economy took place since the end of the 1970s. Chile became a laboratory to test the validity of the assumptions under this neo-liberal approach. High rates of growth were actually achieved but at a high cost in many socio-economic indicators, especially employment and income distribution.

Overall, what lies in the basis and are of prime importance in any society, are the three factors or components of economic growth (Todaro, 2000):

- capital accumulation, including all new investments in land, physical equipment, and human resources,
- growth in population and hence eventual growth in the labour force,
- technological progress

## 1.2 Regional Economic Development: Theory and policy

The emphasis of most of the development strategies discussed above was on the national scale. The regional level analysis that follows refers not only to the sub-national level, but it should also be understood as 'regional analysis' that sees development as it interacts among the different unit of a larger totality, not necessarily a country. A good example of this are the countries of Europe, taken as regions of a larger unit called the European Union. Another example would be the countries of South America as regions of that larger unit that is the sub-continent.

The importance of the regional level in the analysis of economic growth or economic development is that, as Siebert (1969) points out, growth actually occurs in space or it is influenced by the spatial structure and it has a feedback upon the economic landscape. On the other hand, continues Siebert, the problems of regional economic growth are equally relevant to developed and underdeveloped economies. In developed countries, depressed areas exist which lag behind the national growth rate. These countries also experience the problems of over-agglomeration, both cases requiring intervention. In the case of developing countries, regional problems have to do with the allocation of scarce resources, with which strategy to follow for economic development, with the severe problems in particular regions, etc.

The regional approach has been a subject of study since the 1950s with the works of Myrdal, Isard, North, Perroux, Friedmann, among others. Recently the theme has also gained attention, as Riffo (1999) pointed out, due to the interest of many scholars for trying to answer the questions of how economic growth occur, what are the causes of regional growth, what are the reasons that explain regional disparities, and what are the long-run tendencies in growth. This interest, argues Riffo (1999), come from the current phase of capitalist development, which is characterised by an accelerated process of globalisation that, once again "would be retaking its secular behaviour toward divergence in interregional growth" (De Mattos, 1997<sup>6</sup>).

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<sup>6</sup> Quoted by Riffo, 1999.

As regional development has to do with the economics of a region, it is worth defining what is to be understood by 'regional economics and 'regional economic growth'. For Siebert (1969), "'regional economics' is the study of man's economic behaviour in space. It analyzes economic processes in a spatial setting and inquires into the structure of the economic landscape" (p. 1).

On the other hand, Kuznets provides a definition of regional economic growth: "regional economic growth is the sustained increase in the volume of an economic variable of a spatial subsystem of a nation" (Kuznets, 1959, p. 162)<sup>7</sup>. Siebert suggests the following variables to be used as indicators of economic growth: the increase in the welfare of a region, the increase in the output of a region, the increase in the set of final commodities which are available to the region. He also draws attention to the fact that 'regional growth' requires the explicit introduction of two fundamental dimensions: time and space.

Oosterhaven (2000) sets out critical distinctions between several concepts used in regional analysis. He argues that, as uneven initial distribution of economic activities over space is empirically normal, polarisation or concentration occur when the initial spatial distribution becomes more uneven, and dispersion or deconcentration take place when the distribution of activities over space becomes more even. In different words, "an uneven spatial distribution of any single variable implies spatial differences in the density of that variable, e.g. in population densities when looking at numbers of inhabitants. Consequently, polarisation occurs when density differentials become larger, whereas deconcentration occurs when differences in densities become smaller" (p. 2).

Oosterhaven also defines the concepts of convergence and divergence. He argues that is important to distinguish cases with absolute growth differential from cases with relative growth differential. In the case of relative growth differentials, "it is not primarily initial density differences that are looked at; rather the analysis is started with the initial spatial differences in the relative variable at hand, such as income per capita". To distinguish this case from absolute growth differential, "one speaks of *convergence* if the initial distribution becomes more even, i.e. when the per capita income differences become

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<sup>7</sup> Quoted by Siebert, 1969.

smaller, and of *divergence* when the initial distribution becomes more even” (Oosterhaven, 2000 p. 2).

The same author argues that the single most important aspect of this distinction is that convergence might, in fact, coincide with the concentration as well as with the deconcentration of economic activity. Something similar occurs for divergence. It will all depend on whether or not the absolute (de)concentration of one variable (for example income) proceeds faster or slower than the (de)concentration of the other variable (for example population).

### 1.2.1 Regional theory

Defined in the mid seventies (Isard 1975, Kuklinski et al 1975) regional theory provides the theoretical framework through which regional problems can be rationalised and analysed. Also refers to as ‘regional science’, Isard defines it starting from the concept of region. For him, regional science “...is obviously about regions. But a region is not merely an arbitrary demarcated area; rather it is an area that is meaningful because of one or more problems associated with it which we as regional scientist want to examine and help solve” (Isard, 1975 p. 1). To give regional studies the character of scientific, Isard argues that “regional science is also about science” (p. 2). That is, it involves study which uses scientific methods and procedures. Not purely scientific to spend too long collecting and processing information, because “regional scientist like to ask as well; Why are things as they are? And he likes to follow up this query with some hypothesis or theory to be tested, or a policy proposal relating to one or more social problems of his region of study” (p. 2).

This author provides a variety of definitions of regional science ranging from general ones to more specific and applied ones. As they are quite diverse is not difficult to find one for most purposes. Of all thirteen definitions proposed by Isard (1975), five of them seem to be relevant for the purpose of this work.

- Definition 1 states that: “Regional Science is the study of a meaningful region (or system of regions) as a dynamic organism”;

- Definition 2: “Regional Science is the synthesised (integrated) analysis of the political, economic, sociological, cultural, and psychological factors affecting the development of a meaningful region or system of regions”;
- Definition 5: “Regional Science is the study of the diverse organisational and institutional structure of society as they govern the behaviour and spatial distribution of population and economic activity”;
- Definition 8: “Regional Science aims to identify and expose simple, basic principles of spatial organisation-principle that govern equilibrium and organisational structure and relate to efficiency, equity, and social welfare”;
- Definition 10: “Regional Science is a synthesis of the art of planning and management with the science of spatial systems” (Isard, 1975 pp 4-5).

The other eight definitions given by Isard stress, among other aspects, the cultural, space-time, psychological dimensions, rural-urban dichotomy, natural regions, industry and other sectoral economic activities.

The five definitions of regional science discussed here emphasise aspects that will be considered in the analysis and comparison of the selected processes of investment of regional funds of this study. Definition 1, the most general one, points to the concept of ‘meaningful region’, basic concept that defines the sub-national level of the given territory to which the analysis will refer to. Definition 2 stresses the importance of integrated factors such as political, economic, etc, affecting the development of a particular region. Definition 5 talks about the diverse organisational and institutional structures that govern the spatial distribution of population and economic activities, as regional public investment do. Definition 8 appears to be of great significance for this study, specially when emphasising the ‘simple, basic principles’ that govern organisational structure that relate to efficiency and equity. As this research principal aim is to present, and by comparison, discover new forms of basic principles of regional investment, this 8<sup>th</sup> definition appears to greatly address this objective. And, finally, definition 10 introduces the concept of ‘planning’ and ‘management’, quite essential to the process of public regional investment.

### 1.2.2 Regional development planning: the ground for regional policy

According to Alden (1996), a recent European Commission policy document on regional development<sup>8</sup> has stressed the fact that “there is a growing acceptance of the need for spatial planning at a European level among Member States, as well as in academic and professional circles. The European Parliament, the Economic and Social Committee, The Consultative Council of Regional and Local Authorities, and most recently the Committee of the Regions, have all emphasised the need for increased co-operation on spatial planning issues” (p. 1).

This document has emphasised that the rapidly changing European and international context for spatial planning would require a responsive and effective planning system. This come from the fact that a number of major trends have been observed by the Commission in all Member States, specially in those with a longer history of spatial planning. Based on these arguments, Alden (1996) suggests that there is a number of reasons to believe that the need for more regional planning will be maintained and further advanced in the years ahead.

Anyway, in order to define regional planning first we have to accept that there are regional problems that need to be solved. The question to what are ‘regional problems’ is addressed by Hallett (1973).

This author points out that some economists would deny their existence – except as transitory phenomenon or the outcome of ignorance or misguided government policies – on the ground that firms and households will locate themselves in what they find to be the most satisfactory situation, thus, ensuring that in the spatial economy, as well as in the production of goods and services, the economic optimum is achieved. Hallett quoted the definition of the economist Brown who attempts a very general definition:

‘Regional problems ...are whatever are felt as inter-regional economic inequities. The main examples are inequalities in regional levels of income, poverty, unemployment, migration and economic growth rate. Rather less

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<sup>8</sup> European Commission policy document on regional development: Europe 2000+: Cooperation for European Territorial Development CEC 1994a

obviously, however, they may spring from apparent violations not of equity but of the general national advantage –an inter-regional distribution of population, for instance, marked by over-population in the sense of external diseconomies of congestion in some regions and perhaps under-population in a corresponding sense in others: or perhaps a geographical distribution of the population which is thought to make national defence more difficult, or is for some other important reasons less than optimal, without necessarily involving inequity between one region or another. In short, any economic circumstances that give rise to a regional sense of grievance, or any that give rise to a general, or a governmental, belief that the inter-regional distribution of population and economic activity is seriously wrong, may be said to constitute a regional problem’<sup>9</sup>.

For Hallett, this definition is ‘behaviourist’ because leaves out of account the ‘normative’ question whether the people of a region, or the government are right to feel that a regional problem ought to be recognised. Therefore, although regional problems do arise, government intervention is not always justified, and specific policies are not always well conceived (Hallett, 1973). Answering to Hallett, one may say that government action, in front of regional problems, will depend on ideological preconceptions, and the fact that ‘regional policies are not always well conceived’ has to do more with the quality of the planning than with the argument of intervention or no intervention.

Hallett argues that attitudes to regional policies must, explicitly, be based on an economic ‘model’ of regional change. He discusses on two extremes models, one which is an extension of the neo-classical model of price determination, which assumes that divergences between regions (in average income or unemployment rates) will tend to be eliminated by self-equilibrating mechanism. At the other extreme is Myrdal’s model of unstable equilibrium, which suggests that regional divergences, once established by historical accident, become increasingly wide. Areas which have established themselves as industrial centres provide the seed-bed for new inventions and new ideas; areas which have failed to ‘take-off’ are unable to do so, while the emigration of the most enterprising labour weakens economic potential even more (Hallett, 1973).

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<sup>9</sup> A. J. Brown, ‘Survey of Applied Economics: Regional Economics, with Special Reference to the United Kingdom’, *Economic Journal*, Dec. 1969, p. 760. Quoted by Hallett et al 1973.

No matter how they occur, we end up with regional disparities that have to be solved. Hallett suggests that regional disparities in countries such as the UK are neither rapidly and smoothly self-correcting nor (in the longer term) wildly cumulative, and that they can often bear hardly on individuals. Facing the question, what attitude should the government adopt toward them, he revises different situations arising from regional disparities and ends up asking for the right of government and scholars to address these as regional problems requiring regional policy solutions.

According to Hayek<sup>10</sup>, the different views about planning move from the central planning of the Stalinist system to the liberal approach that ‘non-intervention always produces the best possible results.

A first major trend is the growing awareness that spatial planning has shifted from a concern from purely physical planning and land-use matters to a wider concern from social, economic, environmental and political issues. A second trend has been the need not only to identify specific strategic planning issues, but also to integrate the various strategic issues into a more comprehensive and complex form of spatial planning including economic development, transportation, retailing, tourism, housing, urban regeneration, waste management, water quality, the countryside, and nature protection, and their integration with each other.

Third, the wider recognition of the need to take account of market forces within the spatial planning process, notwithstanding the importance of public/private sector partnerships in the development process. The attraction of inward investment and a wider choice as regards location for many companies operating in a global economy has increased the need for spatial plans to respond more fully and readily to market circumstances and requirements. A fourth trend examined has been the increased decentralisation of responsibility for planning policies and controls to regional and local level of government.

On the other hand, regional policies and the policy instruments associated to it are also seen as the necessary steps through which a process of regional development can be

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<sup>10</sup> Quoted by Hallett et al, 1973, p.15.

achieved. By looking at the increasingly process of integration of Europe triggered and sustained by the European Union, the Agenda 2000 proposals sustain that the building of Europe is creating a group of States that are forging close economic links and regulating issues of common interest together. This document states that the concept of European integration can only be considered credible if these States maintain a sufficient level of economic and social cohesion. To do this, the document stress the improvement of the effectiveness of the structural policy instruments and the increasingly role that this policies should play in the Union's future enlargement. (Alden, 1996).

With regard to regional development and policy in eastern European countries, Downes (1996) argues that the regional dimension of development has been put behind the national level but this situation has necessarily started to change through the nineties. The reform task being undertaken by the Central and East European countries (CEE), and the former Soviet Union, is virtually unprecedented. The need to construct a new political and economic system in the ruin of a completely different one has never before been undertaken on this scale. Given this background, priority has been given to national rather regional economic reforms. The design and implementation of regional development strategies or policies were considered of secondary importance to national economic policy issues. However, as economic reform has continued, its spatial ramifications have become increasingly clear, thus forcing the issue of regional policy response onto the political agenda. Regional disparities have emerged in individual countries, as well as for the CEE region as a whole.

The need for regional development planning has also been stressed for the case of Japan (Abe, 1996), where the problems have been mainly associated with excessive metropolisation and relative regional disparities. The rapid economic growth in post-war Japan has caused the concentration of economic activities and population in few metropolitan regions. Regions have been losing their economic vitality due to regional income disparities and population losses.

Abe argues that with the aim of preventing excessive growth of metropolitan regions and correcting regional disparities, the government has, since 1962, formulated four Comprehensive National Development Plans (CNDP). Regional development policies

under the four CNDPs have sought to tackle regional problems by adopting three particular regional development policies: the construction of a national network of transportation and communications, the development of growth poles in local regions, and the relocation of industries from the metropolitan to the local regions. Looking towards the 21<sup>st</sup> century, however, substantial socio-economic changes are foreseen: the rapid changes in the industrial structure under the progress of technology changes, the rising Japanese currency, a trend towards an information network society, the ageing of population and the integration of Japan into international society. These among others causes had made regional development planning in Japan seek a new direction (Abe, 1996).

## 2 The Concept of the Region

In order to understand the notion of regional science, regional development and planning or regional policy, we have to go back to the basic concepts of region and planning. It is not the intention of this study to extensively define what is, and has been, understood for a 'region', or a 'system of regions', for the different disciplines that use the term. The two type of regions to which the regional fund of both cases are directed do present some differences that will be discussed in this section. The most common definitions of the term, used both in older and recent literature, will be presented and discussed

Glasson (1978) points out that the concept of region has been much used and abused over the years and there has been numerous controversies and disagreements over its meaning, perhaps reflecting the variety of disciplines involved in regional studies. According to Hallett (1973), governments increased concern for the economic conditions of regions, as distinct from the country as a whole, date back to the 1930s, but the systematic economic study of regions is even more recent; most books on regional economics have appeared since the 1950s, although some ideas on the location of economic activities go back to the work of Von Thunen in the early 19<sup>th</sup> century<sup>11</sup>. The concept of the 'region' was first developed by geographers, who based their

classifications on physical characteristics. When economists took the concept and tried to classify regions through economic criteria it soon became clear that –in most countries- it was very difficult to draw clear-cut dividing lines, which differed according to the criteria.

To some, the region is a real entity that can be positively identified – a ‘natural region’; to others, it is merely a product of the imagination, a method of classification. Glasson identifies two divergent views of the concept of region – one objective, the other subjective. The subjective view sees a region as a means to an end, simply an idea, a model to help in the study of a particular country or area in the world. According to this author, this would be a method of classification, a device to segregate areal features, with the only ‘natural’ region being the surface of the earth. The objective view adopts an opposite stance, seen the region as an end in itself, a real entity, and organism, that can be identified and mapped (Glasson, 1978).

The objective view that regions actually exist was held by many academics in the early twenty century, and was linked with the search for the elusive ‘natural’ region. At present this view of a natural region is sustained by geographer and other natural scientists that are able to identify natural regions adopting analytical tools on the basis of physical phenomena such as land configuration, weather (climate) conditions, vegetation, latitude and altitude, etc.

The subjective view, where regions are seen as descriptive tools, defined according to particular criteria, for a particular purpose – there being as many regions as there are criteria to define them. Based on this conception the literature present many types of regions: formal regions, functional regions, economic regions, planning regions, etc.

Hall (1970) distinguishes two types of regions: For the first of them he uses the terminology applied by the French writer on regional planning Boudeville<sup>12</sup>. The Boudeville’s homogeneous region, also called statistically uniform region or the static region. According to Hall, this region is defined as a combination of areas exhibiting a

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<sup>11</sup> Von Thunen, H. *Isolated State*, trans. C. H. Wartenburg, ed. P. Hall, Pergamon Press, 1966. Quoted by Hallet et al, 1973.

<sup>12</sup> Boudeville J. R., 1966. *Problems of Regional Economic Planning*. Edinburgh (not revised in this work).

certain statistical uniformity within a stated range. For this definition of region Hall argues that there is a contiguity constraint, that is, the area which are included within the region must be contiguous to each other in order to form a region. In Boudeville's terminology this is a distinction between homogeneous areas, which simply fall within stated statistical ranges, and so are similar to each other, and a 'homogeneous region' which is a combination of those homogeneous areas that are contiguous to each other. For this type of regions Hall concludes that is easy to define them based on one criterion, however, the improvement of statistics has provided a greater and more reliable range of information to find patterns of variation among contiguous areas.

The other type of region distinguished by Hall is the so called 'nodal region' or dynamic flow region. This region results from trying to consider the patterns of movement in geographic space. Some of these movements, of a regular or periodic character, can be used to determine regional boundaries. Examples include: commuting or shopping patterns, or on a large scale, commodity movement or the regular flow of business men travelling on their regular routes. Hall stresses the idea that a characteristic of many of such flow systems is their hierarchic or nodal structure, thus, many small flows out of smaller centres converge and coalesce in bigger ones; in turn, the bigger flows from these bigger centres, together with flows of other smaller centres, may flow into a bigger centre still.

A good example of this system of flows was presented by Christaller<sup>13</sup> in the 1930s where these systems do correspond in a systematic way in many cases to levels of economic activity which are associated with the centres or nodes themselves.

Hall discusses the fact that in this simple system, difficulties can be observed. In the first place, whole sets of regions can in fact be observed at different levels. For example, looking at regions defined in terms of shopping for convenience goods such as food needs; where the analysis gives a very large number of rather small regions; and if one compares this with the set of regions produced also for shopping for the higher level of comparison goods, such as furniture, where one can find a more restricted number of larger regions because people are willing to go further for this type of shopping.

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<sup>13</sup> Christaller, Walter, 1966. *Central places in Southern Germany*. Prentice-Hall, 1966 (idem previous title)

Therefore, the pattern of nodal regions which one produces in any area is not a single pattern of regions. There is no unique set of nodal regions; there are number of possible sets of nodal regions depending on the level of activity one is specifying (Hall, 1970).

As the same author points out, this distinction between homogeneous regions and nodal regions has many practical consequences because the kind of planning will depend on the type of regions used as a starting point. He gives an example of both types of regions as the starting point depending on the planning purposes. For instance, in economic planning it may be felt that a homogeneous region is the clear starting point. Thus, economic planning regions may be defined in terms of the type and also degree of economic development. As a practical application of this categories Hall mentions the North of England, or North East England as a distinctive economic planning region as homogeneous region in need of development. He argues that by using statistical information it could be proved that these regions have a very high proportion of the work force engaged in industries that were nationally declining, and it could be proved also to have a very high proportion of it total social capital stock over 50 years old or even over 100 years old, etc. It would be, therefore, possible to define this area as a region in need of development and to be in fact part of a set of areas in the country with these characteristics. For some other planning purposes, specially those connected with physical planning, the nodal region is very often, according to Hall, the starting point. On the opposite direction one may argue that the given type of planning pursued may well define the type of region suitable for it.

Another interesting definition of 'region' is given by Isard. To fit with his 'analytical equilibrium theory' Isard treats regions as points within a system of regions with a finite number of separated and distinctive regions. "By treating the region as a point we are assuming away distances between the behaving units within the region and hence we assume that transportation cost inputs are required in the execution of exchanges between such units. Conceptually, however, we may allow individuals to reside and organisations to locate at places in their regions other than the economic market, so long as we assume there are no transaction costs of interregional exchange" (Isard 1969, p. 602).

In his work of 1975 Isard provides a different approach to the understanding of the concept of region. He argues that a true regional scientist is first concerned with acquiring knowledge to understand phenomena; second, he wants to attack social problem. Hence, although he may want to study the city and region abstractly and as an intellectual pursuit, he should also seek to obtain knowledge that leads to wiser policies helping to mitigate urban and regional problems (Isard, 1975). He also argues that any definition is dependent on the particular problem with which we are concerned. We may define an area in terms of a political unit or if our problem is to attack transportation congestion, we must look beyond political boundaries and concentrate on sites from which goods are shipped (factories, warehouses, terminals) and sites to which they are shipped (shops, institutions, houses). He suggests that in order to work with such unit, this may well be provided to us by somebody or this delineated (not entirely defined) because of a deadline that existed “which forced us to immediately define our regions” (Isard, 1975 p 12). A comment on Isard suggestion is that this would be the case of a planning purpose before the definition of the region.

For Lipietz (cited in Carney et al, 1980) regional spaces must be constructed on the basis of the concrete analysis of modes of production and their articulation, as they are not delimited by legal-political space, in particular by administrative divisions. A region is a concrete articulation of spatialities appropriate to different social relation. Just as there are several levels in the object of an analysis, so there are several levels in regional division. He argues that is not just a question of a empirically greater or smaller spatial scale. The required scale is determined by socio-economic spatial forms. So, an economic region is characterised by the dominance of an economic form.

For practical reasons, Stöhr (1969a)<sup>14</sup> defined regions within the context of development planning, with special reference to Latin America at the end of the decade of the 1960s. He begins by pointing out a series of restrictive conditions that have to be observed in this particular case: the countries in their majority are still in the process of national building; the social system are not yet fully articulated, both in terms of spatial organisation and along lines of social strata; their economic system are in a transitional

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<sup>14</sup> Professor Walter Stöhr's paper to the I Inter-American Seminar of the Definition of regions for Development Planning. Instituto Panamericano de Geografía e Historia, Comisión de Geografía. Documento del I Seminario sobre Regionalización. Río de Janeiro. 1969.

phase towards industrialisation; the countries are relatively poor; the countries have experienced a process of urbanisation considerably faster than their process of economic development. In this context, Stöhr argues that 'regional policy' need not necessarily be formulated in terms of carefully delimited regions. It may also be viewed as the ordering of population and activities in a continuous terrestrial space, or as a point-related location policy. To explain his assertion he argues that delimiting regions, like any other procedure containing arbitrary elements, will inevitably give rise to arguments.

Stöhr made clear that he did not intend to tackle the task of delimiting regions for development from the traditional angle of homogeneous, nodal or administrative regions (concepts defined above in this chapter), "we are rather looking toward the functions of regions in the frame of national development" (Stöhr, 1969a p. 75). National development in this case, in the context of Latin American countries<sup>15</sup>.

He then proposes four types of regions for development:

- a) Information (statistical) units, the basic areas for the collection, analysis and projection of information for development planning;
- b) Sectoral development areas, these are regions that form the framework for the planning and administration of sectoral development programmes, carried out by ministries and specialised agencies;
- c) Multi-function programme areas, are usually concerned with solving the problems of a specific area through an integrated development, metropolitan development, redevelopment of depressed areas, resource frontier development projects, and border area development schemes; and,
- d) Regions for integrated development. These unite the maximum of functions of regional development. They constitute a level of regional aggregation where the search for direct information and the participation in decision-making is still possible, and from the national level downward where it becomes desirable to delegate decision making and administrative functions in order to maintain their efficiency (pp 75-82).

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<sup>15</sup> Based in Chile, by this time Stöhr was serving as Senior Regional Planning Advisor for the Ford Foundation.

## 2.1 The type of regions in this work

First, regions are understood as the territorial units that exist in the two cases studied, in Chile and in the European Union. These units are already defined, by different means and for different purposes. It is not the intention of this work to discuss the appropriate or inappropriate definition of regions in both cases. They are taken as they are.

The main conclusion that could be drawn from the theoretical considerations about the definition of regions discussed earlier is that there are as many regions as objectives behind their definition.

In the case of Chile, following Stöhr (1969b) the definition of regions had to do with the explicit desire of the central government for stimulating national development, in particular: to raise gross national product, improve income distribution, increase economic autonomy, rate of employment, standard of living, etc. The actual definition of regions, however, responded more to implicit existing geographic, climatic, and cultural differences in a country of more than 4,200 kilometres long and less than 250 kilometres wide in average. Although having been designed with the geographical, cultural and social background in mind of these territories, the thirteen regions of Chile (see Appendix 2), located from North to South, have to be understood as administrative regions for most purposes. Using Stöhr's categories of regions, Chilean regions would correspond to 'Regions for Integrated Development'.

In the case of the European Union regions, the territorial units utilised for the purpose of regional policy design and for the allocation of resources are defined in two ways.

First, the existing NUT regions are the basic territorial units utilised. These would correspond to the so called 'Information (statistical) Units' defined by Stöhr (1969a). Then, according to different purposes more than one NUT unit is used to define a particular region for assistance. As an example, in the case of regions to be benefited by the Structural Funds's Objectives 1 and 2<sup>16</sup>, regions are defined in terms of economic

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<sup>16</sup> Chapter 6 provides the definitions of the objectives of the Structural Funds.

indicators such as GDP per capita, unemployment rate, industrial problems, etc. As a consequence, the resulting region for assistance is one or more NUT units.

Thus, regions utilised by the Structural Funds' allocation purposes can be understood as objective regions. Following the categories defined by Stöhr, regions in the European Union context would correspond to 'Sectoral Development Areas', in the case of the industrial areas in decline regions, and 'Regions for Integrated Development', in the case of Objective 1 regions.

The 'regional level' must be distinguished from 'the local or municipal level', which also fit under sub-national level, but which are different in the scale and scope of the public policies designed to deal with sub-national problems. As the local level is the lowest administrative and government level, its territory is, most of the time, significantly smaller than a 'typical region', and it is, by definition, ruled by its own government, commonly a mayor and a local council. The scope and extent of its policies are limited, generally speaking, to a main urban centre and its rural surrounding. National policies of regional scope usually target areas larger than those of local municipalities..

Thus, the regions in this work correspond to a sub-national entities situated at an intermediate level between the national government and the local governments. The main difference between these two type of regions is that while in the case of Chile these regions do have a regional authority (which some argue is a requisite to be considered a region), in the case of the European Union, this is not always the case.

### 3 Decentralisation and regional development

Centralisation and decentralisation are concepts that have been present for a long time in societies and governments syllabus. As Pieterse (2001) points out, in 1800s and 1900s Europe, the centralisation of government was viewed as a necessary condition for progressive change because the provinces were the strongholds of conservative aristocratic elites. France is probably the most remarkable example of the different

stages these two concepts have passed through (Pieterse, 2001; Garrish, 1986; and Keating and Hainsworth, 1986). As Garrish points out, the ancient regime and the French revolution alike believed that in practice France had to be firmly held together. The Napoleonic state also saw centralisation as a desirable condition for the administration of the territory. Garrish argues that the pre-eminence of the State's role compared with that of local government is associated with 'Jacobinism', or the Jacobin myth, as Keating and Hainsworth claim. As time passed, the meaning of centralisation changed.

Within the theoretical debate of the changing role of the post-Second World War state, decentralisation symbolised democracy in countries that had fascist rules, such as Spain and Italy, and efficiency of service delivery in Western European welfare states (Ozcan, 2000). To this author, the core themes of this debate are the issues of democratic participation, local governance, efficiency and accountability. The reasons for that are that local economies would perform better if they were free from top-down political power and resource allocation structures, and that a better functioning local democracy and governance would be achieved by being accountable for resources and policy decisions and by maximising local capacities.

Nowadays, Pieterse states that "decentralisation is widely considered a necessary step toward progressive change... but what kind of progressive change?" (Pieterse 2001, p 414). The same author suggests that decentralisation involves at least five dimensions: administrative, political, fiscal, public investment and economic policy. He argues that decentralisation pays off only in combination with both central and local measures and effectively can work towards democratisation if it is combined with positive action in favour of underprivileged groups.

Dunford (1998) argues that the slowdown in productivity from the middle of the 1970s and the globalisation of the economic life led to a crisis of nationally organised models of development. According to this author, one consequence of this was a significant change in the structure of economic life and in the organisation and strategies of the state. At a political level, argues Dunford, these changes included a deconcentration and decentralisation of the State with in many cases a significant role for regions in the shaping of their economic development.

### 3.1 Political/administrative decentralisation

For Ozcan (2000), decentralisation and centralisation are referred to as particular situations, and they are not necessarily dichotomies. Cited by Ozcan, Bennett (1990) and Wolman (1900) define decentralisation in relation to centralisation in two main areas. First, decentralisation is analysed within the governance structure. In this, administrative decentralisation relates to concentration or dispersal of administrative functions. Second, as part of the free market, decentralisation symbolises a shift of economic policymaking power from the central authority to localities, non-governmental organisations and the market in general. Economic centralisation or decentralisation would be concern, therefore, with the location of economic decisions within the market mechanism.

On the other hand, Maddick (1963) argues that as all countries are short of certain highly specialised technical skills, with this problem being more severe in developing countries, the central government would be wise to concentrate them, and therefore, their particular function at the central level. To complement Maddick's statement, it is worth saying that not only the shortage of specialised technical skills but all kind of specialised or scarce resources tend to be managed in a centralised form.

For Maddick, decentralisation embraces both processes of deconcentration and devolution. He defines these concepts as:

- deconcentration: the delegation of authority adequate for the discharge of specified functions to staff of a central department who are situated outside the headquarters.
- devolution: the legal conferring of power to discharge specified or residual functions upon formally constituted local authorities.

For Maddick centralisation is not a problem. What he identifies as a disadvantage is too much centralisation or overcentralisation, a problem that according to him, would be more acute in underdeveloped countries. He mentions several general responsibilities of the central government that would be either ignored or inadequately handled when too much centralisation exist. These functions are:

- fixing broad priorities between:
  - i) different sections of policy,
  - ii) different parts of the country;
- Allocating scarce resources in accordance with these priorities;
- Planning the speed and the method of implementation (either by itself or through field agencies and local authorities);
- Planning the speed and method of industrial development;
- Where necessary, providing support services or enabling field agencies and local authorities to do this;
- Where necessary, providing finance for the execution of the plan (either directly or through granting of revenue-raising powers to local authorities).

Martínez (2000), defines several concepts related to decentralisation. According to this author these concept have played an important role in the evolution of the process of decentralisation in Chile.

- Administrative Centralisation. A system is administrative centralised when all its organisation is structured around a common axis. This administration is vertical and hierarchical and all decisions are taken by a central authority. Dependent bodies are judiciary, functionally and economically subordinated to the administrative centre. An example of these kind of dependent bodies are the ministries;
- Des-localisation. Consists of moving, from one place to another within the territory, productive activities, services or administrative functions. This re-localisation does not imply a restructuring of the administrative system, but a mere relocation of services or institution. A good example of this is the inauguration of the Congress in Valparaiso in Chile, at the end of the military government;
- Deconcentration. A deconcentrated administration is a variation of the centralised regime in which the central authority transfers to territorial bodies and personnel competence and responsibilities. This does not mean that these bodies gain any autonomy or acquire their own patrimony. The territorial bodies are dependent and accountable to the central authority. The main aim of deconcentration is to fight excessive centralisation and because of this, it can be understood as an important tool for achieving decentralisation;
- Regionalisation. For the case of Chile, regionalisation meant a new way of structuring the country with the aim of achieving a balance and harmonic

development of each of its territories. For Martínez, it is a reaction against the excessive centralisation that has characterised the country through its history. Chilean regionalisation aimed to strengthen and foster a particular territorial level, in administrative terms, known in Chile as the 'region'. Regionalisation, by itself, can not be understood as part of a concentrated or de-concentrated system, although strengthening the regional level will eventually lead to a delegation of functions and resources to minor administrative units, which in turn will end up contributing to the process of decentralisation;

- Decentralisation. Decentralisation implies a transference of competence from the central administration (presidency and ministries) to inferior administrations (regional and local). Although short and restrictive, this definition embraces an essential element of the process of decentralisation, that is, the transference of competence from a centralised organ to a distinct one. This features a major difference with the process of deconcentration, where the transference of competence was confined within the same hierarchical structure. On the contrary, decentralising entails the existence of two differentiated organs, with no hierarchical dependence between them.

According to these definitions, Chile has not yet achieved a fully decentralised status since its regionalisation does not consider the democratic election of regional authorities. Although regional governments possess legal identity and have their own patrimony, which is different from that of the central government, their authorities are directly appointed by the president of the republic.

As the process of decentralisation is evolving to new stages in Chile (with the election of the Regional Councils as the most probable outcome of recent agreements for the advancement of decentralisation in the country), Tobar (2000) introduces a question about the difference between a regional State and a politically decentralised unitary State. Cited by Tobar, Cea argues that a 'regional State' have to comply with five prerequisites: 1) legal identity, functions, attributions and own patrimony; 2) directly elected authorities; 3) autonomy, given by the constitution, to design and carry out its own duties; 4) the administration, jurisdiction and control of its duties should be done by the decentralised institution. Only ex-post revision of its act should be carried out by

the central competent authority; 5) the right of appeal to the Constitutional Tribunal when its designated tasks are invaded (Tobar 2000, p. 6).

For Ambrossini, the 'regional State' is an intermediate model between the Federal State and the Unitary State. The regional State would be characterised for the existence of two basic principles: 1) The unity of the State, and; 2) the political autonomy of its territorial entities. As a consequence, regions would enjoy of political and normative autonomy, but they would be neglected of having sovereignty (quoted by Tobar 2000, p. 6).

On the contrary, in a decentralised unitary State, regions do have normative capacity, although only in aspects regarding to regulations, not in laws or to a lesser extent with regard to parliamentary power, as in the case of 'federalist States'.

For SUBDERE (2000a), decentralisation is concerned, firstly, with the distribution of political power among the different territorial institutions of the state. This distribution of political power has to do with the functions and responsibilities associated to the different bodies and with the legal attributions and financial resources they have for the accomplishment of their duties. Therefore, decentralisation can be understood, primarily, as a process where political and decisional power is transferred to lower territorial unit.

In order to effectively have distribution of power to the different territorial units it is necessary, therefore, that these units have the competence to take decisions with autonomy respect to the units placed higher in the hierarchical scale. According to SUBDERE this can only be achieved, from the political point of view, when the regional and local authorities have been democratically elected and not appointed from the central government. In this sense, decentralisation is strongly associated with the concept of democracy, incorporating, as a result, a variety of other values and concepts inherent to different cultures.

Under this conception, decentralisation is overall a process that enhance democracy by highlighting the values of equity, participation and autonomy of the sub-national entities. SUBDERE also emphasises the importance of decentralisation as a mechanism

for contributing to the modernisation of the State, for reducing the distance between those who make decisions and those that actually are affected by such decisions. This closer link between decision-makers and citizens would reinforce the pertinence, focusing, efficiency and efficacy of measures, it would also diminish bureaucracy, and it would improve resource allocation and public expenditures.

One of the most illustrative examples of the application of decentralisation in a country is the case of France since 1982. In this case, the central government deliberately carried out a profound process of decentralisation of the administrative and political structure of the country. The reform implemented represented a remarkable renovation of local administration, of its power and in its capabilities. According to Gruber (1986), two technical instruments permitted to achieve this: deconcentration and decentralisation.

The main difference between deconcentration and decentralisation is the political aspect involved in the second one. Decentralisation involves the redistribution of power. Deconcentration does not have the same democratic value as decentralisation, and it is a mere instrument within decentralisation. Authorities appointed in deconcentrated administrative bodies are accountable to the central authority, they are their representatives at the territorial level.

In a decentralised system, the administrative distribution of functions lies on a genuine democratic concept of power. Decentralisation allows decentralised bodies to run their businesses in an autonomous manner; it assumes that these bodies have the necessary means to carry out their duties; and in particular, it assumes they possess legal identity.

For the case of France, Gruber (1986), defines two types of decentralisation: territorial decentralisation and functional decentralisation.

Territorial decentralisation involves a geographical distribution of power in the benefit of local administrative bodies. In consequence, and in apposition to what happens with deconcentrated bodies, the relationship between the central administration and the decentralised one is not hierarchical, but instead, a surveillance relationship intended to avoid the rupture of the national unity. In the case of a functional decentralisation, this is done for different services on the basis of a technical decision. It need not be a local

administrative body - it can be an specialised public establishment in charge of the provision of a public service.

Another example of decentralisation is that that took place in the UK during the eighties. This was primarily concerned with the decentralisation of local governments (Hambleton and Hoggett, 1987, Hodge, 1987, Arnold and Cole, 1987, Maddick, 1986, Garrish, 1986). According to Hambleton and Hoggett, this was because local governments in Britain were in crisis. Several problems, originated at the national level, were having a major impact on British local government. One way they saw these problems could be solved was through the decentralisation and democratisation of public service. In their view, democratisation involves accepting that local government is more a political than an administrative system.

Another example of decentralisation is that of 1994 with the creation of ten Government Offices for the English Regions (GORs). Under this structure, civil servants in the Training Enterprise and Employment Division of the Department of Employment and the Department of the Environment, Transport and Industry were made accountable to one Senior Regional Director. Later, in 1995 the Department of Education was merged with the Department of Employment adding a further significant dimension to the work and responsibility of the GORs (Mawson & Spencer, 1997).

Within the British experience on the decentralisation of local government, Hoggett (1997) draw attention on the use of the word decentralisation and on what may be hidden behind it. He suggests that decentralisation usually masks a multiplicity of prescriptions addressed to different symptoms. He continues, “there is a sense in which decentralisation is an almost empty term, a kind of camouflage behind which a diverse range of, often incompatible, political and organisational strategies can find cover” (Hoggett 1987, p. 215). His research on decentralisation in the London Borough of Hackney in 1982-83 shows that in that case “the word ‘decentralisation’ concealed a situation in which there were a number of competing initiatives with entirely different political and organisational factions lining up behind each other” (idem, p. 215).

As noted by Sharpe (1997), decentralisation of the modern unitary state was not a profusely predicted characteristic for many social scientist in the past from Mill to

Marx, rather the reverse was the tendency. The centralisation of government was thought to be essential for equalisation.

### 3.2 Financial decentralisation

Of all possible functions, using Musgrave's trilogy of public functions: allocation, redistribution and stabilisation, the fiscal federalism literature has reached a broad consensus that while allocation can be assigned to lower levels of government, the latter two remain more appropriate for the national government (Shah, 1999).

For Shah, an implication of public sector decentralisation, specially in developing countries, poses significant risks for the aggravation of macroeconomic problems. However, as Ter-Minassian (1999) states, the literature on fiscal federalism has also highlighted the potential trade-offs between decentralisation and income distribution, especially in countries with wide regional disparities in resource endowments and levels of development.

Financial (or fiscal) decentralisation is defined by Fukasaku and Mello (1999) as "the devolution of taxing and spending powers to lower levels of government" (p. 9). Mello (2000) provides a more comprehensive definition for fiscal decentralisation. He argues that "Fiscal decentralization consists primarily of devolving revenue sources and expenditure functions to lower tiers of government. By bringing the government closer to the people, fiscal decentralization is expected to boost public sector efficiency, as well as accountability and transparency in service delivery and policy-making" (Mello 2000, p. 365).

Mello (2000) argues that the decentralisation of expenditure functions and revenue sources also calls for decentralisation in fiscal policy-making. This would include greater autonomy in debt management, tax administration, and budget execution, so that the task of providing public goods and services and performing standard public sector functions can be shared across levels of governments.

According to Fukasaku and Mello, decentralisation is advocated on the ground that the central government cannot adequately meet the growing local demand for public good and services. They argue that the centre often fails to improve fiscal efficiency, as it tends to ignore local differences in culture, environment and natural resources endowment as well as economic and social factors, all important determinants of public sector performance. By action of bringing government closer to the public, they continue, is supposed to enhance accountability in service delivery and allocative efficiency by closing the gap between expenditure assignment and revenue sources. With significance efficiency gains, fiscal decentralisation will enhance growth as well. At the same time, it can reduce operational and information costs in service delivery and streamline public sector activities, hence facilitating fiscal consolidation and improving overall macroeconomic performance.

A World Bank statement<sup>17</sup> declares that the potential benefits of devolving fiscal responsibilities to sub-national levels of governments area increased efficiency in service delivery and reduce information and transaction costs associated with the provision of public goods and services.

The expected benefits of decentralisation must be, however, weighed against the risks involved in the devolution of taxing and spending powers to sub-national governments. This means that loses can also be expected with decentralisation. Fukasaku and Mello (1999) and Mello (2000) claim that fiscal decentralisation may aggravate fiscal imbalances by creating a deficit bias in fiscal policy making and consequently endanger overall macroeconomic stability. The key policy challenge for many developing countries, at this respect, is to develop appropriate systems of public finance and financial decentralisation to provide local public services effectively and efficiently without risking macroeconomic stability. Such has been the case of Chile during the second half of the last decade.

In general terms, as the study by Mello (2000) shows, among countries the relative importance in the provision of public goods and services is reflected in the size of the government expenditure. This can be measured both, in absolute terms (as in the case of

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<sup>17</sup> World Bank, 1997. Cited in Mello 2000.

the expenditure-GDP ratio), and in relative terms (as in the case of sub-national<sup>18</sup> spending relative to central government spending). As for the absolute size of government, they tend to be smaller in Latin America and Asia, than in the OECD countries. As Mello argues, it is widely accepted that the demand for public goods and services increases with income, in such a way that government expending tends to be larger in richer countries.

Central government spending ratios go from 20% of GDP in Asia, to 40% in the European countries of the OECD, Latin America being around 25%. In terms of relative government size, the sub-national share of total government expending is below 5% in Asia, ranges from 10% to 40% in Latin American, and from 12% to 60% in the OECD sample.

Despite significant fiscal decentralisation until 1995, in Chile, seen through the increase in the share of sub-national spending, this did not worsen central government or sub-national governments budget deficits significantly. The reason for this, argues Mello, is that the increase in sub-national spending was financed by higher sub-national non-tax revenue (fees, sales, fines, royalties, etc), instead of intergovernmental transfers and/or local tax revenue. Probably a very different situation could be appreciated in Chile at this respect by the end of the 1990s. The reason is that during the second half of the 1990s fiscal decentralisation started to be strongly financed by transfers from the central government.

#### 4 Public Infrastructure and Economic Development

Public infrastructure investment is of particular importance for this work. The reason for this is that in both cases, the Chilean Regional Development Fund (FNDR), and the European Regional Development Fund (ERDF), infrastructure investment is the main type of assistance of the funds. It is worth, therefore, to take a look at the way public

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<sup>18</sup> In his study, Mello aggregates data for local and middle-tiers governments. In the case of Chile, included in his sample, this is the aggregation of the municipal and the regional governments.

infrastructure is defined, why it is important, and how this seems to be related to the process of regional development.

Infrastructure issues have been and continue to be a matter of great concern for economists and policy making in the sphere of the public sector. Several studies have been carried out with respect to the importance of public capital investment and its relationship with a number of aspects such as quality of life and the effect of public infrastructure in the overall performance of the economy. Although in the decade of the 1960s and in the mid 1980s some studies were conducted in this area, it was only until the work of Aschauer in 1989a "Is Public Expenditure Productive", that the preoccupation widespread and a debate on the relevance of the subject as well as on the results shown by the study commenced. After that, a number of other authors started to conduct studies of similar nature (Munnell, 1990; Aschauer, 1989b and 1990; Peterson, 1990; Biehl, 1991; Gramlich 1990 and 1994; Cutanda and Parisio, 1994; Holtz-Eakin, 1995; Krol 1995 and 1998; Boarnet, 1998; Stain, 1998; Darby, Li and Muscatelli, 1998; Chandra and Thompson, 2000; Anwar, 2001, and many others).

According to Aschauer (1990a), public infrastructure is the capital stock of social and economic overhead, in its broad sense includes roads, highways, water and sewage systems, electric utilities, telecommunications systems, buildings such as education and health services, and bridges owned by the government. In a similar way Cutanda (1994) points out that 'public infrastructure' "refer to highways, airports, railways, telephones and telegraphs, water and energy supplies, schools, hospitals, etc., that provide an environment which facilitate private production" (p. 70).

Cited by Perry (1995), Muschamp states that "infrastructure... stands for the connective tissue that knits people, places, social institutions and the natural environment into coherent urban relationships.... It is shorthand for the structural underpinning of the public realm" (p. 1).

Infrastructure does not only include the obvious area of physical infrastructure such as roads, bridges, public buildings, but also it includes what has been called 'soft infrastructure'. In this category enters basic research and development and training development (Vickerman, 1991). The terms 'infrastructure', 'public investment',

'public capital' and 'capital investment' are used as synonymous in the literature and so are here.

#### 4.1 The importance of infrastructure investment

Perry stresses the idea that public infrastructure is often taken for granted. He quotes a passage from a work by the 'National Council of Public Work Improvement', of the United States where it is stated that "When roads, bridges, waste disposal sites, and water systems work best, they are noticed least or not at all. And when attention is finally focused on 'infrastructure', usually in response to system failure or severe or continued congestion, real damage has already been done" (Perry 1995, p. 2)

Anwar (1995) argues that public finance plays an important role in the economy by providing an industrial base by way of significant public investment in production infrastructure. He claims that empirical works that have examined the relationship between government spending and productivity growth have shown significant cross-country differences in productivity growth due to differences in the provision of public infrastructure.

Aschauer (1990a) stresses the importance of infrastructure to the quality of life, the environment, and private economic activity. He argues that there is a widespread concern about whether existing and projected infrastructure facilities can adequately support quality of life requirements and improvements in matters such as air quality, the reduction of infections and toxicity, reduce road accidents, etc. He argues that "apprehension appears to be greatest in the areas of the environment and transportation" (p. 25), that is, on water quality, solid waste disposal, mobility needs, and traffic congestion.

Aschauer noted quite a progress in the construction and updating of sewage treatment facilities in certain regions of the USA during the 1970s and 1980s. As a result, this seems have to had a significant positive impact on the nation's water quality. Despite this progress, however, inadequate municipal wastewater treatment remains a significant problem in many other areas of the country. Something similar has occurred

with the ability of municipalities to deal with garbage management<sup>19</sup>. The main reason for this would be the rate at which garbage is being generated compared to the number of facilities capable of handling these wastes.

Congestion problems, on the other hand, were expected to become increasingly severe in coming years. Aschauer claims that the usage of the Nation's surface and air transportation network has grown tremendously in the three decades preceding the 1990s. Apart from these cases where the current nature and future status of a nation's infrastructure may add to, or detract from, the overall quality of life, numerous additional cases can be identify where quality of life has been or will soon be improved or eroded as a result of infrastructure capabilities. For example crime (in the number of prisons or preventive institutions), traffic congestion (and its direct effect on, for example, loss of leisure time). A second direct effect of infrastructure is that associated with the economy. From the 1980's, Aschauer also sees an increasing preoccupation on infrastructure and its role in the economy.

Krol (1998) argues that at the most basic level public infrastructure, such as roads and sewers, make direct contribution to commerce and health because an efficient road and highway system helps to move people and their products in a timely low-cost manner. On the other hand, modern water and sewage systems have improved health in the industrialised world and are making a similar contribution in many of today's emerging economies.

This author examined the literature investigating the impact of public infrastructure on economic growth and development of recent years. He argues that the evidence suggests that examinations of the return to incremental investment in the United States and other industrialised countries shows a mixed result, while for developing countries the potential return is higher. The works of Aschauer (1989a and b) and Munnell (1990a) suggested that decline in US productivity growth and poor economic performance in the 1970s were caused by slower growth in public investment. Cited by Krol (1998), Ford and Poret (1991) were unable to replicate Aschauer's and Munnell's results using data from a group of OECD countries, while other authors questioned the methods used by

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<sup>19</sup> A current widespread problem in several regions in Chile and a highly sensitive topic, as it usually involves the interest of several public sectors as well as private interests.

Aschauer and Munnell for not considering the time trends in their data. These authors suggested that the direction of causality might go in opposite direction when greater level of outputs may encourage infrastructure investment.

Munnell (1990b) presented a further study on public infrastructure and economic growth focusing on the regional level. She estimated state production function in the US which included a measure of a state's public capital stock. Krol (1998), quoting the works of Holtz-Eakin (1994) and one by himself (Krol 1995) argues that Munnell failed to control for unobserved state differences in production characteristics which can seriously bias the results. According to Krol these two works found that additional infrastructure has little or no impact on state-level output.

#### 4.2 Infrastructure and economic growth

There seems to be a consensus on the importance of infrastructure, specially in aspects related to the quality of life of people. What is still under discussion is the effect that public capital may have on the performance of the economy. For some authors there is no doubt about the impact infrastructure has on the process of economic growth, what has to be further studied and analysed is the magnitude and direction of the effects.

Stain (1988) suggests that changes in the rate, structure, and distribution of national economic growth play an important role in both the demand for and the ability to support infrastructure investment. For this author, economic growth do have several effects on infrastructure demand.

First, the rate of growth influences the intensity of infrastructure use and, consequently, the extent to which capital facilities deteriorate over time and need to be replaced. In rapid growth periods, for example, the volume of goods produced and transported increases. Highways are then more intensely used, resulting in more rapid deterioration. This, eventually, creates a need for increased expenditures to repair, replace and construct new roads and bridges.

Second, growth is not uniformly distributed across all sectors of the economy or regions within a country. Different types of economic activity will generate different sets of demands for infrastructure facilities. Stain portrays the example of the United States economy as it has moved from reliance on heavy industry and traditional manufacturing to a high technology, knowledge-intensive, and service-based economy. Such dramatic changes have affected the economic well-being of individuals, as well as communities, states and regions. It has also altered the required mix of infrastructure facilities and results in new capital demands. For example, to accommodate the travel requirements of executives involved in the supervision of global production processes, such as the production of world-cars, many communities have built new airports or expanded existing facilities and runways to handle the larger planes used in international flights. Similarly, the need for public regulation of cable networks has greatly increased as data transmission and computer communications have grown in importance.

Third, again using the case of the United State, Stain argues that economic restructuring and sectoral shifts have combined with other factors to create uneven spatial growth. Some areas of the country, experiencing rapid population and economic growth, generate intense pressures to expand infrastructure facilities. Simultaneously, other areas are suffering from population and economic decline and must struggle just to maintain facilities and to manage excess capacity.

Thus, from an infrastructure perspective a highly inefficient situation has emerged. Some communities struggle to expand their infrastructure facilities, while others must consolidate or close facilities, such as schools or police stations, to reduce excess capacity (Stain, 1988).

According to Stain, the rate and distribution of economic growth influences infrastructure demand in three important ways:

- First, it affects the intensity at which facilities deteriorate and need to be replaced;
- Second, it alters the mix of required capital investment. As the economy restructures and new production technologies develop, demand patterns change and evolve. To the extent that the rate at which infrastructure became outdated

is the result of economic transformations and not neglect, it can be an important indicator of economic vitality;

- Finally, since economic growth is distributed unevenly, some areas of the country require additional infrastructure to serve growing population, while other face the often painful and politically controversial choices involved in closing and/or consolidating public facilities.

After looking at the way public infrastructure has been financed and owned in the United States since the middle of the 1800 century, Tarr (1990) notes that the ownership of major infrastructure services such as roads, bridges, water supply and sewer systems have shifted from private to public several times depending on economic circumstances and on the level of satisfaction of the population with the service, among other reasons. He also argues that burst of infrastructure spending do not necessarily result from concerns over infrastructure deterioration or inadequacy of service, as claimed by Choate and Walter (1984), but instead, agreeing with Stain postulates, rapid increase in investment occur because of a combination of factor on the demand and supply sides.

According to Stain, while concentrating in economic growth the federal government in the United States affects infrastructure investment in different ways. First, federal and fiscal and monetary policies have major impacts on the rate and distribution of economic growth. Expansionary policies accelerate economic growth, which generate tax revenue. At the same time, it also increases the rate of change and alters the mix of required infrastructure. The distribution of federal outlays, the incidence of taxes, and budget priorities all contribute to sectoral and spatial restructuring.

Second, the federal government makes direct investments in public physical capital assets. Third, federal regulatory policies affect the direct cost of infrastructure. Federal environment standards have raised costs in many infrastructure-related areas. Meeting standards, often a prerequisite for state and local governments to receive grants, have resulted in higher per unit costs of many infrastructure investments. In period of rapid inflation the costs of constructing facilities will increase and may unfavourably alter the expected ratio of benefits to costs.

Finally, the federal government provides direct grants to state and local government for capital outlays. Peterson (1988) states that, although federal assistance has varied in importance by functional category in the USA, since 1977 it has accounted for approximately 40% of state and local government funds for fixed capital formation.

In a study carried out for several countries in Europe, Darbi, Li and Muscatelli (1998), found that there was a significant link between increase political instability, reduced public investment and lower productivity. They demonstrated, based on a model of endogenous growth and using political data for various countries for the period 1960-1998, that there was a strong correlation between increased political instability and the reduction in government investment as a proportion of total fiscal spending.

Munnell (1990b), on the other hand, examined the relationship between infrastructure and three aspects that may have an impact on economic growth. These are: the role of public capital in the production process, public capital and private investment, and infrastructure and firm location.

According to Munnell (1990b), several studies have been carried out in order to present empirical evidence of the actual relationship between 'public capital and the production process'. In this direction is the work by Rioja (1995), who developed a model that can be used to make predictions concerning changes in the welfare of agents resulting from additional infrastructure investment.

Munnell (1990b) points out that the benefits of the contribution from public capital seem to greatly differ depending on the sector of the economy, for example, the public capital that one would expect to enhance private output e.g. highways and streets, and water and sewer systems, are actually the ones that have the highest statistically important relationship (see the works of Boarnet, 1998; Feltenstein and Ha, 1999; and Chandra and Thompson, 2000). On the other hand, public buildings, such as schools and hospitals, appear to have no direct measurable impact.

In the second one, that is the relationship between 'public capital and private investment', Munnell (1990b) argues that in this process two opposing forces may be at work. On the one hand, public capital appears to enhance the productivity of private

capital, thereby raising the rate of return and encouraging more private investment. On the other hand, public capital may serve as a substitute for private capital; to the extent this occurs, more public capital will result in less private investment. She concludes that the more robust results in the investment area are: a) public capital positively affects the marginal productivity of private capital, and b) public capital and private capital in the aggregate are substitutes.

The third aspect explored by Munnell (1990b), 'infrastructure and firm location', focuses on the relationship between public capital and new business formation or employment growth. According to this author, infrastructure could influence the location decisions of both firms and households. For example, the construction or improvement of roads, sewer systems, schools and hospitals would be expected to encourage people to move to a given area; in a similar way, firms requiring large amounts of water for their production process, would be attracted, all else equal, to areas with better water supply facilities, etc. In order to test for this hypothesis, Munnell (1990b) uses empirical data dis-aggregated at the regional level for the United State for the period 1970 to 1988. She concludes that the empirical work provided convincing evidence, that a state's investment in public capital has a significant positive impact on the state's private employment growth.

In a different attempt for measuring the impact of infrastructure in economic growth, Arrow and Kurz (1970), and Aschauer and Greenwood (1985), cited by Aschauer (1990a), presented a framework for analysing the potential importance of trends in infrastructure spending to the macroeconomy. They included the public stock of infrastructure capital on the standard neoclassical production function, expressed in labour-intensive form:

$$y = f(k, k^B)$$

where:

y = private sector output,

k = private capital, and

k<sup>B</sup> = public infrastructure capital (all expressed to employment)

Aschauer recognises that although limited empirical evidence suggests that the public capital stock is an important factor of production in the aggregate production technology, this seems to play a direct role in promoting private sector productivity.

This assertion has been questioned by Aaron (1990), for whom there is little evidence of this relationship between infrastructure and economic growth or, in words of Aaron, Aschauer “has greatly exaggerated its quantitative importance” (Aaron 1990, p. 52).

In a previous work, Aschauer (1989a) presented time series evidence for the post-World War II period in the United States that a ‘core infrastructure’ of streets and highways, mass transit, airports, water and sewer systems, and electrical and gas facilities bears a substantially positive and statistically significant relationship to both labour and multifactor productivity. He suggests that infrastructure expenditures may well have been a key ingredient to the robust performance of the economy in the ‘golden age’ of the 1950s and 1960s.

In a similar study, Aschauer (1989b) uses cross-country data from seven countries over the period 1965 to 1985 and finds that “upon controlling for private investment and employment growth, public nonmilitary investment bears a significantly positive relationship with growth in gross domestic product per employed person..” (Cited in Aschauer, 1990a p. 32). It was in this direction that, according to Girard et al (1994), a EU policy response recommended to increase the spending in infrastructure in the so-called Trans-European Networks.

Similarly, a work by Nadiri & Mamuneas (1994) found out that publicly financed infrastructure and R&D capital contribute to productivity growth. However, the magnitude of their contribution vary considerable across industries and on the whole they are not the major contributors of TFP (Total Factor Productivity Growth) in these industries. Their findings, nevertheless, show that the contributions of infrastructure is about twice as large as the contribution of publicly-financed R&D. the magnitude of these contribution of infrastructure capital proved to be however, much smaller than has been reported in the literature (such as the findings by Aschauer, 1989a; and Eisner 1993, quoted by Nadiri & Mamuneas). An even less optimistic view at this respect is that of Jones (1995). See the new growth theory at the beginning of this chapter.

Contradicting Aschauer, and Nadiri & Mamuneas findings, a similar work by Holtz-Eakin & Schwartz (1995), concludes that no important productivity spillovers was encountered when exploring interstate productivity spillovers from state highways.

These authors suggest that since the direct and spillover benefits may significantly differ across industries, further investigation may prove to be worth, as well as disaggregated analysis may be advantageous.

Musgrave (1990) also expressed his doubts, specially about the high ratio, between infrastructure and economic performance. This author draw attention to the causality of the linkage or, as he pointed out, the timing coincidence between high productivity growth and high infrastructure investment. Besides, as Krol (1998) points out, not only the investment in new infrastructure may have an impact in economic growth, lower investment in repair and maintenance of infrastructure as well as better programming and management might have a greater return.

Gramlich (1990) identify three types of infrastructure capital. This classification, based on normative considerations, has to do with the range and scope of the service in terms of the territorial direct and indirect effects. These are:

- *Local allocation*: This type of public capital serves local needs where minimal inter-jurisdictional spillovers and minimal distributional implications are found. Examples of these type of infrastructure would be a public park and a local landfill;
- *Local allocation with spillover*: The same as *Local allocation* except with benefits spillovers from one jurisdiction to another. Illustrative examples of these are national roads, wastewater treatment, or clear air facilities;
- *Local allocation and distribution*: Now public capital serves goals that importantly affect the distribution of income in the long run. Examples are local public schools, and regional university systems.

#### 4.3 Infrastructure and regional economic development

As early as the decade of the 1950s the importance of infrastructure was identified as an important factor for development. Cited by Rioja (1998), Hirshman (1958) pointed out that “social-overhead capital investment, i.e. infrastructure, could attract more private investment serving as a development strategy” (p. 338). Girard et al (1994) contradict this idea arguing that is not clear how new infrastructure would benefit a particular location. They claim that this will depend much upon the type of infrastructure and the

structure of the region in question because different sectors will be affected differently, some will be helped and some will be hurt.

Subsequent works (Lefebvre, 1964; Stain 1988; Vickerman, 1991; Biehl, 1991; Gérardin, 1991; Townroe and Mallalieu, 1991; Krol R., 1995 and 1998) have recognised the relationship that exist between regional development and regional allocation of resources. Regional allocation of resources understood as public capital investment or, what is the same, the investment in public infrastructure.

The ultimate purpose of economic development is to increase the standard of living of the masses of people in low-income group. To attain this goal national income must grow at a faster rate than the increase in population, and the benefits of income growth must be distributed equitably (Lefebvre, 1964).

The process of economic development in its geographical setting requires growth at different rates in different areas. Attempts to industrialise (develop) retarded regions ahead of time and at the cost of slowing down the growth of more vigorous areas must necessarily put off the date of bringing relief to the former. Inefficient regional allocation of investments results in wasting of scarce resources (Friedman and Alonso, 1964).

Lefebvre (1964) pointed out that efficiency of regional resource allocation is crucial for increasing the capacity of investment and economic growth. He, however, recognised that in order to accelerate the future development of retarded regions the growth of industrially more advanced areas must be encouraged. If the latter is stifled by insufficient investment the over-all capacity to save will be diminished and the advancement of retarded areas will be delayed even longer.

Contradicting this assumption Rahman (1964) found out that “in the presence of differential regional rates of saving, the rate of growth of total national income is not necessarily maximised by concentrating investment in the more productive region throughout the planning period” (p. 655). The simple fact that some regions are better endowed with natural, human and technology resources than other or that governments will have a greater urgency in exploiting certain resources favouring certain regions

over another will, as a consequence, provide the ground for regional differences. Lefebvre suggests that growth in some areas will provide surpluses for future investments and the consequential savings will release resources to be invested in other regions, which in turn will raise the living standard of the local population and create new surpluses and resources for continued development. The latter will manifest itself in the creation of new growing points in previously stagnant or slowly growing areas. In good time the number of growing areas should increase to a density which is adequate to provide a satisfactory regional balance.

At this respect, Boarnet (1998) draws attention to the fact that if public capital is provided at a particular place, it enhances the comparative advantage of that location relative to other places. Thus, one possible effect of public infrastructure investment is to draw production into a relatively infrastructure-rich location at the expense of more infrastructure-poor locations. Working under this assumption, Boarnet develops a model of public capital in two cities in order to examine the location impact of infrastructure investment.

There exists the risk, however, as Vickerman (1991) pointed out, of having a negative effect and instead of enhancing a particular place the contrary may happen. Much investment in lagging regions may simply result in leading regions to enlarge the size of their markets, specially if infrastructure investment is roads construction.

## 5 Conclusions

Many theoretical concepts have been discussed in this chapter. Economic growth, regional theory, the process of decentralisation and public infrastructure investment are all related concepts that have to do with regional development. Economic growth as a necessary condition to achieve development, regional theory as the theoretical basis to understand the process, decentralisation and public infrastructure as policy tools for helping in the consecution of the desired objectives.

The interlinking of the main theoretical concepts is presented in a simple diagram below (Figure 2.1). Concepts are grouped into three categories, i.e. *process*, that includes decentralisation, regional funds, and economic growth; the *territorial unit*, the region, as

the space or the basis where all processes converge to produce the resulted *state* of development.

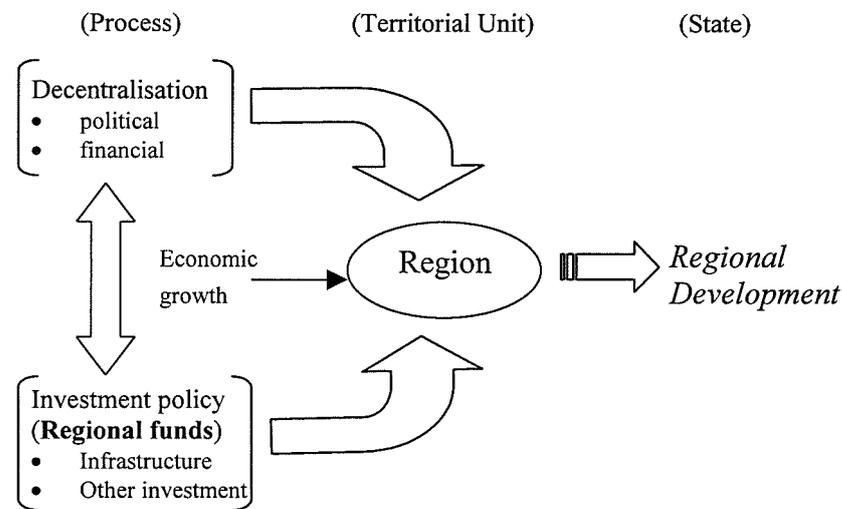


Figure 2.1: The linkages between Regional funds and regional development

The main interest of this work is the study of the regional funds and the way these may influence regional development. Regional funds do not act alone in the territory, on the contrary, they are influenced and they at a time affect other components of the process of development of the regions. In the case of Chile for example a neo-liberal strategy of economic development dominates Chile's economic strategy of development. On the political side, an increasingly process of decentralisation is undergoing with political and financial consequences for the administration of the country as a whole and for the regions in particular.

On the other hand, regional funds, that have been in existence for more than twenty-five years in the country, are starting to play a fundamental role in development strategies of the regions themselves. These funds, that once distributed from the central government, are used for whatever purpose regional authorities believe may better help regional development (within certain limits that restrict their use on specific sectors of investments and type of projects).

The gains in financial and political decentralisation of recent years and the continuous growth in the amount of resources for regional funds have raised concern on the use of these funds and the role they can play in regional development in Chile. Chapter 4 gives a detailed account on the nature and current use of these funds.

## Chile's Regional Development Experience

### Introduction

This chapter gives an account of the country's development experience in recent years. The emphasis is on the main features that concern regional development, that is, the evolution of Chile's administrative structure regarding its regions, and its economic and social development. The chapter begins with an account of the historical periods (phases) establishing processes of decentralisation and de-concentration throughout its history, particularly during recent years. It continues with a description of the Regional Government administrative structure, in operation since the mid-nineties, and ends with a description and analysis of Chilean economic and social performance.

### 1 The Process of Decentralisation

Regional disparities in Chile reflect the high degree of centralisation of the country rather than actual social or cultural differences between regions. The colonial legacy of centralisation of political power and the economic apparatus of the country focus resources in the city of Santiago. The corollary is a constant draining of the surplus produced in the rest of the regions. National policy in Chile exhibits several attempts to decentralise its recognised highly centralised political and administrative structure.

Although demands for decentralisation have regularly emerged throughout Chile's history, it is only in recent years that these have taken a political form. Similarly, proposals for decentralisation from the central government, with different and dubious degrees of success, have also appeared from time to time, either responding to specific demands from the regions or simply as national strategies for the development of particular regions.

The importance of national government in regional development in Chile has been largely recognised over time and can be mainly explained by the role the state has played in the process of economic development of the country. During the last century

(1900s) and especially during the second half of it, the state has played an active role in promoting several economic policies of national and regional impact. These policies were directed, essentially, towards the provision of a social infrastructure and the location of basic key industries outside the capital city.

During the 1940s and 1950s the country adopted the import-substitution model of development<sup>20</sup>, well known to the rest of Latin American countries. Heavy industries such as oil refineries, steel and electricity were created under the close protection of the state. The national financial system matured in this period and the overall economic growth that resulted from these policies was followed by the creation of widespread programmes in the areas of education, health, and housing.

In the 1960s and early the 1970s the state influence was used to promote social participation. From 1973, under the military government, the most important aspects were the reduction of the public sector, the privatisation of the economy, and the subdivision of the country into regions (Hernández y Abalos, 1996).<sup>21</sup>

Since the early 1990s democratic governments substantially revised predecessors social and economic policies. Decentralisation and democratisation of the nation are now the main priorities. Despite the experiences of the past decades, when different governments tried to adopt measures in favour of the development of particular zones of the country, it is in this period where the most significant advances in democratisation and decentralisation have been achieved.

## 1.1 Historic background

The strong political and administrative centralism imposed by the Spanish Crown during colonial times did not change significantly in the first years of republican life. In this sense, Chile's early years as an independent state did not differ much from other

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<sup>20</sup> The import-substitution model of development, adopted in most Latin Countries during the 1950s and 1960s, is that in which technologically advanced products (refrigerators, radios, televisions, motor cars, etc), rather than being imported, were first assembled and then manufactured in these countries.

<sup>21</sup> After one year in office, in 1974, the military government divided the country into 13 regions, numbered in Roman characters from Region I to Region XII (north to south), plus the Metropolitan Region of Santiago (the Capital City) which for some reason was not given a number.

Latin American countries where the newly established governments of reactionary *Caudillos*, as Woodward (1971) points out, were dedicated to restoring the peace of the colonial era. A recent study from the 'National Office for the Promotion of Regional Development and Administration' (SUBDERE) has characterised the early periods of republican life in Chile as one strongly influenced, with different degrees of intensity and legitimacy, by its centralism and presidentialism (SUBDERE, 2000a).

SUBDERE points out that the first idea on decentralisation corresponds to a federalist attempt by José Manuel Infante, who in 1826 proposed the establishment of the so called 'federalist laws', inspired by the model of the United State of America.

Beginning with this episode SUBDERE's study describes several measures in favour of decentralisation of the country up to the present day. These measures were grouped into four clearly differentiated periods in the history of decentralisation in Chile.

a) From the Federalist laws (1826) to the end of the 1833 Constitution

The Federal Republic attempt consisted of regional governors appointed by the central authority and *cabildos* to be elected by popular vote. The three original provinces of the republic were expanded to eight, and regional assemblies were created composed of elected members. However, as a result of the political instability of the period these laws were never applied, although the eight provinces scheme prevailed.

This 'anarchic period', as it was called, ended in 1833 with a new Constitution that would remain in force until 1924. This charter created the presidential regime that set the basis for political organisation and the centralised administration known today. This constitutional text maintained the division of the country into provinces and *departamentos* headed by appointed authorities.

The most important progress towards decentralisation made during this period was the promulgation of the first law for the creation of municipalities in 1854, and the law for the transference, from the departments to the municipalities, of several public services, in 1887.

In conclusion, this first phase in Chile's history as an independent state was characterised by the establishment of a centralised administration system.

b) From the 1925 Constitution to 1973 (the beginning of the military government)

The Constitution of 1925 includes the first explicit attempt for decentralisation. Here, the functions of 'government' and 'administration' are clearly separated, limiting, therefore, any attempt for decentralisation to the simple matter of administration. This conception was based on the ground that the unitary nature of the Chilean state would reject by itself any forms of political decentralisation.

The 1950s saw the materialisation of several strategies of regional development for selected provinces, which involved the de-concentration of the offices of Credit, Investment Promotion, and Planning. In 1967 ODEPLAN, the Office for National Planning, was created. ODEPLAN's primary mission was to work on the development of the country from the basis of a regional subdivision.

In this period municipalities were led by democratically elected *alcaldes* (mayors), that functioned under the control of each province assembly.

Focused more on technical rather than political aspects, ODEPLAN, set up the bases for the regional subdivision of the country. Stöhr (1969b) argued that Chile was the prototype of a highly decentralised country. Although a formally unitary system, "there existed several implicit factors of regionalism in a country of such narrow extension from North to South (4,200 kms) and great geographic, climatic and cultural differences such as Chile" (p. 124). According to this author, the implicit forms of regionalism were based on three factors: differential ecological patterns; different colonisation background, and; regional legislation.

- Based on ecological patterns Stöhr identified three zones: 'metropolitan zones' Santiago, Valparaiso and Concepción; the 'consolidate zones', from Aconcagua, right North of Santiago, to the Island of Chiloé in the South, and; the 'colonisation zone', that comprises the low populated peripheral parts of Chile in the North and South;

- Based on Colonisation background (this refers to period of colonisation, national composition of the settlers and former national affiliation of territories) this author highlights the preponderance of Yugoslav settlers in the far South and coastal zones in the North of the country, the historical roots with the neighbouring countries of Perú and Bolivia in the North, the predominant Spanish cultural elements of Central Chile, the German settlers in the south, and the Indian frontier South of the Biobío river;
- Based on Regional legislation, which refers to certain legislation that contains privileges or incentives for certain parts of the national territory, he identifies attempts of the national government to tie peripheral areas more closely to national authorities. Examples of these have been the ‘copper law’ that intended to channel parts of the returns of Chile’s copper export to the copper areas of the North, the law establishing the Magallanes Corporation in the far South.

With these implicit regionalisms existing, ODEPLAN defined by the end of the 1960s ten regions plus a metropolitan zone<sup>21</sup>. According to Stöhr (1969b), the regions were to serve three concrete purposes: the regionalisation of the national development plan, administrative decentralisation, and the elaboration and execution of regional plans.

This period established two key elements for future regionalisation. One was the regional administrative framework. The other, codified by the Constitution of 1925, was the grafting of decentralisation onto the public agenda. This opened wider spaces for democracy.

#### c) The military government (1973-1989)

At the beginning of its period, in 1974, the military government implemented what was called the ‘process of regionalisation’<sup>22</sup>. This process consisted of a spatial re-ordering that sought to articulate the economic, social, geo-political and administrative features of sub-national territorial units, for the purpose of attaining a sustainable regional

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<sup>21</sup> With further transformation regions were incremented to twelve plus the Metropolitan Region of Santiago. The same units that exist up to these days.

<sup>22</sup> Which was part of a package of measures called ‘the seven modernisations’ (Rosenfeld and Marre, 1997) undertaken to remake Chilean politics.

development (CONARA, 1974). These units, that experienced few changes until finally implemented, became the thirteen regions of present day Chile.

These regions were given a nominated authority, the *intendente*, government institutions, devolved public administrations, space for community participation, and responsibility for the planning of their economic and social development. However, there were no funds allocated for their administration. In this early stage of regionalisation the emphasis was put on the peripheral regions of the country under the concept of geo-political measures to reinforce the country's more vulnerable areas.

The former *departamentos*, *subdelegaciones* and *distritos* were suppressed, regions, headed by appointed *intendentes*, were divided into *provincias* and these into *comunas*. Provinces were led by *gobernadores*, and *comunas* by *alcaldes*, both appointed by the head of state.

The priority attributed to regionalisation at this time, has been argued to do more with the adjustment to a new open economy than to a real attempt for decentralisation (Boisier, 1993; Dockendorf, 1996; Martínez, 2000). According to Boisier this attempt could not survive within the logical contradiction between a so called 'policy for decentralisation' and an authoritarian regime unable to open political spaces.

Therefore, the process of regionalisation, in this period, can be understood as an administrative devolution under a centralised political power, because, rather than a transfer of power to sub-national units, what actually occurred was a delegation of functions to regional and local institutions. Later, in 1980, this was reinforced by the transference of the education and health services as a municipal responsibility.

There were other significant actions in support of decentralisation such as the creation of CODERES<sup>23</sup>, a body made up of private entrepreneurs that decided on the allocation of investment resources within regions, the creation of SUBDERE in 1985 as the public office in charge of pushing the decentralisation process, and the setting up of SERPLAC

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<sup>23</sup> The exact meaning and functioning of this body is explained below in this chapter when presenting the historic background of the Institution of the Regional Government, numeral 2.1.

(the regional planning offices), located in each region and responsible for the administration of regional funds and planning.

In terms of fiscal resources, the year 1974 saw the set up of the Regional Development Fund (FNDR) and the *Fondo Común Municipal* (FCM). The FNDR fund functioned for ten years with national resources, but its reserves were increased in 1985 through a loan from the Inter American Development Bank (IDB). The FCM is made up of contributions from all Chilean municipalities. Once collected, the fund is then re-distributed back to municipalities providing that the poorest receive more than they actually contributed to the fund. In addition to the fiscal changes, this period saw the creation of regional universities, which were made up from the regional branches of universities based in Santiago.

The de-concentration process carried out in this period was seen as the way to increase efficiency of the delivery of certain services, with no attempt to link ‘municipalisation’ and ‘regionalisation’ with participation and democracy. The level of de-concentration achieved in the period clearly signified a great advance for a system of regional and local administration (SUBDERE, 2000a).

d) From 1990 to the present, a return to democracy

After 1990, decentralisation took a different pace. The interest of the newly elected governments to improve democracy and to increase participation fostered the development and application of a variety of policy instruments for increasing regionalisation, at both the regional and local level. Decentralisation in the 1990s was based on what has been called a ‘policy for modernisation’. Essentially, this policy concentrates on three areas: Strengthen democracy, understood as the increase in opportunities for citizen participation; Effective management, oriented to the improvement of the quality of the services from the public sector; and, Increase budgetary efficiency, understood as the best possible use of public resources avoiding waste and improving allocation focusing.

There is evidence of these policies in the changes introduced at the local level. The *alcaldes* (mayors) started to be democratically elected from 1992, including those of the

most populated *comunas* of the country (such as Santiago, Concepción, and Valparaíso) which, prior to the military government, were appointed by the President of the Republic. To finance their expenditure and increasing activities at the local level municipalities rely now on their own resources. The main sources of revenue for local government are road tax, business duties, construction levies, and the FCM.

## 1.2 Financial decentralisation during the democratic governments

The process of decentralisation of the state can not be conducted separately from the political, administrative and financial components, but, on the contrary, the process has to advance at a similar pace among all of them. In the 1990s the main steps towards this end have been:

- a) A financial decentralisation with emphasis on expenditures rather than public revenues. This has been characterised by a real increase in the magnitude of resources available to sub-national territorial entities, and a less important growth in relative terms compared to total public expenditures;
- b) The development of new instruments for regional investment such as the ‘programming documents’<sup>24</sup>, the ‘Regional Investments of Local Allocation (IRAL), and the *Ley de Concesiones* (Law on Conceding) that allows the participation of private contractors in the building of roads and other civil works;
- c) The establishment of the Regional Governments as the main actors in the process of public regional investment.

Important achievements of this decade were:

- The diversification of the instruments for regional investment. Up until 1990 the only regional investment fund was the FNDR, in the year 2000 there were four different investment instruments;
- FNDR Investments. The FNDR fund was responsible for a 55% of the regional investment in 1994, in relative terms reduced to a 36% by the year 2000, but still remaining as the most important regional fund within the IDR. In real terms, the

FNDR grew by 45% in the same period, while total public investment grew only by 1%;

- ISAR funds. The sectoral investment decided by the Regional Government grew in the number of sectors it covered and in the absolute amount of resources involved. Its importance in relative terms, however, decreased from 1994 to 2000. ISAR represented only a 19% of the total IDR in the year 2000 (Figure 3.1a and 3.1b);
- IRAL resources. This regional fund is distributed from the Regional Governments to the municipalities, which have the final decision on the allocation of resources. These funds have experienced a slow growth over time and by the year 2000 they represent 8% of the total IDR;
- Programming Documents. These are agreements between one or more sectors and one or more regional governments for the execution of projects that due to their size and the amount of resources require the participation of at least two partners. Projects carried out under this scheme usually last for more than one year. The investment in this type of instrument represented, in the year 2000, 26% of the regional-decided investment (figures 3.1a and 3.1b).

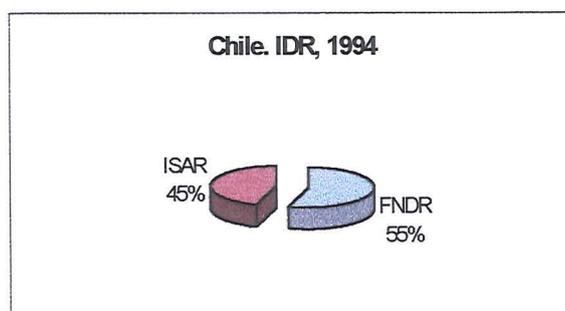
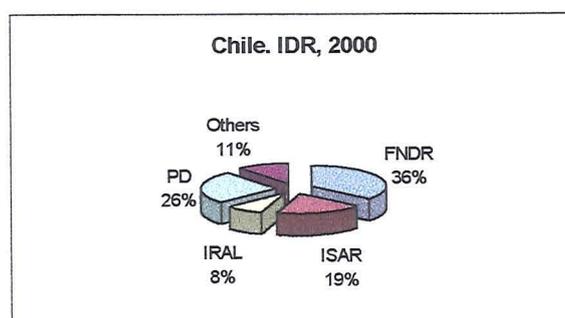


Figure 3.1a: Regional Investment Instruments (IDR), 1994



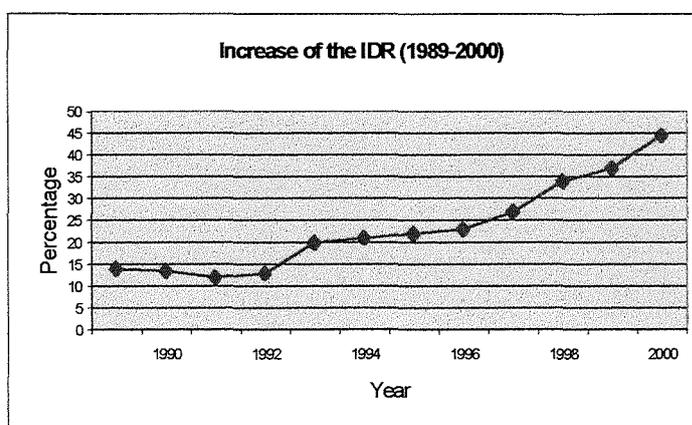
Source: Adapted from SUBDERE, 2000-C

Figure 3.1b: Regional Investment Instruments (IDR), 1994

<sup>24</sup> Investment plans with the participation of one or more regional governments and one or more sectors (sectors or ministries).

The presidential goal of doubling the amount of regional-decided investment resources announced in 1994, in order to go from a 21% in 1994 to a 42% in the year 2000 has been achieved. In the third *Concertación* government the new target figure is to reach 50% by the year 2006.

However, despite the progress from 1989 to 2000 in the amount of resources available for the regional level (Figures 3.2 below), funds still remain strongly conditional on restrictions imposed by both the central government and by the source of finance of the funds. SUBDERE (2000a) has estimated that about 65% of the IRD is under some kind of restriction.



Source: Calculated from data from the Banco Central, 2000

Figure 3.2: Increase of the IDR (1989-2000)

### 1.3 Summary and conclusions

A United Nation Development Programme (UNDP) study ranked Chile 34<sup>rd</sup> on human development<sup>25</sup>, amongst 174 nations in 1998. As an average indicator for the country as a whole this figure seems to be acceptable. The reality of many regions within the country is, however, quite distant from this achievement.

Decentralisation in Chile has certainly played an important role in increasing opportunities for regions in the areas of public administration, and the management of

<sup>25</sup> With an index of 0.893. In order to measure Economic development and economic and social divergences among countries, in 1990 the United Nation Development Programme (UNDP) introduced

investment resources. It has played a lesser role in the election of local authorities and, although indirectly, in the election of the regional assemblies.

The structural problems caused by the traditional highly centralised system persist in the country. There are still many things to do in terms of the distribution and re-ordering of political power. Hernández (1994) claimed that decentralisation is not only a way of conceiving the functioning of the state, but overall, a way of articulating political power, that is, a way of distributing political power to sub-national territories.

The redistribution of power, although considered in the “Agenda for Decentralisation” of the present government, is something which has not yet been achieved in Chile. The greatest achievement in this area has occurred in the amount and management of regional resources for public investment. As these resources continue enjoying a period of sustained growth, Regional Governments, the bodies in charge of the administration of regional funds, will certainly play a key role in Chilean regional development.

In economic terms, the country has lost relative competitiveness compared to countries with similar characteristics. Ulloa (1997) attributes this to the economic strategy followed by the country. The emphasis on the exploitation of natural resources, combined with the supply of cheap labour, limits the sustainability of growth. A radical shift of economic expansion is needed to regions beyond the traditional ones and to other activities with greater value added and better qualified manual labour.

This strategy has had a differential impact on regions. Economic development has concentrated in Santiago, although natural resources are located in regions outside the capital city. The regions have been unable to appropriate their share in the benefit of economic growth and benefit proportionally with the overall development of the country. The incapacity of the centre to redistribute wealth is something that needs to be addressed alongside with decentralisation if the current model is to be sustainable in the long run.

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the so-called human development index, which combines various indicators such as life expectancy,

## 2 The Institution of the Regional Governments

This part of the chapter presents the main components and describes the principal tasks of the recently created institutions of Regional Government (RG) in Chile. These public bodies, created by law in 1993, are responsible for the administration of the existing territorial units known as 'regions'. They have also been the main keepers of future public policies embracing de-concentration and decentralisation initiatives. As the law on Regional Governments established a wide-ranging number of tasks for the regional governments, these are acquiring an increasing number of responsibilities as they have been consolidating since 1993.

The administrative territorial division of Chile consists of:

- a) Regions: There are thirteen (13) regions which are headed by the *Intendentes*.
- b) Provinces: There are 51 provinces. Depending of geographical factor, population, and other factors, regions may have two or more provinces. Provinces are headed by the *gobernadores* (governors).
- c) *Comunas*: There are 342 *comunas*. Similarly, depending on geographical factors, population and other characteristics, provinces may have several *comunas*. *Comunas* are headed by *Alcaldes* (mayors).

*Comunas* are the only territorial divisions where the main authority is elected by popular vote. In the regions and provinces *Intendentes* and *Gobernadores* are appointed by the President of the Republic, as has been the case since 1925.

### 2.1 Historic background

The previous section documented the processes of decentralisation and territorial administration as far back as to the nineteenth century. These concepts were included within the 1814, 1818, 1822, 1828, and 1833 constitutions, that to certain extent established the existence of different territorial de-concentrated units (the *cabildo*, regional assemblies, etc., and their corresponding authorities).

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educational attainment and GDP per capita in a single index (<http://www.undp.org/hdro/report.html>).

The 1925 Constitution (chapters VIII and IX on Internal Government and Administrative Regime) established that Chile was to be divided into provinces administered by an *intendente* with the support of a Provincial Assembly. This organisation lasted until the end of the democratic regime in 1973.

During the Military Government, Acts 573 and 575 divided the country into regions administered by an *intendente* with the support of a *Consejo de Desarrollo Regional* (CODERE), which was a regional council integrating representatives of the different economic sectors of the regions plus the provincial governors and representatives of the different bodies of the armed forces. One of the most important tasks of CODEREs was to participate in the appointment of the *alcaldes* (the mayors of local councils).

The 1980 Constitution followed the model dictated by Acts 573 and 575 but with some differences. The main difference was in the approach to the definition of the concept of de-concentration. In reference to 'regions', the introduction of article 3 of the constitution established that "its administration is to be territorially and functionally decentralised..." and not as it was previously stated in the Constitutional Act N° 2 of 1976, which established "a functional and territorial de-concentrated administration"<sup>26</sup>. Therefore, the introduction of the concept of 'decentralisation' appeared for the first time in a law that defined the establishment of territorial units (regions) for the administration of the country.

At the end of the military regime, on August 17, 1989, a reform of the 1980 Constitution (specifically article 47 of law N° 18.825) gives the future Regional Governments '*personalidad jurídica de derecho público y patrimonio propio*'. That is, it gives the Regional Governments legal personality (autonomy) and own patrimony (goods, and funds delivered from the central government).

On 12 November 1991, under President Aylwin, the first elected president after the military government, a new reform of the 1980 Constitution (law N° 19.027) set the ground for the birth of the new public bodies of the regional governments. The law established that the goal of Regional Governments is to become the superior

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<sup>26</sup> Luz Bulnes, *La Regionalización*, pp16-17, Editorial Jurídica de Chile, 1988. Cited in Tobar (2000).

administrator of the regions. Finally, based on these reforms, in November 11 1992, “Ley N° 19.175 Orgánica Constitucional sobre Gobierno y Administración Regional” – LOCGAR founded the Regional Government institution. The law was published in March 1993. Thus, the official birthday of the Regional Governments is considered to be in 1993.

LOCGAR stated that the principal aim of the Regional Government is the social, cultural and economic development of the region. It also provided that to carry out its mission it will have to observe, as a basic principle, a balanced and stable development of its territory. To perform its duties the Regional Government will have to comply with the principles of justice, efficiency and efficacy in the allocation and utilisation of public resources and on the supply of services; to ensure effective participation of the regional community and to work for the preservation and improvement of the natural environment (Articles 13 and 14 of LOCGAR).

## 2.2 The structure of the Regional Governments

Regional Governments (RG) consist of two bodies: The Regional Executive, and the Regional Assembly. The head of the RG is the *Intendente Regional* (the *Intendente*) who acts as its president and head of the Executive. The Regional Assembly is a representative body with normative, resolution, and control faculties. LOCGAR provided that the *Intendente* is appointed by the President of the Republic, and the Regional Assembly is elected by the councillors of all the municipalities that form part of the region.

### The Regional Executive

This body is made up of the Regional Cabinet and the Executive office, the administrative service of the Regional Government, which the *Intendente* has at his disposal to accomplish his role.

The Cabinet is made up of the governors of the provinces of the region and the heads of the de-concentrated offices of the national ministries. Led by the *Intendente*, the Cabinet

elaborate and co-ordinate the different initiatives that are to be proposed for the consideration of the Regional Assembly.

The Executive assists the *Intendente* in the accomplishment of his duties as established by law, particularly in the administration of the FNDR fund. At present, the management of the FNDR fund represents almost 100% of all the activities being carried out by the Executive office.

To carry out its duties The Executive Office of the Regional Government is organised into departments grouped into two Divisions: the 'Division of Investment and Productive Promotion', and the 'Division of Finance and Administrative Affairs'. The number of departments in both division varies in the different regional governments.

#### The Regional Assembly

Each Regional Assembly is constituted by varying number of members (14 to 28 counsellors) dependent upon the region characteristics (population and number of provinces). The Counsellors are elected by the municipal councillors, who are elected by popular vote, thus granting the Regional Assembly a political representation. To perform their duties and responsibilities the counsellors are organised into commissions, similar to those of the National Parliament or the municipal councils. The number of commissions varies from one region to another, however, the main commissions are found in all the thirteen regions of the country. These include: Interior Administration, Territorial Management, Investment, and Productive Economic Development.

### 2.3 Tasks of the Regional Government

LOCGAR distinguishes between general objectives and specific tasks of the Regional Government (RG).

#### General Objectives

In general terms, LOGGAR establishes that the RG has to pursue an harmonious and balanced development of the territory. This should be done under the principles of equity, efficiency and effectiveness in the allocation and utilisation of public resources,

and in the provision of services and effective regional community participation, as well as in the preservation and to improvement of the environment (Article 14).

In doing so, the RG is to pursue the attainment of the following three objectives<sup>27</sup>:

- the economic development of the region;
- the social development of the region and;
- the cultural development of the region.

In pursuing these objectives the law identifies general tasks for the RG (Article 16). The most important responsibilities of those related to economic, social and cultural development are:

- the preparation of policies, plans, and programmes of development for the region, and the formulation of the regional annual budget;
- to decide on the allocation of resources delivered to the region that correspond to the Regional Development Fund (FNDR), and other regional funds;
- to decide on the distribution of resources for regional sectoral investment (ISAR);
- to assist municipalities in the formulation of their plans and local development programmes;
- to co-ordinate with the Central government on the different aspects of their action.

### Specific Tasks

LOCGAR identifies specific tasks for the Regional Government (Arts 17, 18, and 19). These tasks are grouped into three areas of regional development: territorial development, productive activities, and social and cultural development<sup>28</sup>. The principal tasks for each subject area are outlined below.

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<sup>27</sup> These objectives are similar to those defined for the work of the Fondo Nacional de Desarrollo Regional, the FNDR, and sometimes this has led to confusion at the moment of evaluating the results of the action of the fund. The establishment of a clearer definition of the objectives of the FNDR will be discussed in chapter 5.

<sup>28</sup> There is not an exact correspondence between each of the three objectives and the three areas of development for which specific tasks were identified. Article 14 of LOCGAR is one single paragraph that states the principles on which the RG have to base its functioning, and at the same time just mentions the objectives with no specificity.

#### Specific tasks on territorial management

- To set up policies and objectives for a balanced and integrated development of the system of urban centres in the region;
- To participate, in conjunction with the national and local corresponding authorities, in the provision and improvement of public infrastructure;
- To promote and support the protection, conservation and improvement of the natural environment;
- To promote the development of rural areas and isolated urban settlements, ensuring an integrated action on these localities.

#### Specific tasks on productive activities

- to help the Central Government towards the formulation of productive activities policies, technical assistance and development of employment through job qualifications and training;
- to establish priorities on productive investment for the different sectors, and to guarantee a rational exploitation of resources in both the public and private sector;
- to encourage scientific and technological research and care for the development of higher education;
- To support the development of tourism at the regional and provincial level.

#### Specific tasks on social and cultural development

- to set up regional priorities to cope with poverty;
- to participate, with the corresponding authorities, in initiatives destined to provide basic services to poor people or those who live in isolated areas within the region, in the areas of health, education, culture, housing, social security, sport and recreation and legal advice;
- to make sure the regional programme of investment only include projects that comply with the socio-economic and environmental requirements established by law;
- to carry out studies to assess the level and quality of life of the inhabitants of the region;
- to promote cultural manifestations, to care for the historic and artistic patrimony of the region, and to protect the development of ethnic groups.

## 2.4 Summary and conclusions

The current operative institutional structure that resulted from the creation of the regional governments embodies significant advances compared to past decades. According to Boisier and Zurita (1993), one of the main characteristics of this new form of administration is its wide diversification in the offering of policies and programmes that intend to cope with the different problems faced by the inhabitants of regions.

The wide range of objectives and tasks assigned to the Regional Governments represent a more comprehensive conception of development, compared to previous experiences. This wider concept of development clearly differs, in qualitative and quantitative terms, from that which purely concentrate on economic growth of former decades. This new idea incorporates the social, cultural and economic dimensions of development as three inter-linked concerns for the different territorial bodies in charge of regional development, that is, the Regional Assembly and Executive, the regional-based offices of the central ministries, and the provincial and local administrations.

The attempt to reach a practical combination of these three features of development is evident in the general objective and different tasks assigned to the Regional Government by LOCGAR. The existence of regional funds, and particularly the FNDR, is an attempt to provide a practical tool for carrying out these tasks.

Although the establishment of Regional Governments in the territorial administration of the country has been said to be a mere act of political voluntarism from the central government, the extent of its principles and the political agreement reached by all political parties in Chile for its execution, gives this initiative validation and the strong possibility of continuing in its development. The magnitude and importance of this event, in words of Boisier and Zurita, make this initiative 'more than a mere administrative act, a real refunding act of the government and administration system of the country' (Boisier and Zurita 1993, p. 1).

### 3 Chile's recent economic performance

Chile's economic development is said to be ahead of other Latin American countries. Internal administrative changes, the increasing degree of integration of Chile within the global economy, and the country's early implementation of structural reforms of the first and second generation as well as its opportunity to successfully carry out reforms of the third generation<sup>29</sup>, situate the country in a leading position compared to its neighbours.

The figures that support this thesis are the high growth rate of the economy (about 8.0% annually from 1990 to 1999), the growth of the per capita GDP (annually 6.4% for the period 1990-1999), the investment growth (102.2% between 1989 and 1999), growth in the level of saving (21.6% of the GDP in the period 1990 and 1999), and the growth of exports and imports, among others (data from Central bank of Chile).

Economic policies implemented during the last two governments have been based on the following diagnosis (in a report from the Ministry of Finance, June 1998):

- During the 1990s the cornerstone of macroeconomic equilibrium has been the sound management of fiscal policy. As the economic authorities have put it, "this is an asset for the country as a whole that will not be put at risk" (Ministerio de Hacienda 1998, p. 1);
- The Chilean public sector relies on an institutional framework that allows it to face important external shocks by having at its disposal price stabilisation funds for two key commodities, copper and oil. The Copper Stabilisation Fund today has amassed approximately US\$ 1,700 million, while the Oil Fund contains US\$ 130 million;

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<sup>29</sup> Eduardo Aninat (2000), *Revista Que pasa*. According to this author, first generation structural reforms carried out by Chile refer to the liberalisation of external trade, reduction of tariffs, the re-ordering of the monetary policy, autonomy of the Central Bank, and fiscal discipline; reforms of the second generation were the changes in sectoral policies such de-regulation and privatisation of sectors such as energy, water and sewer services, etc. Third generation reforms are those related to structural changes in education and higher education, information technology, health, decentralisation or transference of power to regional levels. Aninat was Minister of Finance of Chile from 1994 to 1999, at present he is one of the deputy managers of the IMF.

- These stabilisation funds give additional degrees of freedom to the country, permitting it to soften some of the effects of external highs and lows, in a responsible and well-financed manner;
- With respect to the current account deficit, this is said that it is not in itself an indicator of economic problems. It is just a signal of the rate at which the country borrows from the rest of the world. Chilean foreign debt is low, representing only 34% of GDP (81% of which corresponds to the private sector) and has a long maturity (96% of total Chilean debt is of medium and long-term maturity).

This structurally solid economy, according to the Ministry of Finance, would “allow the country to keep on growing and improving the quality of life of its people” (Ministerio de Hacienda 1998, p. 2). The main problems being, according to some observers, the threat of an increase in the current account deficit.

Before discussing the main problems and achievements of the economic model adopted by the country, and the effects this strategy has had on the country in the present and the consequences for its future development, it is worth looking briefly at the conception of the present economic model and the way it has evolved in the country since the mid seventies.

### 3.1 Historic background

Chile’s traditional economic model was based on industrialisation. Following the 1930s Great Depression, and mainly supported by the government, industrialisation became the national priority. The import-substitution industries became the key economic activity in the country benefiting certain areas more than others. In the 1950s and 1960s heavy industry plus highly protected textile and pottery manufactures accounted for much of the Chilean labour medium class.

In 1974, at the beginning of the period of the military regime, Chile undertook a profound shift in its economic development strategy that would have dramatic consequences on the traditional economic and social structure of the country. This process consisted of the implementation of an externally market-oriented economic

strategy. As Ellison has put it, the changes began in earnest a couple of years after Pinochet took power and continued until 1990. Unproductive state-owned firms were auctioned off, tariffs were slashed from 94 percent to 10 percent, triple digit inflation was reduced to double digit and the country positioned itself for a new era of growth (Ellison, 1998).

The ideologists behind these transformations came from a group of Chilean economists who had studied with free-market mentors Milton Friedman, Frederick von Hayek and Arnold Harberger at the University of Chicago. According to Rosenfeld and Marre (1997), this link goes back to the fifties, “in the 1950s, the University of Chicago developed a ‘special relationship’ with the Catholic University in Chile. A systematic approach to ‘ideological transfer’ was supported by the Rockefeller and Ford Foundations, and the US” (Rosenfeld and Marre 1997, p. 2). By 1975 the Chicago Boys (as they were known) took position on Pinochet’s Cabinet and the neoliberal counterrevolution began. Sympathetic Chilean businessmen collaborated with this group in the design of a free-market economic programme for Chile.

One of the first measures implemented to carry out these transformations was the opening of the Chilean economy to international trade. As a result, traditional industry fell under the pressure of international competition, and in 1975 GDP dropped to 14%. The widespread crisis generated by the economic reforms gave the opportunity to the Chicago Boys to restructure the whole of the economy. From 1975 to 1981, the strategic banks and industries that had been nationalised under the Allende’s Government were privatised to a small number of economic groups formed at the beginning of the military government. These new groups became the new driving force in the Chilean economy.

Chile’s traditional industries like textile, clothing, pottery, and shoe production collapsed under import pressure in the first years of the neoliberal policies. Many industrial workers lost “their decent-paying union jobs in that period, settling for lower-paid and unstable processing jobs in the fishing, forest and fruit-export sectors” (Rosenfeld and Marre 1997, p. 2). As a consequence many of these workers and their families migrated to more economically active regions, mainly to Santiago.

The radical redistribution of national wealth to a few conglomerates coincides with a decline in the percentage of national income going to wages, from 42.7% in 1970 to 33.9% in 1993. This also coincided with an overall rise in poverty. In 1994, 28.4% of Chilean lived in poverty, compared to 17% in 1970, and the poverty rate peaked at 45% in 1987. As Todaro (2000) claims, “in a quarter century of almost constant ‘structural adjustment’ in Chile, the top 10% of the population has gained, but the bottom 90% remains worse off” (p. 728).

Traditional class structures also suffered rapid changes. Historically, Chile’s middle class grew during the expansion of the state. When state and state enterprise employment was drastically reduced, wages for teachers, health service and public servants and other remaining state-sector workers also declined. At the same time, a new middle class and upper-class of professionals emerged in connection with the boom in finance and services.

The relative economic success seen in the late 1970s and early 1980s permitted the dictatorship to implement what Rosenfeld and Marre have called “its ambitious project to permanently remake Chilean politics, economics and culture” (1997, p. 3). This project was called the ‘Seven Modernisations’ that included: A new constitution, the regionalisation and de-concentration of the state, the privatisation of state-owned industry and services, a new system of labour law, and the municipalisation and privatisation of state-run health, education and social-security systems.

### 3.2 Recent achievements

Back in democracy, in 1990, the *Concertación* of Parties for Democracy, a coalition of centre and left-wing political parties, headed by the Christian Democrat Patricio Aylwin, won the presidential elections and marked the end of 17 years of military rule and the beginning of Chile’s transition to democracy. As Vergara points out, the principal motto of the Aylwin administration was ‘growth with equity’, a notable counterpoint to the neoliberal model implemented by the previous military regime. While the dictatorship has succeeded in achieving high economic growth rates, 8% annually by the end of the eighties, income inequality actually worsened. The Aylwin

government argued that economic growth was a necessary, but not sufficient, condition for achieving greater equality in Chile (Vergara, 1996).

Table 3.1: Chile's Main Macroeconomic Indicators (1986-1999)

	1986-97	1996	1997	1998	1999
GDP growth rate (%)	7.7	7.4	7.4	3.4	-1.1
Inflation rate (%)	14.5	6.6	6.0	4.7	2.3
Unemployment rate (%) <sup>1</sup>	6.8	6.5	6.1	6.2	9.0
Gross fixed capital formation (% of GDP) <sup>2</sup>	25.1	31.0	27.2	26.5	21.1
Gross national saving (% of GDP) <sup>3</sup>	20.9	21.4	21.6	20.3	20.9
Real interest rate (%) <sup>4</sup>	6.0	7.3	6.8	9.6	6.0
Real exchange rate (1986=100)	99.0	84.7	78.2	78.0	75.0
Average nominal tariff (%)	14	11	11	11	10
Current account deficit (% of GDP)	3.2	5.1	4.9	5.7	0.1

<sup>1</sup> Average 1992/1997

<sup>2</sup> In 1986 prices

<sup>3</sup> At current prices

<sup>4</sup> On 90-day Central Bank promissory notes

Source: Banco Central de Chile (2000)

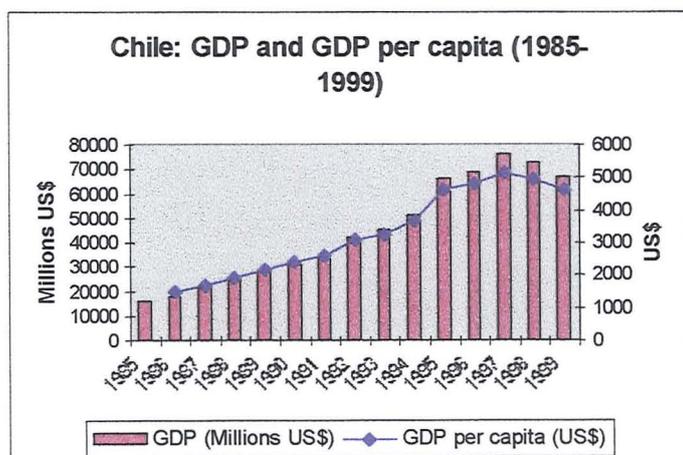


Figure 3.3: Chile GDP and GDP per Capita (1985-1999)

Source: Based on data from the Banco Central of Chile (2000)

The *Concertacion*'s formula for 'growth with equity' has been to embrace the free-market, export-oriented economic model implemented during the military government, but also pays significantly more attention to poverty and social policy than its predecessors. In pursuit of free trade, the *Concertacion* has reduced import tariffs, privatised many remaining state-owned enterprises, and aggressively pursued bilateral and multilateral free-trade agreements, including entrance to NAFTA and MERCOSUR.

Table 3.1 and Figure 3.3 above shows the success on Chile's main economic indicators of the last fifteen years. Social indicators are presented below in Tables 3.2 and 3.3 and Figure 3.4. These economic and social indicators summarise the country's main achievements in recent years.

Table 3.2: Reduction of Poverty in Chile during the 1990s

Year	Extreme Poverty		Poverty	
	People	%	People	%
1990	1,659,300	12.9	4,965,600	38.6
1992	1,169,300	8.8	4,331,700	32.6
1994	1,036,200	7.6	3,780,800	27.5
1996	813,800	5.8	3,288,300	23.2
1998	820,000	5.6	3,160,10	21.7

Source: Ministerio de Hacienda, Chile (1999)

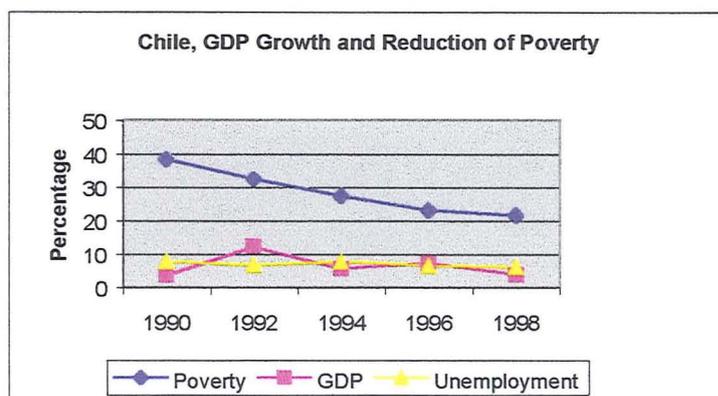


Figure 3.4: Chile, GDP Growth and Reduction of Poverty (1990-1998)

Source: From data from INE (2000) and Central bank (2000)

Table 3.3: Income distribution in Chile (1996-1998)

Income Decile	Autonomous Income <sup>1</sup>			Monetary Income <sup>2</sup>		
	1996	1998	Sum98	1996	1998	Sum98
1	1.3	1.2	1.2	1.4	1.4	1.4
2	2.6	2.5	3.7	2.7	2.7	4.1
3	3.5	3.5	7.2	3.6	3.6	7.7
4	4.5	4.5	11.7	4.6	4.6	12.3
5	5.4	5.3	17.0	5.5	5.4	17.7
6	6.3	6.4	23.4	6.4	6.4	24.1
7	8.2	8.3	31.7	8.1	8.3	32.4
8	11.1	11.0	41.7	11.0	10.9	43.3
9	15.5	16.0	57.7	15.4	15.9	59.2
10	41.6	41.3	100.0	41.3	41.0	100.0

<sup>1</sup> Autonomous income considers self-generated income only

<sup>2</sup> Monetary income includes also monetary transfers from the state

Source: Ministerio de Hacienda, Chile (1999)

The transnationalisation of the Chilean economy has also intensified since 1990. The *Concertación's* commitment to free trade and privatisation, together with the political stability since the transition began, has translated into increased foreign investment. International investment in Chile rose from US\$1.5 billion in 1990 to US\$2.8 billion in 1993, and then skyrocketed to US\$ 4.3 billion in 1995. Chilean investment abroad also rose, financed by Chile's private pension fund system and yankee bonds -corporate bonds sold on Wall Street. Growth has boomed at an average annual rate greater than 7% since 1995-by far the highest in Latin America (Rosenfeld and Marre, 1997).

In sum, the transition to democracy that began in 1990 brought a consolidation of, rather than a challenge to, the free-market model imposed during the military regime. The accent in the 1990s has been put, however, in overcoming the most critical social problems inherited from the crude application of the neoliberal model of the decade before.

### 3.3 Problems

This 'solid Chilean economy' is, however, extremely vulnerable. Its strong dependence on foreign markets with just few main trade partners, and the fact that it is just based on few export products, leave the Chilean economy enormously exposed to external variations. Despite the encouraging macroeconomic indicators that the country exhibits, a more in-depth look shows many structural problems in both, its economic model and the social indicators associated with.

Londoño and Székely (1997) argue that within the Latin American context Chile does not differ much from the average in terms of the general trend followed by the different countries. Summarising the general trends of Latin American economies during the last thirty years, they identify three major stages. The 1970s were characterised by macroeconomic stability and high growth rates. The 1980s were the years of volatility and stagnation (for some, the lost decade in Latin America), while the first half of the 1990s (and now we can say the whole decade of the nineties) has seen a return to a more stable macro environment and the recovery of positive growth rates. As these authors argue, under the favourable scenario of the 1990s one would expect that the numbers of

poor households and the level of inequality would have been reduced. The main findings of this study show that, with important differences among countries, this has not been the case. Poverty remains in many regions of South-America and income distribution has worsened in many cases.

With regard to the financial system, Caballero (2000) argues that although ahead of the Latin American pack, Chile still suffers from four external and internal weaknesses: (a) weak international financial links and excessive sensitivity to external conditions. And of internal origin; (b) a Central Bank mandate that, while reasonable on average, is ill-designed to deal with terms of trade shocks and their impact on external financial conditions; (c) a propensity to waste scarce liquidity in the banking system; and (d) a continuing limited development of financial markets, particularly for medium and small size firms.

The impact of economic crises on the Chilean economy is greater as the country's trade links are concentrated in just few regions in the world. For example, according to the Ministry of Finance, Chile is the country in the Americas which trade most with Asia (as a proportion of the volume of its economy). As such, the Chilean economy suffered greatly from the economic downturn in those countries at the end of the 1990s, both from the perspective of its exports to the region and from the fall in copper prices. Although a third of Chilean exports are directed towards Asia, exports to those countries (Japan and Korea) did not account for more than 25% of total exports, 16% and 6% respectively.

Chile has a unique experience with regard to the level and persistence of open unemployment. Riveros (1997) argues that unemployment skyrocketed with the financial crisis of the 1980s because the economic reforms of the 1970s did not prepare the labour market for a more flexible response to aggregated shocks. Unemployment declined significantly after 1985, as a result of more flexible labour market institutions. The problem, however, is still one of the main issues in Chile's economy, with around 10% of unemployment by the end of the year 2000.

A study by Meller (2000) demonstrated that Chile is one of the countries with a worse income distribution in Latin America and even in the world. This author argues that

there is a recognised direct relationship between education and income distribution. According to this, policies should be oriented to improve the access and the quality of education. Chile already exhibits higher education levels compared to countries like Argentina, Costa Rica and Mexico. Meller argues that for an average Latin American, throughout his entire life, completing his secondary studies (12 years of school) does not allow him to even triple the average income of an illiterate. The difference only materialises when this average Latin American gains a University career. Since going to the university is not the answer to this problem, or at least not for everyone, Meller suggests concentrating on other solutions. Relative government expenditure in education, as a proportion of its GDP, falls in the lower third of the countries with similar GDP per capita<sup>30</sup>.

As a result of all these weaknesses, the neoliberal model implemented in Chile, despite its success -mainly at the macroeconomic level- is still vulnerable. A very good example of the country's vulnerability can be found by looking at the way its main export product has been managed in recent years<sup>31</sup>. Copper, Chile's main export product, represents a 40% of total Chilean exports. Total Chilean exports account for US\$ 15,615.5 millions (that is, more than fifteen thousand millions) in 1999.

Caputo (2000) argues that since copper is so important for the economy of the country, copper exports should be the main concern of economic authorities, but this does not seem to be the case, judging from the way Chile has managed its export policies on copper. The stagnation of the value of Chilean exports since 1995 is the main cause of the recent economic crisis. The average annual value of exports between 1996 and 1999 reached only US\$14,750 millions (in dollars of 1995). In 1995 exports accounted for US\$ 16,000 millions.

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<sup>30</sup> In a study by Engel et al (1998) on the relative government expenditures in health and education. They argue that as the GDP grows, so should do the expenditure in these sectors (if the country is going to follow the pace of developed countries).

<sup>31</sup> Based on a newspaper article by Orlando Caputo in January 2000. The origin of this article is a response to the Ministry of Finance of Chile, that day before announced his satisfaction due to the fact that Chile had reached the highest historical level in its exports. For a country that found its economy in exports, like Chile, argued Caputo, reaching every year the highest level should not be a surprise. Exports for Chile should be a matter of concern rather than of 'satisfaction'. Orlando Caputo is an economist and researcher from Universidad ARCIS. See bibliography for complete references.

The stagnation of its exports is one of the major problems Chilean economy is suffering at present, and this is principally due to the importance of copper exports in the total national exports, and not a consequence of the Asian crisis, as published by the government. Caputo argues that the decline in the price of copper in the world market was the fault of Chile. It took 90 years for Chile to produce 1,500,000 tons of copper. Afterwards, in six years, the production was doubled. In ten years the production was tripled, reaching by the year 2000 the staggering amount of 4,500,000 tons of copper.

Table 3.4: Chile Main Export Products 1997-1999  
(As percentage of total exports)

	1997	1998	1999
<b>Mining</b>	<b>44.6</b>	<b>39.5</b>	<b>40.7</b>
Copper	41.1	36.0	37.7
Gold	2.2	1.8	1.6
Nitrate and iodine	1.3	1.7	1.4
<b>Manufacturing</b>	<b>16.6</b>	<b>17.2</b>	<b>17.7</b>
Fishmeal	3.3	2.3	1.8
Salmon	2.8	3.5	3.9
Wine	2.5	3.6	3.4
Pulp	4.1	4.6	4.9
Sawn and planed wood	2.6	2.4	2.8
Methanol	1.3	0.8	0.9
<b>Agriculture</b>			
Fresh fruit	7.2	8.0	7.2
<b>Percentage of total</b>	<b>68.3</b>	<b>64.7</b>	<b>65.5</b>
Other	31.7	35.3	34.5
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Banco Central, 2000

Chile is the main producer and exporter of copper in the world. It generates about 40% of the world production and supplies more than 50% of the total world exports. Comparatively, all countries from the "Organisation of Petroleum Export Producers (OPEP) generate 37% of the world production of oil. Saudi Arabia, the main producer in OPEP, contributes with 11% of the world total, or about 28% of OPEP production (Caputo, 2000).

Chilean copper production grew much more than the growth in world consumption, therefore world copper stocks grew as well. As expected, this resulted in a sharp drop in copper prices. In July 1995, the price was of 140 US cents per pound of copper (cpc). For several months in 1999 the price reached no more than 60 cpc. The average annual

price in 1999 was of 71.4 cpc. As predictable, this downward trend has profoundly impacted Chilean economy. In dollars of the same year, exporting 2.5 million tons in 1995 Chile got about the same earnings that those in the year 2000, but exporting 4.5 million tons.

Caputo points out that in the neoclassical theory of international trade, this situation has been called the “impoverishing growth model”, that can be characterised by a huge growth in production, and a slow down in the global revenues and the welfare levels in the exporter country.

The effects in Chile of this stagnation in copper prices meant that the state realised only US\$2,200 millions, compared with US\$4,400 millions value of copper exports in 1989; that is, only 50% of the value of the total exports. In 1995, it got US\$1,940 millions, which corresponds to 30% of the total exports. In 1999, the state got only US\$305 millions, representing just 5% of the total global copper exports.

This a strange case where prices fall, for the first time in 50 years, while the world demand has increased more rapidly than in past decades. Against all the signals from the market, the response of Chile has been to increase production.

As shown in table 3.4 above, Chile’s main export products, copper being the primary one, are based on the exploitation of natural resources, and within these sectors the country is specialised in just few products. Table 3.5 below shows the changes in the relative importance of the main sectors in their contribution to the GDP. Traditional sectors based on the exploitation of natural resources are loosing importance compared to service sectors such as transport and communications, and personal services. The table suggests a shift from primary sectors to more advanced and labour intensive ones –as mining and agriculture are highly intensive in capital and technology in Chile and therefore use less labour. For this to be true in the long term, important changes will have to occur at the regional level, as agriculture and mining are mainly concentrated in just only a few regions.

Table 3.5: Changes in GDP by Origin of Economic Activity (1990-1998)

Sector	1990 (=100)	1993	1996	1998
Agriculture, livestock and forestry	6.7	97	79	81
Fishing	1.5	107	93	93
Mining	12.6	45	56	33
Manufacturing Industry	18.5	104	103	98
Electricity, gas and water	2.6	119	115	104
Construction	5.6	121	127	143
Trade and catering	13.9	101	91	101
Transport and Communications	6.7	104	106	116
Financial Services	9.8	104	114	115
Housing	4.6	89	83	85
Personal Services	8.6	124	142	158
Public Administration	3.4	100	106	115

Source: Banco Central de Chile (2000)

On the other hand, exports destinations are confined, again, to just a few countries or areas of the world (table 3.6 below). The most significant changes would be the increase of the importance of North America, that goes from 15.4% to a 19.5% in the period shown, and the decrease in importance of the Asia region. Due to the short period covered by these figures, however, changes in the relative importance of each region destination would most probably correspond to short time variation in the purchasing countries than to general trends in the world market.

Table 3.6: Main Export Destinations 1997-1999  
(Total Exports in Millions US\$)

	1997 (%)	1998 (%)	1999 (%)
<b>Latin America</b>	<b>21.1</b>	<b>23.9</b>	<b>21.8</b>
Brazil	5.9	5.6	4.5
Argentina	4.7	4.9	4.6
Mexico	2.2	3.4	4.0
<b>North America</b>	<b>15.4</b>	<b>17.4</b>	<b>19.5</b>
United States	14.6	16.4	18.4
<b>Europe</b>	<b>25.8</b>	<b>29.2</b>	<b>27.6</b>
United Kingdom	6.2	7.8	6.8
Germany	4.5	3.8	3.6
Italy	3.0	4.5	4.0
France	2.7	3.0	3.1
<b>Asia</b>	<b>35.3</b>	<b>27.6</b>	<b>29.3</b>
Japan	16.1	13.8	14.4
Korea	5.9	2.8	4.4
Taiwan	4.6	3.6	3.2
China	2.6	3.3	2.3
<b>Sub-total</b>	<b>97.6</b>	<b>98.1</b>	<b>98.2</b>
Total Exports	16,667.2	14,829.6	15,615.5

Source: Banco Central, 2000

### 3.4 Summary and Conclusions

The rapid changes experienced in Chile since in the decade of the seventies have profoundly transformed the country's economy and social structure. The economic model imposed in the 1970s and the reordering of the territorial management carried out through the past three decades have had a significant impact on economic structure of the country as a whole and in most regions outside Santiago.

The greater attention given to concerns for equity by the democratic governments, to reverse the cutbacks in social spending of the Pinochet regime, has meant a ramping up of efforts to allocate more resources to education, basic health care, housing, water, sewage, electricity. These efforts have gone together with the main focus of government policy toward giving assurance of a balanced economy while simultaneously preserving the main macroeconomic indicators.

Despite the success in raising several basic social indicators, and achievement at the macroeconomic level, there still persists a series of economic and social problems. The economic problems are associated to the vulnerability of the model in the face of external changes in the world economy, and in the differential impact this has on the regions of Chile. The social problems have to do with the level of poverty, income distribution, and unemployment in the country as a whole, among others social indicators, and with the way these problems affect some regions more than others.

The accelerated changes in the internal territorial administration and distribution of power, specially since the 1990s, have been intended to cope with the territorial manifestation of these problems. The creation of the Regional Governments institution and the increasing transfer of functions and financial instruments to them is intended to involve regional communities in the development of their own regions and to move the decision-making process closer to those directly involved in it.

For these initiatives to succeed they have to go in the same direction as the development strategy of the country as a whole. This is not completely clear for the case of Chile. Whether the main objectives of governmental policies intend to cope with economic growth, employment or poverty; at a national scale or concentrating on particular most

affected areas is something that has not yet attracted much discussion among politician, government authorities and other actors in Chile.

The maturity of the economic model adopted almost thirty years ago, the experience gained after two decades transiting under a process of decentralisation, plus the setting up of the Regional Governments institution, in the last decade, as a tangible body to carry out development from the regions, provide a new scenario to conduct development at the beginning of the new century.

Some argue that there is enough experience accumulated in recent years to think of the Regional Government as key players in the way economic and social development will be conducted in the future. As Tobar (2000) argues, the country has only since the dictation of the first laws in 1974, passed through twenty six years of regionalisation, seventeen under the military government and ten under democratic governments. He claims that since the beginning we have seen a procession of Regional *Intendentes*, Provincial Governors, Directors of de-concentrated offices of ministries, Regional Counsellors (appointed by the military authority first and then democratically elected) all with the purpose of working for the development of regions from a regional perspective. This has certainly provided a substantial basis for the acquisition of expertise and know-how on regional matters. Or, as Boisier (2000) puts it, the country possesses at present around 10,000 people who are involved in different aspects of regional development. The process is not over, but on the contrary it is evolving to new stages. It is time now, suggests Tobar, after 26 years of trial and error to examine and evaluate the process in order to correct it and deepen it adequately to face the development of regions.

Regardless of whether or not this 26-year experience is sufficient base on which to construct significant regional policy change, it has certainly opened potential new regionalisation scenarios. New scenarios may concentrate on the equally important experience of regional fund development. These funds must be assessed as policy tools for future Regional Government transformation.

## 4 Regional economic and social disparities in Chile

This section presents the main economic and social differences in the regions of Chile in recent years. It incorporates administrative and interpretative regional descriptions. The former is a recapitulation of the thirteen administrative regions and the latter, after Stöhr (1969), proposes dividing the country into three macro zones, each of several regions. These macro zones group regions of similar characteristics and also illustrate the main differences among them. The first part of the section uses actual regions (the thirteen regions) for data and analysis, then it uses 'zones' or 'macro zones' to group regions of similar characteristics. The last part introduces the additional concept of winner and loser regions to group those territorial units that have performed well or badly under the neo-liberal economic model that has predominated in Chilean's recent history. Regions grouped under these categories do not necessarily present geographical continuity.

### 4.1 Historic background on Chile's regional development

Despite its unique geographical features, a narrow shape more than 4,200 kilometres long and less than 200 kilometres wide on average, and great physical, climatic and cultural differences, Chile has been identified as the prototype of a highly centralised country (Stöhr, 1969b). Nevertheless, although a formally unitary system, Chile has several implicit factors of regionalism. Stöhr argues that these implicit forms of regionalism, i.e. differential ecological patterns; different colonisation background, and; regional legislation permit us to identify three distinctive zones in Chile (see chapter 2 for Stöhr classification of regions in Chile).

The colonisation background factor, claimed by Stöhr, has not been specially important in the determination of particular zones in Chile. No other author, known to this study, has ever claimed such a thing. Although small groups of immigrants settled in various regions in the north, centre and south of the country during the nineteenth and twentieth centuries, they have not been identified as a determinant in shaping the country's

different regions (except, may be, by the Los Lagos Region, colonised by German settlers by 1850).

What have actually been much more influential in this sense are the other two factors identified by Stöhr, the territory's characteristic geographical feature (its length and differential ecological patterns), and the particular development policies, 'regional legislation', that have been implemented for specific regions (including Santiago).

In terms of territorial administration, during the 1960s the country was subdivided into ten administrative regions plus a metropolitan zone (Santiago). Later, in 1974, at the beginning of its government, the military regime implemented the so called 'process of regionalisation' that basically consisted of a spatial re-ordering based on these existing 11 regions. This process sought to articulate the economic, social, geo-political and administrative features of sub-national territorial units. These changes resulted in the creation of twelve existing regions plus the Metropolitan Region of Santiago. (See Appendix 2 for map of Chile with the regional subdivision).

Using a combination of only two Stöhr factors it is possible to distinguish three types of ecological macro zones in Chile. These three characteristic ecological zones also present clear differences in terms of population density and economic performance (as it will be seen later). These zones are:

- the 'metropolitan and consolidated zone', that extends from the Valparaíso region in the North to Biobío in the South. This zone comprises the core urban and industrial centres of Santiago, Valparaíso and Concepción. More than 74% of the population of the country lives here, although the zone accounts for just 15% of the territory of the country. Some 74.7% of the GNP was generated in this zone in 1996 (Riffo, 1998).
- The 'north macro zone' extends from the Coquimbo region (Region IV) to the far north Region of Tarapacá (Region I). This is a thinly populated peripheral zone that contains only 11.3% of the population and 39.8% of the territory. This zone contributed 16.5% to the national GNP in 1996.

- The 'south macro zone' that extends in the north from La Araucanía (Region IX) to the extreme south of Magallanes (Region XII). This is also a sparsely populated peripheral zone having 14.3% of the population, with 44.9% of the nation's territory. The contribution of this zone to the national GNP was 8.9% in 1996.

In order to cope with the economic and social differences amongst regions, during the second half of the 1900s the state started to play an active role in promoting several economic policies for regional development. These policies were directed, essentially, towards provision of social basic infrastructure and location of basic key industries outside the capital city. Under the import-substitution model of development, adopted in the country during the 1950s and 1960s (discussed in chapter 2 above), the government carried out important projects of regional impact for several regions of the country, notably the case of a steel and petrochemical plant in the Biobío region and a motor car assembly plant in the Tarapacá Region during the 1960s.

The most remarkable feature of regional economic development during the 1970s was the implementation, by the military government, of the neo-liberal economic strategy of development discussed above. The early days of the application of this model were characterised by a rapid lowering in import tariffs and an overall opening of the economy. This had a significant impact in all regions, but particularly in those that had previously based their economy on import substitution products. These products had been highly protected from external competition and they could not survive in an open market economy. The industrial regions of Valparaiso and Biobío of central Chile, and Tarapacá in the north, were among those most negatively affected. Employment, economic growth and productivity in these regions were unable to adjust to the new external conditions.

Chile's rapid economic growth during the last fifteen years and specially over the last decade has left the neo-liberal model unchallenged, despite the economic and social costs observed in several regions. The model has, in spite of the acknowledge success of some macroeconomic indicators, had profound negative effects on particular territories within the country. Although continuing the same 1974 economic model, democratic governments since the 1990s have introduced a more equitable approach.

Thus, one of the most significant steps in the development of regions in recent years has been the deliberate decentralisation of the political and administrative structure of the country carried out by the successive democratic government of the 1990s.

#### 4.2 Recent evolution in regional differences

Regional differences are presented using recent data on the performance on both economic and social indicators such as population, employment, GNP, and economic growth. Data account for current social and economic divergence among regions.

##### Economic Performance

Table 3.7 below shows the economic growth by region from 1960 to 1997. The six sub-periods that appear in this table show significant differences in the rate of growth of the economy experienced in the regions of Chile. The periods 1972-75 and 1982-83 represent the two major crises experienced by the country in recent years. The first one reflects the enormous decline in economic activity due to the profound transformations that the economic structure of the country was experiencing as a result of the implementation of the new economic model at the beginning of the military government. The second period is associated with a world-wide recession influenced by the prices of oil, helped in the case of Chile by the action of emerging economic groups, today already consolidated, that were taking over the former state companies.

Table 3.7: Regional Economic Growth 1960-1997 (Average annual rates)

		1960-71	1972-75	1976-81	1982-83	1984-97	1960-97
I	Tarapacá	4.3	-0.9	8.6	-4.4	7.6	5.2
II	Antofagasta	5.7	-0.2	7.7	3	7.3	5.9
III	Atacama	3.9	-0.4	5.7	-2.1	10.2	5.8
IV	Coquimbo	4.2	3.2	2.7	0.4	6.4	4.5
V	Valparaiso	3.7	-2	3.7	-6.2	5.3	3.1
RM	Santiago	6.2	-6.8	7.4	-8.3	7.5	4.7
VI	O'Higgins	2.4	4.1	4.5	-2	4.8	3.6
VII	Maule	3.5	0.8	3.7	1.1	6.8	4.4
VIII	Biobío	4.7	-4.2	5.4	-3	4.6	3.4
IX	La Araucanía	3.2	-0.4	3.6	-2.4	6.6	3.9
X	Los Lagos	3.2	-0.5	3.6	-3.1	7.2	4
XI	Aysén	8.1	-1.6	3.2	3.4	5.9	5.2
XII	Magallanes	1.8	-7.1	9.4	-1.9	2.2	2
	Country	4.7	-4.8	6.8	-8.5	7.3	4.3

Source: Riffo, Luis (1999)

Although economically successful today, the negative impact of taking over the country's traditionally state-owned companies "drove Chilean economy to a deep crisis that cost Chile around US\$ seven thousand million, between 1982 and 1985" (Monckeberg, 2001). The impressive performance in economic growth in the 1984-97 period shows the consolidation of these groups and the economic success of the neo-liberal model.

With regard to regional differences, the 1960-71 period presents, in general, an even pattern of economic growth among regions, the notable exception being 8.1% economic growth in Aysén. The period 1984-97 presents a very different situation. The rate of growth of the economy is in general higher than in previous years and several regions of the centre, north and south of the country seem to be benefiting from the new model with high rates of economic growth for a long period of time, notably the cases of Atacama, Tarapacá, Antofagasta, Santiago and Los Lagos regions. Los Lagos (Region X) is the only one from the agriculture 'south macro zone', while the first three belong to the 'North macro zone', mainly associated with mining activity.

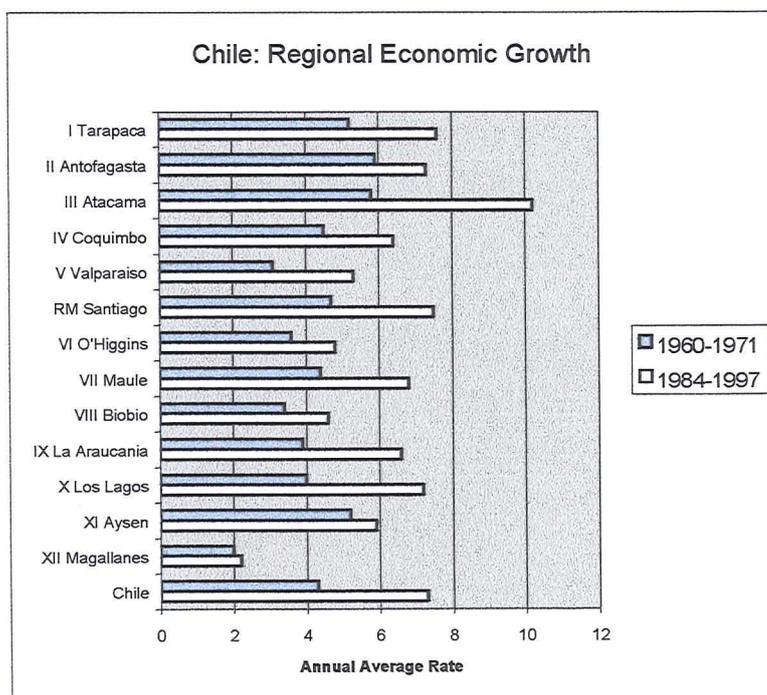


Figure 3.5: Chile Regional Economic Growth (1960-1971, 1984-1997)

The period 1984-1997, fully under the neo-liberal economic model, shows a higher annual average economic growth for all the regions of Chile compared to the 1960-1971 period (Figure 3.5). A distinction can be made in terms of how particular regions performed compared to the rest. In this sense, three regions, O'Higgins (VI), Biobío (VIII) and Magallanes (XII) are the ones with lower performance. Regions of the north, that experienced high rates of foreign investment, in general, performed better than those of the centre and the south.

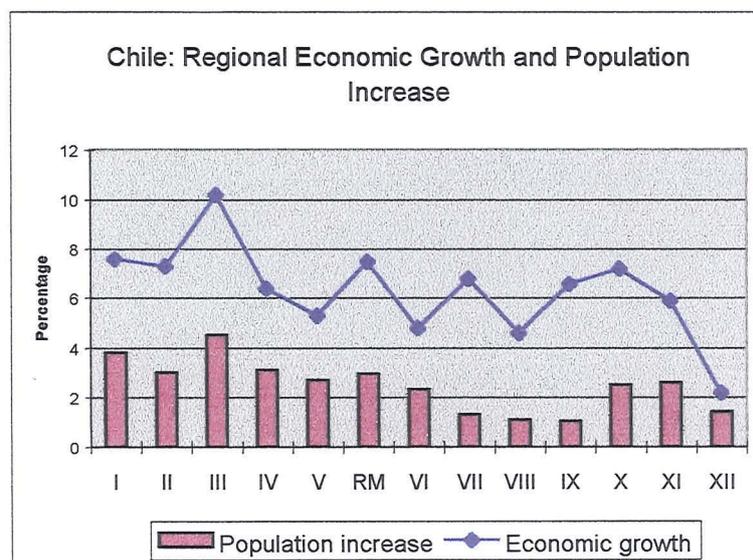


Figure 3.6: Chile, Regional Economic Growth (1984-1997) and Population Increase (1990-1998)

In the relationship between economic growth and population increase (Figure 3.6), although the periods do not fully coincide, there is a direct correlation between the two variables. Highest rates of economic growth tend to correspond with highest rates of population increase, with the exception of regions VII (Maule), VIII (Biobío) and IX (La Araucanía), where relatively high rates of economic growth (more than 6% per year as an average for regions VII (Maule) and IX (La Araucanía); and over 4% for region VIII (Biobío) correspond to the lowest rates of increase of the country.

The north to south pattern of decrease in growth rates in population, in general, correspond to a similar pattern in population growth. The birth rate in Chile is more or less constant among the regions, the main difference being between urban and rural

populations. Rural population in Chile accounted for 14.4% of the total population in the year 2000<sup>32</sup>. In the 'north macro zone' rural population is slightly less than the national average, thus, what would actually explain a higher population rate in this period is immigration, probably due to better employment opportunities that go with higher economic growth.

The Atacama Region (III), along with its predominant mining activity (in terms of product) has a highly developed agricultural sector in several irrigated valleys, particularly in grape production, both for direct consumption and for wine and spirits. The high growth rate in population can be mainly explained by the job opportunities in this region, particularly for seasonal immigrants for harvest work.

Within the industrial 'metropolitan and consolidated macro zone' of the centre of the country, the Santiago region has the highest rates in both economic and population growth. In the case of the 'south macro zone' the most distinctive feature is its lagging position compared to the other two. This agriculture macro zone presents the highest rural population of the country with 32% of its population living in rural areas.

The rate of unemployment for these three macro zones tends to follow an inverse pattern compared to the other two indicators (Figure 3.7). The picture for 1990 in unemployment presents a diverse configuration with regions of the north, centre and south performing both well and badly. The year 1998, on the other hand, shows higher variations in the rates of unemployment in the north, where the highest rates of economic growth were observed, and lower variations in the centre. The south exhibits, in general, a more even performance in the variation of the rate of unemployment.

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<sup>32</sup> Since 1996 the National Statistical Office (INE) started to define urban areas as localities with a population over 2,000 inhabitants, or between 1,001 and 2,000 people where at least 50% of the economic active population is enrolled in secondary and tertiary activities. A rural locality is that with more than 1,000 inhabitants, or between 1,001 and 2,000 where less than 50% of the economic active population is enrolled in secondary and tertiary activities (INE 2000).

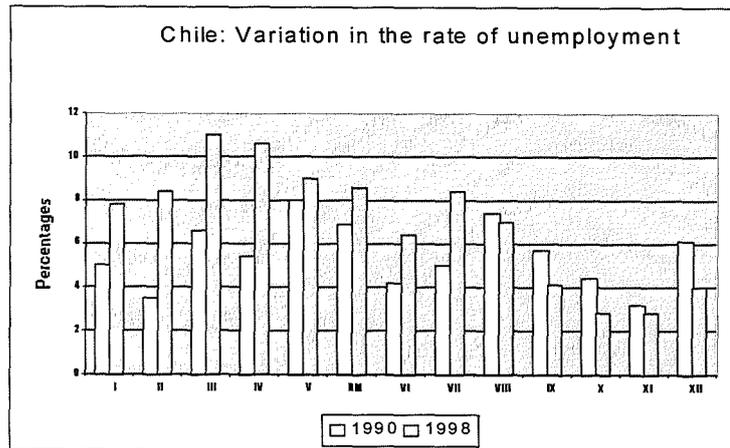


Figure 3.7: Chile, Variation in the rate of Unemployment (1990-1998)

“Winner” and “loser” regions in economic terms

Table 3.8 below presents the performance of regions in three economic indicators: gross regional product (GRP), and both employment and productivity growth in a period of eleven years, from 1986 to 1996. Beside the comparative analysis that can be made amongst regions by looking at the differences in the individual performance on each of the three variables, an informative comparison can be made by combining these three factors to see how regions perform in all of them combined.

Table 3.8: Regional Economic Growth, Employment and Productivity. Annual variation rate (1986-1996)

Region	GRP	Employment	Productivity
I Tarapacá	7.1	4.2	2.8
II Antofagasta	8.1	3.7	4.2
III Atacama	12.1	4.6	7.1
IV Coquimbo	7.0	3.6	3.2
V Valparaiso	6.4	2.6	3.7
RM Santiago	8.2	3.9	4.2
VI O'Higgins	4.8	2.3	2.4
VII Maule	7.2	2.4	4.7
VIII Biobío	4.6	2.8	1.8
IX La Araucanía	7.2	2.0	5.2
X Los Lagos	6.8	3.5	3.2
XI Aysén	5.6	3.2	2.3
XII Magallanes	2.1	1.8	0.3
Country (regionalised GNP)	7.9	3.3	4.5

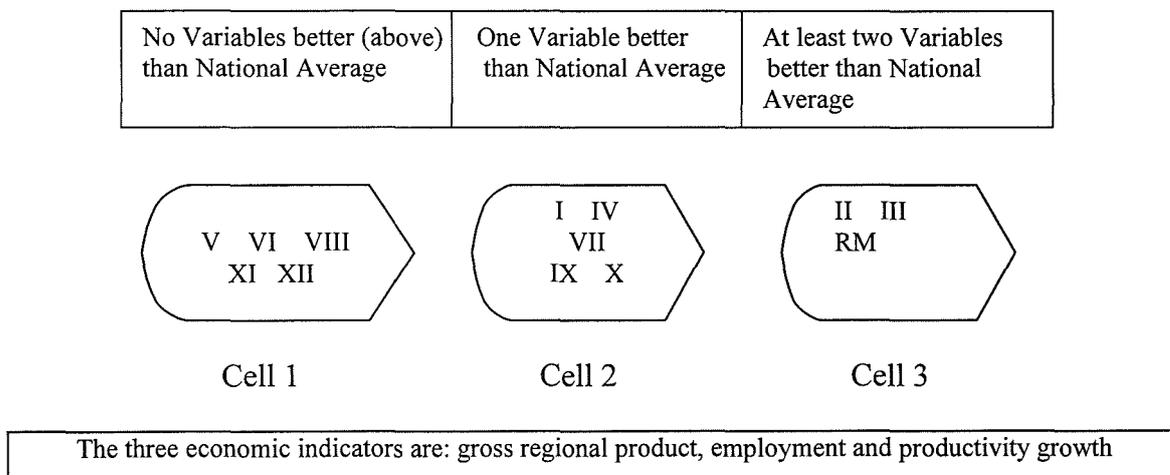
Source: Riffo, 1998

Figure 3.8 below groups regions in term of their performance in the three factors combined. Cell 1, to the left of the figure, groups the regions that in all the variables

performed below the national average, cell 2 (the one in the middle) comprises the regions that in one variable were above the average. Cell 3 (the last to the right) groups the regions with at least two of the variables above the average. In cell 3, only Region III, Atacama, is above the average in the three variables.

The Metropolitan Region of Santiago (RM), that represents almost 45% of the country's GNP as an average for the period 1985-1996, is also a highly diversified region in terms of its economic structure. The other two regions, II (Antofagasta) and III (Atacama), are mostly dedicated to mining activities. The high investment on mining as well as the level of technology utilised in this activity would explain their performance on the three variables presented. Part of the Atacama success can also be explained by the tremendous development in vineyard plantation, mostly oriented to export, during the last twenty years.

Figure 3.8: Regions grouped by Economic Performance



Regions I (Atacama), IV (Coquimbo), VII (Maule), IX (La Araucanía) and X (Los Lagos), in cell 2, had just one variable above average. Of these, regions I and IV are located in the 'north macro zone', region VII belongs to the consolidated zone, and the other two, regions IX and X are located in the 'south macro zone'. The main economic activity of these last three regions is agriculture and none of them exhibited an economic growth rate above the national average.

The group of regions in cell 1 in Figure 3.8, are the ones that performed the worst in economic terms. None of them had any indicator above the national average. Three of these regions are located in the 'metropolitan and consolidated zone' regions V (Valparaiso), VI (O'Higgins) and VIII (Biobío). Of these, regions V, and VIII were the traditional protected industrial regions that immediately after the military coup suffered the most with the opening of the economy to the world market. Region VI is an agriculture, mining, and industrial zone right north of Santiago, but with agriculture providing most of the employment. The other two regions, XI (Aysén) and XII (Magallanes), are located in the extreme south of the country and performed really poorly on these three economic indicators. Both regions combined, with around 250,000 inhabitants, represent only 1.6% of the country's population. Main productive economic activities of Aysén and Magallanes are mining, agriculture and fishing.

These three economic indicators seem to be very illustrative about the way regions are coping with the economic conditions imposed by the economic model pursued by the country. However, when looking at another significant indicator of how regions are performing within the model, it is interesting to note that things are not as straight forward as they appear. Take poverty and income distribution for example. High rates of GNP growth alone offer the chance to expect good performance, or at least not bad performance, in these two social indicators. Even more, a combination of high rates of growth in GNP, employment and productivity would suggest optimism on the performance of related social indicators such as poverty and income distribution. As discussed below, this has been the case.

### Social Performance

Poverty and income distribution (ID) is still a matter of profound concern in Chile. Despite the relative success in several economic indicators the country has been unable to translate this economic performance into social improvements. For example, nationwide distribution shows almost no improvement during the last ten years.

Chile's Ministry of Planning measures poverty levels and income distribution. It uses the 'income method', also called the 'direct method', to estimate levels of absolute poverty. This method measures the level of household living conditions with reference to a poverty line expressed in the cost of a minimum basket. This basket is supposed to

satisfy the family basic needs. A household is considered poor where income is insufficient to satisfy the basic food and non food-related needs of the family members. In operational terms, a family is considered poor when its per capita income is below double the value of a basic basket in urban areas, and 1.72 times for the rural area<sup>33</sup>.

For income distribution, data at both the national and regional level are presented below. For the first case, the method of measurement employed is the distribution of 'earned and self-employment income' and 'total household income'<sup>34</sup> and for the regional level the Gini Coefficient has been used.

The autonomous income is defined as the sum of all the payments received by a household as a result of the ownership of productive factors, it includes all forms of income. The monetary income of a household is defined as the sum of the autonomous income and the monetary transfers that a household receive from the state (Table 3.10 below).

#### National level

Poverty reduction is a significant achievement of the democratic government (Table 3.9), though the level of poverty still remains high and the security of jobs for those above the poverty line appears to be very unstable. Anyway, poverty has been reduced by almost a half in ten years since the return to democracy.

Table 3.9: Evolution of Poverty in Chile (1990-1998)

	Number of Poor	%
1990	4,965,600	38.6
1992	4,331,700	32.6
1994	3,780,000	27.5
1996	3,288,300	23.2
1998(a)	3,160,100	21.7

(a) Preliminary figure

Source: MIDEPLAN, 1999a

<sup>33</sup> In November 1998, the value of the poverty line was equivalent to an income per capita of US\$ 82 per month in urban areas, and US\$55 per month in rural areas. In US\$ of that year. Source: Ministerio de Hacienda (1999).

<sup>34</sup> Ingreso autonomo and Ingreso monetario in Spanish....

In contrast, income distribution has hardly improved under these governments. There is a slight difference when comparing autonomous and monetary income (the last one includes transfers from the public sector). Table 3.10 below shows a high concentration of income and a tendency to remain unaltered through time. The first income decile received 1.2% compared to 41.3% of the richest income decile. This distribution slightly improves when looking at the monetary income, in this, the first decile reached 1.5% while the last decile had 41% of the national income.

Table 3.10: Income Distribution (Earned and self-employment and Total household) per capita (1990-1998)

Earned and self-employment Income (%)				
Tenth	1990	1994	1998	Accum 98
Lowest income 1	1.4	1.3	1.2	1.2
2	2.7	2.7	2.5	3.7
3	3.6	3.5	3.5	7.2
4	4.5	4.6	4.5	11.7
5	5.4	5.5	5.3	17.0
6	6.9	6.4	6.4	23.4
7	7.8	8.1	8.3	31.7
8	10.3	10.6	11.0	42.7
9	15.2	15.4	16.0	58.7
Highest income 10	42.2	41.9	41.3	100.0
Total	100.0	100.0	100.0	100.0

Total household Income (%)				
Tenth	1990	1994	1998	Accum 98
Lowest income 1	1.6	1.5	1.5	1.5
2	2.8	2.8	2.6	4.1
3	3.7	3.6	3.6	7.7
4	4.5	4.6	4.6	12.3
5	5.4	5.6	5.4	17.7
6	6.9	6.4	6.4	24.1
7	7.8	8.1	8.2	32.3
8	10.3	10.5	10.9	43.2
9	15.1	15.3	15.9	59.1
Highest income 10	41.8	41.6	41.0	100.0
Total	100.0	100.0	100.0	100.0

Source: MIDEPLAN, 1999a

“Winner” and “loser” regions in social terms

Poverty and income distribution affect regions in very different manners, as expected. This is due to the regions’ different economic structure, and to the ways by which they have coped with the neo-liberal model. The surprise comes from the fact that the way regions are doing in terms of their performance in social indicator has apparently little

to do with their performance in the economic indicators. Table 3.11 below shows the number of poor per region in absolute and relative terms.

Table 3.11: Poverty by region (Approximately by the year 2000)  
(Index from National Average = 100)

		<b>Total Population</b>	<b>% of Poor</b>	<b>Poverty Index</b>
I	Tarapacá	398,947	16.0	79.53
II	Antofagasta	468,411	13.1	65.13
III	Atacama	273,576	28.4	141.23
IV	Coquimbo	577,881	25.1	124.49
V	Valparaiso	1,561,406	18.8	93.49
RM	Santiago	6,102,211	15.4	76.60
VI	O'Higgins	788,814	23.2	115.10
VII	Maule	915,246	28.1	139.49
VIII	Biobío	1,936,271	29.6	147.04
IX	La Araucanía	874,245	31.6	156.98
X	Los Lagos	1,061,496	24.8	121.26
XI	Aysén	95,035	14.1	75.11
XII	Magallanes	157,769	11.9	58.97
	Country	15,211,308	<b>20.1</b>	<b>100.00</b>

Source: Population: Est 2000, INE; Poverty: Mideplan, Casen 1998

Table 3.12 below uses the Gini Coefficient to show regional differences in terms of distribution of income. This coefficient is an indicator of inequality, where values range between 0.0 and 1.0. A value of 0.0 (zero) would indicate that there is no inequality in income, that is to say, all households and individuals have the same income level. On the contrary, 1.0 (one) expresses a maximum inequality where all income is concentrated in just one household or individual<sup>35</sup>.

Table 3.12: Evolution of Income Distribution by regions using Gini Coefficient (1990-1998)

	<b>Region</b>	<b>1990</b>	<b>1994</b>	<b>1998(a)</b>
I	Tarapacá	0.55	0.53	0.49
II	Antofagasta	0.53	0.52	0.53
III	Atacama	0.55	0.48	0.50
IV	Coquimbo	0.54	0.51	0.55
V	Valparaiso	0.55	0.51	0.53
RM	Santiago	0.57	0.56	0.58
VI	O'Higgins	0.52	0.53	0.53
VII	Maule	0.61	0.56	0.53
VIII	Biobío	0.58	0.55	0.59
IX	La Araucanía	0.60	0.59	0.63
X	Los Lagos	0.61	0.57	0.55
XI	Aysén	0.52	0.53	0.59
XII	Magallanes	0.54	0.45	0.55
	Total	0.58	0.56	0.58

(a) Preliminary data

Source: MIDEPLAN, 1999a

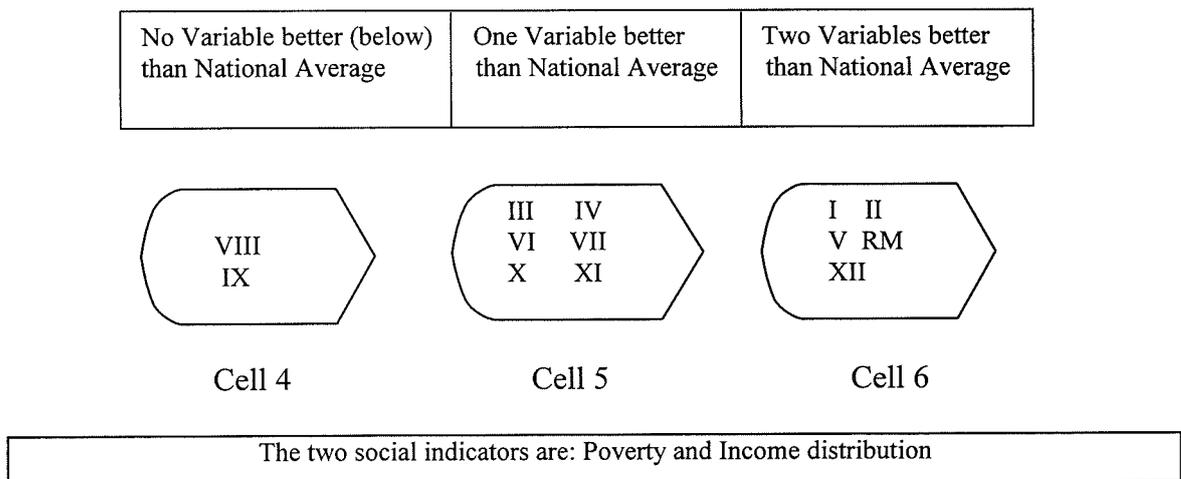
<sup>35</sup> See Mideplan 1999a for a complete description of the methodologies used in the calculation of poverty and income distribution.

Although there are no extreme values, significant differences can still be seen between, for example, Region I (Tarapacá) in the north macro zone, and Region IX (La Araucanía) in the south macro zone. Tarapacá has (by 1998) the most equal income distribution and La Araucanía with the least.

Figure 3.9 below summarises the performance of regions below or above the average in terms of the number of poor as a proportion of their population, and in terms of their income distribution index, also compared to the national average. The national average of 20.1%, for the median national level of poverty is used as an index base value of 100 (for 1998) to which the regional averages in the same indicator are compared with (see last column in Table 3.12). Regions were ordered into three groups, each representing their position and distance when compared to the national average.

For poverty, regions were grouped into cell 6 if they performed below the national average -abbreviated 'NA'- (they presented an average number of poor below the national average), in the centre, cell 5, if they performed not more than 20% above the NA, and in the left, cell 4, if they were more than 20% above the NA. For income distribution (ID), cell 6 groups regions that performed below the national average (regions with better ID than the national average), regions whose ID was the same as that of the NA (cell 5), and regions whose ID was over the NA (regions with the worst ID) appear in cell 4 (Figure 3.9).

Figure 3.9: Regions grouped by Social Performance



Comparison between the performance of regions in economic and social indicators:

There is not a clear correspondence between the performance in economic and social indicators. Several regions that either performed well or poorly in the three economic indicators analysed in Figure 3.9 have not performed well in the reduction of poverty of income distribution. That is, the relationship is not necessarily positive and in most cases is even negative. For example, region III (Atacama) is the one with the best performance in economic indicators, showing an average rate of increase in all three variables well above the national average. However, in terms of poverty is one of the worst ranked. Atacama did well in ID and therefore was able to keep itself in the cell of the centre, cell 5, for social performance (see Figure 3.9 above).

Something similar occurred with Magallanes (XII), which in the economic indicators was grouped among those of worst performance. In the social indicators, however, Region XII has an average number of poor below the NA and an income better distributed than the NA. These two conditions place Magallanes among the regions with the best performance in social indicators. These regions represent the two extreme cases with the highest negative correlation between the selected economic (GNP, unemployment and productivity) and social (poverty and income distribution) indicators.

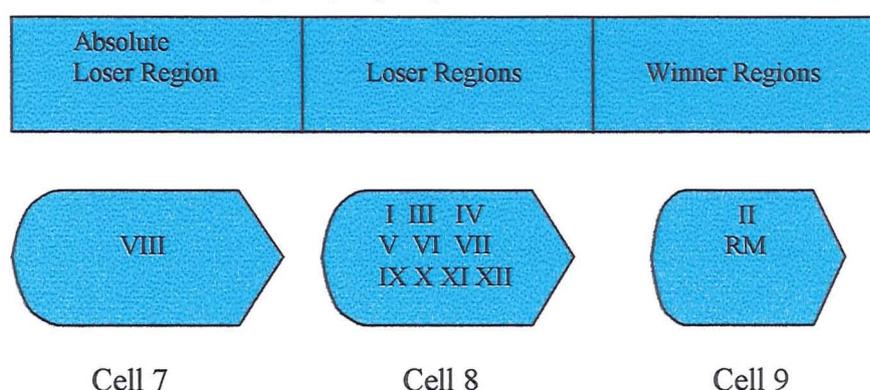
#### 4.3 Summary and conclusions

Table 3.12 and Figure 3.10 below summarise the overall performance of regions in both types of indicators, economic and social. Regions II (Antofagasta) and RM (Santiago) on the right cell (cell 9) can be said to be the “winners” under the neo-liberal model implemented in Chile. On the contrary, the region in cell 7, that groups the absolute losers of the model, has performed below the average in the five indicators selected.

Table 3.13: Winner and Loser Regions grouped by Economic and Social Performance (1986-1998)

	Absolute loser regions	Loser regions	Winner regions
Economic indicators	V, VI, VIII, XI, XII	I, IV, VII, IX, X	II, III, RM
Social indicators	VIII, IX	III, IV, VI, VII, X, XI	I, II, V, RM, XII
Overall performance	VIII	I, III, IV, V, VI, VII, IX, X, XI, XII	II, RM

Figure 3.10: Winner and Loser Regions grouped by Economic and Social Performance (1986-1998)



Of all regions of Chile, Biobío (region VIII) is the one that suffered the most with the implementation of this economic model in the mid 1970s. A heavily industrialised region, Biobío has been unable to recover from the shock of the opening of the markets to foreign competition. Many distinctive characteristics, i.e. its reliance in industrial activities with low value added and mostly based on the processing of raw material, its large number of people employed in coal mining activities (closed down at the end of the 1990s) and its large amount of natural resources seem contrary to its potential as the second most populated region of the country.

Regions grouped in the cell 8 were labelled as the “loser” regions. All have no more than three indicators (out of five) above the national average and at least six of them performed poorly in at least one of the social indicators. These regions are encountered in the three macro zones identified in Chile. In the case of the south macro zone, all its four regions belong to this category of losers, while in the other two macro zones, at least one region in each of them could be placed in the group of the winner regions.

Persistent absolute growth differential between regions ultimately leads to the concentration of jobs, inhabitants or production in the few places that have gained through application of the model. The way public policies have dealt with these differences, and particularly the action of the Regional Development Fund of Chile (FNDR) is analysed next in an attempt to link the action of this fund and the needs of regions for achieving a more sustainable development.

## Chapter 4

# The Regional Development Fund of Chile (FNDR)

This chapter defines and characterises the FNDR in its historical and present context. It also highlights the problems the fund faces in its future development. The chapter has been divided into three parts. The first part concerns the historical context and specific circumstances that permitted the creation of the fund. The second, describes the FNDR as it is today, providing information on its importance within the overall public investment, the type of investment carried out, and the importance of the fund within regions. In order to provide additional information for the understanding of the fund, this part includes an analysis and discussion of three studies which have addressed the problems of the FNDR. Finally, the conclusion of the chapter identifies the questions that arise after analysing the performance of the fund and the main problems addressed by specific studies at this respect.

## Introduction

The *Fondo Nacional de Desarrollo Regional* [Regional Development Fund of Chile] (FNDR) was created by law (Decreto Ley N. 573 of 1974) in order to complement the process of regionalisation initiated by the Military Government at the beginning of its mandate. Article 240 of this law specifies the origin and amount of resources to be devoted to the fund. Since then, the FNDR has constituted the main source of funding to the newly created regions of Chile. The fund was primarily conceived as an instrument for regional economic growth, according to priorities set up at the national level, in the areas of basic social infrastructure (Boisier, 1992) however, soon the geopolitical interest of the military rule overtook the regional growth objective.

Later, article 104 of the new Constitution of the country (1980) gave constitutional rank to the FNDR and pointed out that “the government and its administration...., will observe, as a basic principle, the search for a balanced and harmonious territorial development... incorporating the principle of solidarity amongst regions and inside them in matters related to the distribution of public funds”. (Ministerio de Hacienda, 1997).

The availability of resources for the FNDR became significant in 1984, when the amount of money involved was drastically increased as a result of a loan from the Inter American Development Bank (IDB or the Bank, as will be used subsequently). Since then the fund has become the most important regional policy instrument for the development of regions in Chile. From that time up until the present there have been three consecutive loans from the IDB, which has become known as the ‘Local Development Programme FNDR-IDB’ or simply FNDR-IDB. The total FNDR is therefore made up of two interrelated parts: The FNDR-IDB and the FNDR-National Resources.

At the beginning of the democratic government, in the 1990s, and as a consequence of a long process of decentralisation and democratisation of the local institutions (See chapter 3), the new government passed a law to create the Regional Governments in Chile (Law N. 19.175 of March 1993 on ‘Government and Regional Administration’ LOCGAR). This law redefined the FNDR fund and its objectives, it transferred the responsibility for its administration and the decision making process to the new regional administrative institutions, the Regional Governments, and created new instruments for its administration.

## 1 Definition and main purpose

LOCGAR defines the FNDR as a programme of public investment set up for territorial compensation through the financing of social and economic infrastructure of the regions (Subdere, 1993)<sup>37</sup>. The overall aims of the FNDR, from the point of view of public policies, point to three main areas: ‘territorial compensation’, ‘social and economic infrastructure’, and at the end of the period, ‘strengthen the Regional Governments’.

In practical terms the FNDR can be described as a multi-sectoral public investment fund administered at both the regional and central level. The main attributes associated to the fund are its ‘regional character’, that is, the responsibility for the allocation of money lies entirely within regions; its great ‘flexibility’ in terms of the kind of projects that can

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<sup>37</sup> A complete definition is given in the analysis of the objectives of the FNDR below in this chapter.

be financed; and the ‘expertise’ of the public bodies in charge of its administration after more than 25 years of experience running the fund.

The problems associated with these attributes, especially with the last two ones are that its ‘flexibility’ causes difficulties related to the intersectoral co-ordination of projects, the ‘expertise’ has meant a continuation of the same (same kind of projects although needs might have changed, same procedures and resistance to incorporate new ways of doing things). The fact that the fund has not experienced any important transformation during the last fifteen years is a clear demonstration of this. On the other hand, although the fund considers the carrying out of different types of actions, the actual execution of the programme has widely favoured the infrastructure dimension.

Since 1985 the fund is made up of two interrelated parts, the FNDR-IDB, and the FNDR-National Resources. The FNDR-IDB’ share has varied in time changing from 90% in the first loan to 15% in the current one (1995-1999). Table 4.1 shows the total appropriation of the FNDR in the three programmes so far.

Table 4.1: FNDR-Total, IDB and Chilean Resources (1985-1999).

<b>FNDR Programmes</b>	<b>Period</b>	<b>IDB Loans</b>	<b>National Resources</b>	<b>Total FNDR</b>	<b>IDB share</b>
141/IC-CH	1985-1989	125,000,000	146,000,000	271,000,000	46%
578/OC-CH	1990-1994	210,000,000	90,000,000	300,000,000	70%
853/OC-CH	1995-1999	75,000,000	425,000,000	500,000,000	15%

Source: Reglamentos Operativos. Subdere, 1985, 1990, 1995

Note: In US\$ of beginning of periods

The FNDR-National Resources represents the national counterpart of the FNDR-IDB. These resources come from a variety of sources (see table below) known as ‘provisions’. The amount of resources available to the provisions has consistently increased over the last years due to the increasing number of ‘provisions’ incorporated since 1994, and an increase in the amount of funds in all of them. By 1998 the provisions of the FNDR accounted for 36% of the total FNDR (Universidad Austral, 1999). Education infrastructure is by far the most important, representing in 1998 more than 50% of the total funds from the provisions (or FNDR-National Resources).

Table 4.2: FNDR-National Resources (Provisions) and FNDR-IDB

Provisions	1998	
	M\$	%
Efficiency	4,572	3.14
Emergency	4,572	3.14
Mining Levies	2,318	1.59
Education Infrastructure	28,594	19.62
Rural Electricity	4,769	3.27
Drugs	10	0.01
Pre-Investment	1,055	0.72
Productive Investment	2,900	1.99
Compensation Fund for Water & Sewer Systems	4,000	2.74
<b>FNDR-Nat. Resources</b>	<b>52,790</b>	<b>36.21</b>
<b>FNDR-IDB+Inv. Menores</b>	<b>92,979</b>	<b>63.79</b>
Total FNDR Investment	145,768	100.00

Source: Adapted from Universidad Austral (1999)

Note: Millions of Chilean pesos of 1998

For 1998 the FNDR total (IDB+National-Resources+Provisions) reached the sum of M\$145,768,251 (Chilean pesos) or US\$ 289,128,902 (almost two hundred and ninety million dollars<sup>38</sup>), expressed on 2000 prices. The FNDR is intended to benefit around 40% of the Chilean population, that is, about 5,928,680 (almost six million people by the year 1998<sup>39</sup>). On this ground the FNDR investment per capita for this proportion of the population is of US\$48.77.

In sum, the FNDR is an important source of financing for local infrastructure projects. The availability of resources has increased and diversified throughout time, with the FNDR-IDB as its main component. Nevertheless, the importance of the FNDR-IDB in the total FNDR fund has decreased in relative terms due to the increase in the number of provisions input into the FNDR and the amount of money involved in it. The FNDR-Total has grown in absolute terms by almost 12% annually over the last 4 years. Given the decentralised character of the FNDR, the regions have, at present, a stronger policy tool to tackle development problems from a regional perspective.

Two studies consider that despite the growing importance of the fund, the extremely diverse aims of the FNDR has lead to significant discussion about whether the

<sup>38</sup> 1US\$ = 540 Chilean pesos

<sup>39</sup> Out of 14,821,700 (Estimated to the year 1998 by the Chilean Statistical Office, INE 2000)

objectives contradict each other in pursuing their goals (DIPRES, 1997; Universidad Austral, 1999). The findings of these studies are presented later.

## 2 How the FNDR works

The financing of all projects funded by public resources in Chile is carried out under the Sistema Nacional de Inversiones (National Investment System)- SNI. This system establishes the procedures for the design of the projects, the technical and economic appraisal, and the timetable all projects have to follow to apply for public funds. Projects seeking FNDR funds have to follow and comply with all the requirements defined by the SNI.

The way the FNDR-Programme of investment is constructed and approved within the Regional Government is presented below. The presentation includes the main stages and the time schedule. The same process is then presented from the point of view of an individual project seeking FNDR funds.

### 2.1 The approval of the budget

The approval of the FNDR Programme of Investment can be divided into three main stages. These stages are not formally established in the FNDR administrative procedures and not all regions follow exactly the same steps, however, specific deadlines exist at the national level for the main phases. The whole process can be summarised as follows.

Stage 1:

Strategy and Priorities Discussion, Formulation of Projects

*Date: January - May*

Although general deadlines have to be followed by the Regional Governments in Chile, the process itself differs from one Regional Government to another. The process begins with the Executive and Assembly discussion on strategies and priorities for the following year. According to this, local authorities (Municipalities) and public spending bodies (Education, Health, Public Works, etc) seeking FNDR funding for the following year submit their investments proposal (projects) to the Executive's technical office. In this stage they also participate in the process of decision making by informing the Regional Government of their own priorities.

Stage 2:

Preliminary Draft budget and the discussion of Projects and Priorities

*Date: End June – End July*

At the end of June the Executive hands over a draft proposal to the Regional Assembly. The Assembly analyses the proposal and returns it back to the Executive suggesting any changes that they consider should be made to the final proposal. The size of the budget under consideration is an estimated figure based on the latest budget amount, plus a twenty percent. The exact amount available is provided by the Central Government at the end of December each year.

Stage 3:

The Final Proposal

*Date: Mid August – End December*

By mid July the Executive presents the final budget proposal for Regional Assembly consideration. The Assembly has one month, by law, to approve or reject the Executive's proposal. At this stage what usually takes place is an agreement on the final proposal in such a way that the Assembly members are able to make minor changes on the Executive proposal. The experience of recent years is that the Regional Assembly modifies the Executive's proposal in about 25% to 30%. It is of the executive responsibility to try to avoid changes that will pose technical problems in carrying out of the budget. Once accepted, the proposal is presented to the Executive at the National Level (Ministry of Finance) in September each year for final approval.

## 2.2 A project seeking FNDR financing

For an individual project seeking FNDR funds, the whole process takes at least two years from the first draft of a project to the final completion of works. For this project, usually presented by the municipalities, the FNDR represents an offer of resources from the regional level. The FNDR process of investment is part of the ‘National System of Investment’ (SNI). This system requires that there must be a group of projects seeking funds for every public source of investment, like the FNDR. Accordingly, the FNDR have its own set of projects to chose from. Normally, the sum of the costs of all projects applying for FNDR funds every year exceeds by 3 to 1 the available resources.

Table 4.3: Administrative Procedures utilised in the administration of the FNDR

Step		Participant	Time
	<b>Pre-Investment</b>		Eight months, January- August
	<i>* Project formulation</i>		
1	Outline/proposals of ideas of projects	Local communities, Sectors, Municipality	Throughout the year
2	Using pre-established methodologies (developed by the Ministry of Planning) sectoral offices and municipalities write down the projects	Sector, Municipalities	Three months January to March
3	Projects are input into the ‘Sistema Nacional de Inversiones’ a national computerised system containing all projects seeking public funds	Sectors, Municipalities	One month, March
4	Social-economic assessment of projects	Serplac, Ministry of Planning	Three months, March to May
	<i>* Selection of projects for investment (Prioritisation)</i>		
5	Construction of the programme of investment. Projects are selected from those that were recommended after the evaluation	Regional Executive	Two months, June-July
6	Discussion about the projects selected and changes to the final list	Regional Assembly	30 days, July-August
7	Agreement of the final list of projects to be financed the following year (the FNDR Programme of Investment)	Regional Government	August
	<b>Financial Execution of Projects</b>		Throughout the year
	<i>* Financial creation</i>		
8	Start of the new budgetary year. A budgetary code is assigned to each projects. This process is done by selecting groups of projects through out the year (considering the best moment for investment)	Regional Governm, Subdere, Ministry of Finance, Contraloria	Throughout the year Starting in January
9	Regional Government-Technical Units (TU) Agreement for the execution of works (Technical Department of Sectors and municipalities act as the TU of FNDR projects)	Regional Government, Sectors and Municipalities	Throughout the year
	<b>Physical Execution of Works</b>		Throughout the year
10	<i>* Contract of Works and payments</i>		
	Technical Units contract the works with private contractors	Sectors and Municipalities, Private contractors	Throughout the year
11	Money in advance and payments (Projects are paid as work progresses)	Regional Government	Throughout the year
12	Final payment and reception of works	Regional Government	Throughout the year
13	Hand over of completed works to the institutions responsible for it operation	Sector and Municipalities	Throughout the year
14	<i>* No ex-post evaluation of projects is carried out, apart from isolated cases in a few regions.</i>		

In addition to the general obligations and steps to be followed by all projects in the FNDR, the projects to be financed by the FNDR-IDB part of the programme have also to comply with special requirements in order to be accepted by the Bank. These are:

- The validation of documents (costs of projects, public auction procedures, contracts).
- Parallel accounting by Subdere.
- When the cost of a particular project exceeds MUS\$ 3 (three million US\$) for infrastructure works and US\$ 0.35 (three hundred and fifty thousand US\$) for the acquisition of furniture and equipment for schools and health centres<sup>40</sup>, the execution of projects has to be contracted through international auctions with the participation of IDB member countries.

These tasks are carried out by Subdere and its regional offices (the UCRs).

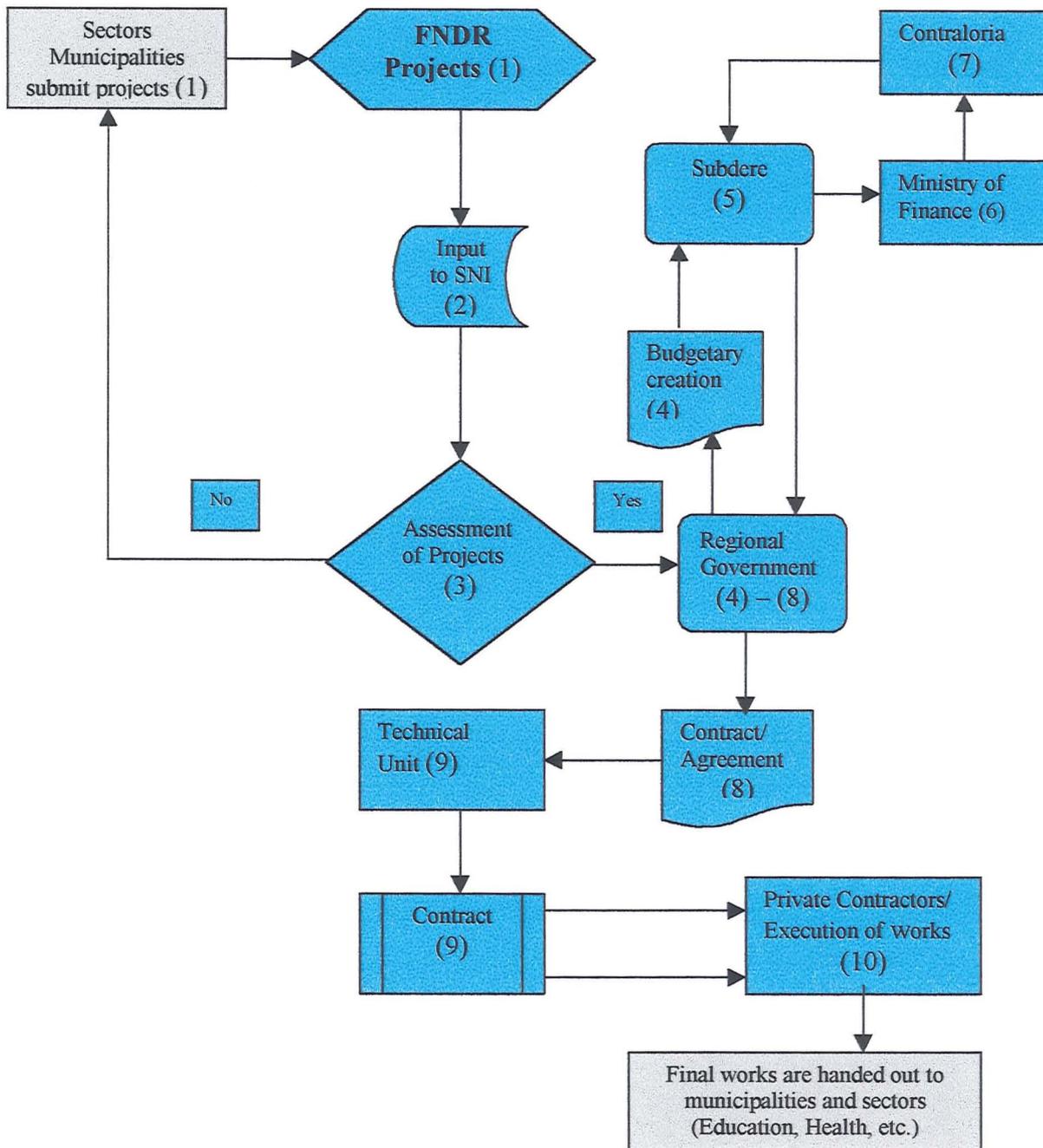
Figure 4.1 summarises the different steps followed by a FNDR project, from the moment the first draft of the project is done by a public body or a municipality and included into the National System of Investment, to the moment the works are contracted with private contractors. The entire process takes at least two years and includes the participation of the three levels of territorial administration in Chile, the local level (municipalities), in the making of the projects; the regional level (Regional Government), as the administrator of the fund; and the central level, through Subdere, in the administration, and the Ministry of Finance and *Contraloría* (the national public body that control all public administrative acts in Chile) in the conformation of the investment within the national policies and administrative procedures.

The skills acquired after a relatively long experience of the administration of the FNDR have permitted the public institutions involved in its management to conduct the process in a reputedly efficient manner. Nevertheless, two distinctive problems have been identified in relation to the management of the fund. The first concerns the lack of written instructions for various aspects of its management, especially those related to the communication between the institutions that are part of the process. The second is the lack of regular information from the Regional Government to the regional community on the progress and achievements of the fund.

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<sup>40</sup> Threshold costs for the last IDB credit 1995-1999.

Figure 4.1: Steps followed by a FNDR Project for its financing



- (1) Elaboration of projects based on pre-existing methodologies
- (2) Input of projects to the National System of Investment for Technical Evaluation
- (3) Evaluation of Projects. If Yes can be selected for investment. If Not project can be presented the following years
- (4) Regional Government begins the process of financial creation of projects
- (5) Subdere creates the projects
- (6) Conformation of financial creation
- (7) Conformation of financial creation
- (8) Contract Regional Government-Technical Unit for the implementation of projects
- (9) Technical Unit-Contractors Agreement for the execution of works
- (10) Execution of works

### 3 The FNDR within public investment

In order to obtain a clear understanding of the role that the FNDR plays in Chilean public investment, the fund will be presented in terms of its importance to public investment and in terms of the kind of investment it carries out.

The FNDR is the principal source of investment decided at the regional level due to the degree of autonomy in its use, and because of its magnitude compared to the rest of regional investment funds. Table 4.4 below shows the three existing regional funds ISAR, IRAL and the FNDR. Together these funds represent the total public investment decided at the regional level.

Table 4.4: Participation of the FNDR in total Regional Investment (%) 1994-1996

Regional Investment	1994	1995	1996
ISAR <sup>(a)</sup>	41.73	47.57	42.55
IRAL <sup>(b)</sup>			3.13
<b>FNDR</b>	58.27	52.43	54.32
Total	100.00	100.00	100.00

Source: Subdere, 1999

<sup>(a)</sup> ISAR stands for *Inversiones Sectoriales de Asignación Regional*. Sectoral funds where the power of decision on investment lies with the Regional Government while its administration is carried out by the regional offices of national ministries. It includes sectors such as housing, water and sewer system, sport and recreation, rural roads, urban roads, rural household water supply systems, and health.

<sup>(b)</sup> IRAL, *Inversiones Regionales de Asignación Local*. Sectoral funds distributed by the Regional Governments to the city councils, where the councils have the responsibility for their final use. It includes two funds, one for urban restoration, and the other for rural investment.

Although important within the regional funds, the FNDR accounts for only a 10% of the total regional public investment, with little variation during the period 1994-1996, as shown in Table 4.5. Regionalised sectoral investment, controlled at central level, represents over 70% of the total in this period. This situation changed after 1996 due to a presidential mandate on increasing public investment decided at the regional level. The policy target increased from 27% in 1994 to 40% by the end of that decade.

Table 4.5: Participation of the FNDR in total public investment (%) 1994-1996

Public Investment	1994	1995	1996
Municipalities	8.22	7.70	9.03
Social Fund	0.25	0.24	0.25
Sectoral Investment	72.23	74.60	71.90
ISAR <sup>(a)</sup>	8.05	8.30	8.01
IRAL <sup>(b)</sup>	0.00	0.00	0.59
FNDR	11.24	9.15	10.22
Total	100.00	100.00	100.00

Source: Subdere, 1999

The constant growth of the resources of the FNDR, amounting to 12% a year from 1994 to 1998 (going from \$95,499 to \$145,768 million Chilean pesos in the period) is not as impressive when the weight of the FNDR is viewed at the national level. Table 4.5 illustrates the importance of each regional fund in relative terms. Little variation is observed in the relative weight of each of the funds, which means that, given the upward trend maintained by the FNDR, the rest of the funds have grown at almost the same pace. Since the ISAR and IRAL funds did not exist before 1994, what has actually grown is the total investment decided at the regional level. Like the FNDR, these two funds are managed within the structure of the regional governments, which has facilitated the co-ordination of an important part of public investment at the regional level.

#### 4 A review of three studies on the FNDR

Although several studies have been carried out in Chile on the FNDR fund<sup>41</sup>, only a few of them have focused on more detailed aspects of the fund such as the role the fund has played in the process of decentralisation of the country, its use as a development policy tool or the level of efficiency in terms of its management and performance in the allocation of resources within regions. A critique of three selected studies on these different aspects is provided below. The purpose of this review is to be familiar with studies developed on this subject and with the many questions that arise on the functioning of the FNDR fund.

The aim and scope of these studies varied depending on the purpose and institution that had undertaken the task. The first study, commissioned by SUBDERE, focuses on an analysis of the second FNDR Programme finished in 1994. The study consists of an ex-post evaluation of the performance of the FNDR in the period 1990-1994. The second, from the Ministry of Finance, comprises a more general evaluation of the fund. This study was part of a wider programme of evaluation of all public investment programmes in Chile. The third study, completed by a regional university of southern Chile, focused on the variables used for the distribution of FNDR funds.

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<sup>41</sup> Boisier (1982) and (1992), SUBDERE (1995), Rosende (1997- memo), Angulo (1997), MIDEPLAN (1999).

In order to provide a comprehensive account of these studies I summarise each of them in terms of the following aspects:

- the study's aim
- the main contents
- its methodology
- main findings and conclusions

Later, more specific features of these studies are considered and discussed in order to help with the definition and analysis of the specific questions the present study aims to answer.

#### 4.1 **Study 1: Evaluación Ex-post FNDR 1990-1994'** (SUBDERE, 1997)

##### Study's aim

The main purpose of this work was to identify the fund's main achievements and weaknesses in order to enhance its administration as well as to provide information for improving the focus of its activity within the regions. The study evaluates the FNDR performance on a period of four years, from 1990 to 1994, which corresponds to the second FNDR Programme (IDB credit 578/OC-CH).

##### Specific Objectives

- a) Analyse the relationship between the expected focus (on low-income groups) and the degree to which this segment of Chilean population has actually been incorporated to development
- b) Verify the socio-economic impact of the action of the FNDR on low-income people
- c) Study the links between pre-investment (basic studies and engineering design) and the quality and functioning of the finished works
- d) Evaluate the state of conservation of the public infrastructure financed by FNDR funds, the operation and maintenance actions of the premises, and the relationship between the actions schedule for maintenance and the state of conservation of works.

## Main contents

Based on the analysis of qualitative data, chapter 2 of the study describes the general performance of the FNDR, including the results of the regional distribution of funds, the sectoral appropriation, and the level of execution of the annual budget. Chapter 3 analyses the social-economic and territorial focalisation of FNDR resources at the regional and local level. Chapter 4 reviews the operational stage, once the works have been completed and delivered to the beneficiaries institutions. This was done by selecting a representative group of projects from different sectors. Chapter 5 provides information on the management and performance of the FNDR from the point of view of the people directly involved in the administration of the fund. This part covers two aspects: it first deals with public policies and the decision making process; the second focuses on the problems related to the administrative procedures of the FNDR.

The final chapter presents the results of an ex-post evaluation of 18 projects executed during the period 1990-1994. The analysis highlights the most relevant aspects of the different phases during the execution of a project and the relationships amongst them, i.e. the links between the pre-investment and execution stage, the implementation of projects, and the degree of utilisation of the resulting infrastructure. More specific aspects such as the characteristics of the designs, their functionality, the quality of the works, the maintenance, and the operation and conservation of the premises are also covered in this chapter.

## Methodology

The study comprises two types of analysis. One carried out through the analysis of quantitative data, and the other, of qualitative origin related to the information provided by the people directly involved in the administration of the fund. Four instruments were used in the collection of information:

- Data from the National System of Investment (SNI)
- Interviews to high ranking officials at central, regional and local levels
- Questionnaires to a selected sample of projects currently in operation
- The documentation of a representative group of projects throughout their life cycle

The method prioritised the information supplied by people most directly involved in the management of the fund, from the all three levels of administration (central, regional and local). For this purpose a sample of seven regions was selected. Regional and local authorities were interviewed and a questionnaire was sent to 349 projects in different stages of development. Eighteen projects were analysed throughout their duration.

Representatives from SUBDERE, Department of Investment of MIDEPLAN, and from the Ministry of Finances were interviewed to gain a national perspective of the process. The work was structured in seven chapters plus an annex containing statistical data.

### Study's main findings and conclusions

#### \* FNDR action in the period 1990-1994

Most of the resources of the FNDR were directed to the financing of basic social infrastructure in order to satisfy the needs of the poorest people of the regions. More than 50% of the investment projects were directed to Education and Health. The IDB eligible sectors: Education, health, Drinking Water, Sewer Systems, Urban and Rural Roads, and Rural electricity absorbed more than 90% of the resources in the period. Of that 90%, half of the money was directed to investment in new constructions and the expansion of existing infrastructure.

#### \* Dispersion of investment and the supremacy of the territorial compensation objective

The final distribution of resources for the 1990-1994 period prioritised the peripheral and less densely populated regions of the country. The regions of Tarapacá, Antofagasta, and Atacama (I, II, and III respectively) of the north, and the regions of Aysén and Magallanes (XI and XII) of the southern most tip of the territory were favoured over those of central Chile. Although the latter contained the highest population density, such as the regions Valparaiso, Santiago, and Biobío (regions V, RM, and VIII).

#### \* Lack of co-ordination

After asserting that "The FNDR is the main financial instrument for the process of decentralisation...", this study argues that there is an evident lack of co-ordination amongst the different public offices that run the regional funds. This lack of

coordination, as well as the differences in the timing process of each fund, limited the regional government's possibilities of implementing a programme-based strategy of investment.

\* Low impact and administrative procedures burden

The 1990-1994 Programme was characterised by investment in a large number of small projects of local influence. The problems associated with this type of investment rested in the low impact that they had on regional development and consequently the great effort and energy involved in their administration. According to SUBDERE, this posed an unnecessary burden in the still weak regional administrations.

\* Focusing of investment

The results of this study show that per capita intra-regional distribution of funds tended to benefit the less densely populated areas of the regions. Therefore, within the regional level, the FNDR is also responding to its role as a fund for territorial compensation. However, at the aggregated level of all the municipalities within regions, there is not a clear association between the components of the FNDR (or sectors of investment) and the poverty indicator for them. That is, distribution of funds within regions does not follow the same patterns as that of the interregional level.

\* Type of projects that can be financed are limited by the eligibility criteria

The wide range of possibilities offered by the FNDR (as stated by law), in terms of the type of actions and projects that can be financed, is limited by the conditions of the credit from the IDB. This study concludes that the IDB credit restricts the flexibility of the FNDR of incorporating new sectors of action. On the contrary, the FNDR-National Resources offers a wider range of possibilities to the regions. This two approaches within the same fund is an important contradiction and constraint for the development of the fund.<sup>42</sup>

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<sup>42</sup> This contradiction was partially overcome in the last credit from the IDB. The door was opened for new sectors of regional interest to be included in the Programme under the compliance of the development of the corresponding methodologies for the elaboration and evaluation of projects by MIDEPLAN.

\* Lack of feedback in the stages of pre investment-execution-operation

The study identifies a lack of co-ordination and therefore of feedback amongst the different institutions that participate in the process of investment of the FNDR within regions. The municipalities, the main bodies in the drawing up of the projects, do not have a say in the physical execution of works. Once the works have been completed the resulting public infrastructures are handed out to these same bodies, that afterward will have the responsibility for the operation and maintenance of the premises. The lack of feedback imply, amongst other things, an increase in the costs of operation for the local governments. A similar situations is observed in the lack of co-ordination between the office in charge of the evaluation of projects and the regional government.

#### 4.2 **Study 2: ‘Programa de Evaluación de Proyectos Gubernamentales: Programa FNDR’** (DIPRES, Ministry of Finance, 1997)

In 1997 the Chilean Executive, through the Budgetary Office (DIPRES) of the Ministry of Finance, implemented the *Programa de Evaluación de Proyectos Gubernamentales* (a governmental project for the evaluation of all Public Investment Programmes currently being carried out in the country). During the first year, in 1997, twenty programmes being financed by public funds were evaluated, forty in 1998, and twenty more were expected in 1999.

##### Programme’s aim

The Programme aims to contribute to the process of ‘State Modernisation’ by improving the overall performance of the programmes and in particular the allocation of resources delivered through these programmes. This initiative also intends to provide reliable and updated information on the results of the application of these programmes. Once the evaluation has been concluded, the corresponding public institutions, in charge of these programmes, is suppose to incorporate the recommendations suggested by the ‘panel of evaluators’ of this programme. (Ministerio de Hacienda, 1997).

##### The FNDR Programme evaluation

The FNDR was one of the firsts programmes to be evaluated under this initiative in 1997. The main objectives in the evaluation of the fund are those mentioned above for

the entire programme. The office directly responsible for this work was DIPRES, the department of the Ministry of Finance in charge of the budgetary bill for all sectors of the economy.

#### Specific objectives

- a) Identification of the explicit and implicit objectives of the programme
- b) Analysis of:
  - the continuity and justification of the programme
  - the overall design of the programme
  - the organisation and carry out of the programme
  - the aspects related to the efficacy and efficiency of the programme
  - the sustainability of the programme
  - the experience acquired during the execution of the programme
- c) Recommendations on each of the aspects mentioned before

#### Main Contents

The evaluation of the FNDR Programme includes a number of topics that are general for all the programmes considered in this initiative, and therefore for the analysis of the FNDR fund. The themes included are:

- a) The identification of the explicit and implicit objectives of the Programme and a discussion on whether they are being achieved at the lower cost and at the most efficient manner,
- b) Discussion on the relevance and continuity of the Programme,
- c) Discussion on the way the Programme was designed and the implications of this on its efficacy and efficiency
- d) Analysis on the organisation and carry out of the programme, considering all the public bodies that take part in the process,
- e) Analysis and conclusions on the sustainability of the Programme and the experience acquired along its administration,

Recommendations, suggested by the 'panel of evaluators', on each of the aspects analysed on the study.

## Methodology

The methodology used for the evaluation of the programme is the so called *Marco Lógico*. The analysis is carried out by several groups of experts or 'panel of evaluators'. These panels are integrated by professional evaluators from outside the public sector and selected for their knowledge and experience on the subjects.

## Study's main findings and conclusions

### \* About the validity and pertinence of the Programme

According to this study, the FNDR's primary objective was to support the creation of the new administrative regions in the mid seventies in order to assure that their development were harmonious and well-balanced, at both the interregional and intraregional level. This objective had two dimensions, one was to support the process of regionalisation, and the other to improve the quality of life of the poors living outside the capital city of Santiago. These two goals have continued to be central for the governments of the last decade until the present. In conclusion, the study argues that the FNDR Programme appears to be strongly justified and appropriated under the current public policies on regional development.

### \* About the assumptions on the execution of the Programme

There exist a number of assumption under the existence of the FNDR Programme. These assumptions are related to the existence of:

- Financial capacity in the public bodies that have the responsibilities for the administration of the final works financed by FNDR funds,
- Adequate co-ordination amongst the different bodies that participate in the carry out of the Programme (Regional Executive and Assembly, SERPLAC, regional offices of sectoral ministries, and municipalities),
- Adequate technical capability and administrative skills to successfully run the Programme,
- Allocation of resources is done according to objective criteria based on socio-economic priorities, as stipulated on the region's Strategy of Development,
- The existence of a large enough group of projects seeking resources from the FNDR fund.

- According to DIPRES the majority of these assumptions are not being met or do not entirely satisfy the requirements set up for this evaluation. Based on the 1990-1994 ex-post evaluation of the FNDR, this study demonstrated that the public bodies that receive the final works for their operation are not given the resources to adequately maintain the various premises (building, roads, bridges, etc.). Out of the 348 projects evaluated in the period 1990-1994, 44.2% of them are not receiving enough resources for their appropriated functioning, 40.3% do not receive enough resources but that this does not affect the normal functioning of the premises.

- Based on the same evidence, DIPRES shows that people who is directly involved in the administration of the fund recognise a lack of co-ordination amongst the different institutions that take part in the process: the municipalities that draw the projects, the regional office that assess the projects, and the technical units that carry out the physical execution of works. Lack of personnel, poor quality of projects, amongst others, are mentioned as the main problems in this aspect.

- The objective criteria for the allocation of the resources are, according to DIPRES, again not adequately met. The variables utilised are extremely diverse, not always explicit, and with no direct correspondence to the socio-economic conditions of regions or the objectives proclaimed in their Regional Strategy of Development.

- Finally, the assumption of a sufficient group of projects applying for resources from the FNDR is not fully met due to the same problems mentioned before, that is, the lack of co-ordination among institutions. This problem is aggravated by the way the programme actually functions. The FNDR financing requires that the cost of the elaboration of projects and the financing of engineering designs has to be assumed by the institution that is applying for funds, normally the municipalities. These bodies, in the majority of cases, do not have enough money to invest in an expenditure that only in the case the project is financed, the municipality recuperates the costs of investment, the chance being one in three in a given year.

\* About the definition and accomplishment of the objectives of the Programme

According to DIPRES the objectives of the FNDR can be found in LOCGAR and in the contract of the third IDB credit for the FNDR Programme. DIPRES argues that these

two documents identify three objectives for the FNDR, which have been given a differential priority depending on the different institutions involved. This originates a confusion at the moment of evaluating the results of the action of the FNDR, particularly with respect to the beneficiaries and the focalisation of the resources. According to DIPRES these objectives are:

- To support of the process of regionalisation and territorial compensation
- To improve the living conditions of low-income groups
- To foster the institutional development of regional governments

A more detailed analysis of the objectives and the apparent contradiction amongst them is presented in chapter 5.

\* About the Efficacy and Efficiency of the Programme

- The investment of the FNDR has been clearly oriented to the financing of a large number of small infrastructure projects. According to DIPRES, this can be interpreted as a mechanism for compensating the lack of investment from the local or municipal level. For DIPRES, this is an indication of the deviation of the original objective of the FNDR as a regional policy instrument.

- DIPRES argues that in order to increase the efficacy of the Programme a new strategy of investment should be developed. What they propose is a programme-based approach of investment instead of the projects by projects one currently in use. The existence of a net of interconnected projects would also make easier the implementation of the Regional Strategy of Development in each region. Beside, this would allow to co-ordinate the action of the FNDR with the others regional funds in existence.

\* Regarding the efficiency of the Programme

DIPRES highlights several aspects, among them: shortage of resources for operation and maintenance of the buildings and other premises financed by the FNDR, the urgent need of incorporating new sectors of investment and the increase in the flexibility of its management, and the lack of co-ordination amongst the different institutions that participate in the process,

\* About the 'Provisions' of the FNDR

DIPRES argues that the Provisions have, instead of increasing the flexibility of the fund, tended to complicate and constraint its management due to the increasing number of projects associated to the process. This is specially true at the regional level. In fact, the Provisions and the resources associated to them are decided at the central level and the regions' role has been just to absorb the administrative burden and to expend the money within the shortest possible time.

#### 4.3 Study 3: 'Diagnóstico de las Variables del FNDR'

(Universidad Austral de Valdivia (UA), 1999)

The third study: *Informe Final Investigación y Diagnóstico de las Variables de Distribución del FNDR* - final report on the investigation and diagnosis of the variables of distribution of the FNDR fund, was carried out in 1999 by Universidad Austral de Valdivia, Chile (UA). It corresponds to a detailed study that analyses the variables of distribution of the FNDR fund at the national level and proposes an alternative method of distribution of resources.

##### Study's aim

The aim of the study is to propose a new model for the distribution of the resources of the FNDR fund from the central level. The model bears implicit the proposal of a new set of indicators for the calculation of the weight of the different variables utilised in the distribution of funds. The proposal includes two models, one inside LOCGAR, and the other outside the law. The proposition outside the law eliminate the restrictions on the number and type of variables considered for the distribution of funds. The study also analyses the variables of distribution for the 'Provision of Efficiency' and proposes several innovations for its allocation to regions.

##### Main Contents

The study contains a description of the FNDR that features the main characteristics in terms of the kind of investment it finances, the sectors covered, and the type of projects carried out. The study also includes a revision of the main facts under the fund, such as the country's public policies on regional development and decentralisation, the history

of the fund, and the present state of the regional heterogeneity of Chile. The major part of the study is dedicated, however, to the analysis of the variables and indicators used for the distribution of the FNDR from the central level to the regions. Finally, the work includes an extensive set of tables containing statistical data about the fund as well as the questionnaire and interview models used in the survey.

## Study's Methodology

### Quantitative Methods Analysis

The study used information supplied for SUBDERE and that contained in the *Banco Integrado de Proyectos* – the computerised data base (BIP) of the National System of Investment (SNI). The first set of information has to do with the variables and indicators used for the interregional distribution of FNDR funds and the amount of resources involved. The second set of data consists of statistics about the costs and number of projects financed by the FNDR as well as the typology of projects financed by sector.

### Qualitative Methods Analysis

The use of qualitative methods for the gathering of information was utilised for two central themes of the research, i.e. futures scenarios for the process of decentralisation and present and future role of the FNDR. The instrument utilised for this purpose were Questionnaires, Focus Group work, and Interviews applied to national, regional and local authorities.

The specific objectives are:

- Evaluation of the performance of the current FNDR fund,
- Future challenges for regional development and expected scenarios for the application of the FNDR,
- Opinions on the variables and indicators utilised for the distribution of the fund.

### Study's main findings and conclusions

\* About the regional heterogeneity of Chile

- The analysis of the variables utilised in this study permit to visualise important regional disparities in Chile. These disparities are mainly explained by the economic structure of the regions. Regions with the highest level of poverty are associated to their concentration on the primary sectors of the economy, i.e. agriculture, fishing, etc. This

is, at a time, strongly linked with the lowest level in the educational levels of the work force. This condition is supposed to negatively influence the competitiveness of regions and their capacity to achieve sustainable economic growth.

- According to this study the regional disparities caused by these circumstances justify the use of the compensation criteria in the distribution of the FNDR. For that reason, and given the current process of decentralisation that is undergoing in the country, the national authorities would have the ground to look at the potential of the FNDR as an instrument for regional compensation.

- Regional disparities are mainly observed where the State has few possibilities of intervention, for example the geographical circumstances, the market, and the socio-economic conditions of regions. UA points out that, in the opinion of people interviewed in the survey, the FNDR can do little to contribute to the reduction of regional disparities, mostly due to the small amount of resources involved, and because of the project by project approach, among other reasons. The FNDR, hence, could not pretend to play a significant role in the reorientation of territorial differences.

\* About the objectives and impact of the FNDR

- The original conception of the FNDR, as a 'programme for territorial compensation designed to stimulate regional development', was modified with the loans from the IDB. This was done by understanding/transforming the 'interregional compensation of inequalities' concept contained in the original objective of the fund with that of 'supply of basic social services to provide equal access to opportunities' that is being applied from the beginning of the FNDR-IDB Programmes.

- The amount of resources involved in the period 1994-1997 for both, the 90% of the FNDR and the 'Provisions', shows that the FNDR represented only a small share in the total regional-decided investment. Its importance in the total public investment in the regions was, hence, even less significant.

- The interregional distribution of the FNDR has, since 1985, mostly benefited the peripheral and less densely populated regions of the country over those that exhibit the highest levels of poverty. UA argues that territorial compensation has been understood as compensation for regions located at long distances from the capital

city, i.e. those located in the extreme north and south of the country, although these regions show a higher standard of life, above the national average. This behaviour in the distribution of the FNDR would betray the compensation attribute originally stated for the fund.

- The distribution of the 'Provisions' of the FNDR has mainly been based on population variables. This, plus the fact that the 'Provisions' are distributed in conjunction with the FNDR but using different parameters, has distorted the objective of territorial compensation of the fund. Based on this argument, UA suggests that the distribution of the 90% of the FNDR has little chance of producing compensation effects amongst regions.

\* About the future scenarios of the FNDR

- Two areas of interest are identified as the most important challenges that regional and national authorities will have to face in the future of regional development. These are, the 'Answer to social deficits' in infrastructure and services, and the 'Productive development'. UA argues that the way regional authorities most probably are going to cope with these problems in the near future will be through the use of the FNDR fund, due to the unavailability of other instruments.
- UA suggests that the FNDR will have to become more and more an instrument to orient public and private investment under a regional strategy approach. This can be achieved, according to this study, through the implementation of the Regional Strategies of Development.

\* About the indicators and model of distribution of the 90% of the FNDR

The methodology of distribution of the 90% of the FNDR -as it was in application in 1998- consists of a group of procedures that combine a total of 18 indicators grouped in two dimensions: a) a socio-economic, and; b) a territorial dimension. In the socio-economic dimension the indicators are grouped within five variables: economy, health, education, housing, and access to basic services. The territorial dimension comprises six indicators grouped in just one category. Even when the indicators used by SUBDERE for the distribution of the FNDR take into consideration interregional differences, principally on the relative level of development of regions, the information some of them provide is redundant. For example:

- The methodology assigns the two dimensions the same importance. This means that the territorial indicators have a greater weight compared to those in the socio-economic dimension due to the larger number of indicators in the latter one.
- Indicators in use are basically of quantity. No qualitative indicators are being employed.
- The highest correlation in the socio-economic dimension is encountered between the indicators of 'overcrowding', 'GNP', and 'poverty'.
- In the territorial dimension the highest correlation corresponds to the indicators of costs (among themselves and with other indicators).
- Several of the indicators of the socio-economic dimension present a high correlation with that of 'rurality', of the territorial dimension. When correlating both dimensions there is also a high correlation between the indicator 'distance to Santiago' and the indicator 'unemployment'.
- The indicator of 'territorial dispersion' does not comply with what has been stated in LOCGAR, because population density and dispersion are two different phenomena.

In addition to these problems, UA suggests that the distribution of the 90% of the FNDR is not being determined by the indicators utilised at present, which are not sufficiently relevant in the definition of the sums received for each region, but, instead, by the functional specificity of the model and, specially, by the control of the variance.

## 5 Empirical evidence on the main purpose of the FNDR (Questionnaire)

A field study was conducted in Chile to complement the information supplied by the three studies analysed above. It assessed changes noted by some of the main Fondo Nacional de Desarrollo Regional (FNDR) actors from the end of the military regime to the start of democratic governments, during the transition period from the end of the 1980` up to the beginning of the 1990`.

A semi-structured questionnaire gathered information using four closed and one opened questions about the future role of the FNDR. Seven relevant actors in both academic/theoretical and empirical/practical aspects of the existence and main objective

of the fund and about its administration and allocation to the regions and sectors of financing, were contacted. These seven people had worked directly with the FNDR during the transition period, at the national and regional level. Five questionnaires were received back - three from the national level; and two from people from the regional level.

The main idea in the use of the questionnaire was to find out the opinion of the people, who had been directly involved with the FNDR in that period, about what they had anticipated and had been working for, with respect to what was going to be the new role of the FNDR under a democratic government. It was generally agreed that the fund, despite its objective for regional development and overcoming poverty, had been mainly used for the hard and solid line of infrastructure. The idea was to find out to what extent these key actors had anticipated something different.

The first question was about the FNDR and the process of decentralisation that was in the agenda of the democratic alliance; the second addressed the type of action and sectors of investment to be accomplished; the third to the financial and administrative procedures involved; and the fourth referred to the relationship between the FNDR and the task of regional development at the regional level. The fifth question was open in order to encourage the interviewees to add anything else not covered by the fourth structured questions.

With respect to the relationship between the FNDR and the process of decentralisation the representatives of the regions were more optimistic about the role the fund could play under a democratic government. In both cases, they saw the FNDR as one of the main tools to make sure decentralisation would become a reality. They felt that, due to the FNDR multisectoriality, the fund could play a role to coordinate the different public offices and sectoral budgets, particularly at the regional level. For the regions, the FNDR should become the main instrument to realise the regional strategies of development. This could be achieved if the fund was to become more decentralised with real decision power transferred to the regions.

Other opinions pointed to the role the FNDR should play to overcome the negative impact that the National Government's economic model had had on some of the less

favoured regions. In this respect, these opinions coincide with the lack of participation of regional actors suggested in the DIPRES (1997) and UA (1999) studies.

The main criticism to the sectors of investment carried out by the FNDR is that from 1985, the first year in which the IDB started to participate in financing the program, the basic social infrastructure sectors selected were those that were already being financed by sectoral funding. In this sense the FNDR just replaced what was already been done by other means. All those interviewed agreed in their wish to transform the fund into a more comprehensive, regional oriented development fund.

Two opinions specifically pointed to the role the FNDR should have played at the pre-investment stage, that is, in the financing of studies and engineering designs to improve physical investment and focusing. The territorial aspect of the investment is also mentioned. According to one of the representatives of the regional level, the FNDR should have concentrated in particular territories within regions to accomplish one territorial problem in a multisectoral way.

It is interesting to note that none of the three studies presented before argued in favour of this option. In fact, the three studies, and particularly those by DIPRES and UA, the more critical ones, identified many weaknesses and inconsistencies between the objectives of the fund and the way this is being actually run, but, at the end, they do not progress in presenting and evaluating new alternatives.

With the beginning of the democratic governments in Chile in 1990, and particularly with the establishment of the Regional Government institution in the thirteen regions of the country in 1993, the FNDR achieved its major step towards a decentralised administration. Although this is true in one sense, because the regional governments effectively became responsible for the financial administration of the fund, the many restrictions imposed from the central level severely limited the range of action of these decentralised and democratically elected bodies.

The explanation for this is shared by most of the interviewees. The fear of the central government was that the regions were not technically prepared to carry out the new range of regional responsibilities. That was certainly true for the first years of operation

of the regional governments, but it is not the case after ten years of progressive regional experience. The FNDR itself has considered funds to enhance the administrative skills required to run the fund. On balance, after a decade of operation a high level of centralisation is still present in the operation of FNDR funds in Chile.

In the same line, both the central and the regional level respondents recognise the lack of leadership by regional government to produce a break at this respect and validate themselves as capable, trust-worthy institutions to lead their own development and fully administer their main policy tool which is the FNDR.

Following this line, the last two questions referred to the relationship between the FNDR and the development of the regions in Chile. All interviewed recognised the direct link between the action of the fund and its effect on regional development. However, they disagree in terms of the degree of intensity of this relationship. For some of them the central preoccupation on basic social infrastructure, specially in the less populated peripheral regions, has had a significant impact on local economies by providing the basic environment for productive investment to arrive. Furthermore, the simple provision of basic infrastructure was said to be a contribution for the development of region at this stage of development.

On the other hand, the FNDR has permitted the development of groups of public officials, politicians, local leaders and professionals who directly and indirectly have worked in the administration of these funds. This has created the necessary expertise within regions to accept new and more complex responsibilities for the management of their own development.

Finally, the FNDR has not been able to stop the permanent process of political and economic concentration in Chile, but has, certainly played a fundamental role in slowing it down.

## 6 Summary and conclusions

There are many questions that arise after looking at the way the FNDR fund is been used, first, with respect to the objectives and variables employed in the distribution of fund to regions and its consequential impact on particular sectors, and, second, and in a broader aspect, from the theoretical point of view of regional development in the country. The description of the way the fund has been structured and the way it functions together with a review of academic works done in recent years on the fund permit us to get closer to the type of questions that have been asked and the answers that have been proposed to the many problems identified in the functioning of the fund. The revision of these three studies has permitted to define more precisely the scope and boundaries of this research.

The main conclusions and question derived from this revision are summarised below. These were ordered according to two categories: 1) those that have to do with the distribution of funds and with the technical and operational aspects of the process; and 2) those related to more general aspects related to the impact of the fund on regional development and economic growth.

- 1) Conclusions/questions on the distribution of funds and the technical and operational aspects of the process:
  - a) The redundancy in the use of variables and indicators for the distribution of funds from the central government to regions,
  - b) The questionable share regions get from the distribution of funds, despite the weight of population and other social indicators,
  - c) the reduction of the flexibility of the fund due to the introduction and subsequent growth of the 'Provisions' as a way to increase the availability of resources,
  - d) the project-by-project approach rather than a more comprehensive programme-based strategy in the financing of projects,
  - e) the technical and administrative expertise gained by the responsible of the management of the fund at the national and regional level,
  - f) the lack of participation of the different actors that take part in the process,

- g) the lack of information on the functioning of the fund, both to the actors involved in the different stages of its administration and to the people of the region about its management and its action and impact on regions,
- h) the lack of co-ordination between the FNDR and the rest of the regional investment funds and national sectoral public investment funds,
- i) Lack of feedback in the stages of pre investment-execution-operation of projects,
- j) Lack of resources for operational purposes on projects financed with the fund.

## 2) Conclusions/questions on aspects related to regional development

- a) Contradiction among the objectives of the fund,
- b) The restrictions imposed by IDB bank that limit the implementation of new initiatives,
- c) the limited number of actions defined for the fund in from of the wider set of possibilities that may be used to have an impact on regional development (only three type of investments: infrastructure, basic studies, and programmes, and in a lesser extent pre-investment studies, technical assistance and designs),
- d) the limited number of sector covered by the action of the FNDR (90% of the fund is being utilised in just seven economic sectors),
- e) the unchangeable character of the fund, or the poor adaptability to new realities,
- f) Multiplicity of small projects and therefore low impact of regions,
- g) the neglected relationship between the FNDR and the social indicators of development in certain regions,
- k) the achievement on the reduction of particular needs (the best example being the reduction of the deficit of domestic electricity supply in rural areas from 50% to less than 20% in the last decade),
- l) Little chance for the FNDR to contribute to the reduction of regional disparities, mainly due to the small amount of resources available for the fund,
- m) Doubts about the future role of the FNDR as a regional development fund.

Several of the questions mentioned above have been addressed in the three studies analysed and others in recent years. Although some works have analysed the FNDR in

the context of regional development, most of them have been focused on specific, and some time only technical, aspects of the functioning of the fund.

Despite the valuable contribution these works have made to the overall understanding of the fund, they have suffered from several limitations. Among these limitations can be mentioned:

- a) the concentration on rather technical and specific characteristics of the fund than on more general aspects related to regional development,
- b) Most studies have limited themselves to the restrictions imposed by law for the functioning of the FNDR, and therefore have limited their findings to this circumstances,
- c) Very few studies have trespassed the boundaries of the country to carry out their analysis. As far as it is known until the completion of this work, no comparative studies have confronted the FNDR with other experiences of regional funds.

In this sense, the present study focuses its attention to the problems of regional development and the action of the FNDR. This study goes beyond the limits imposed by law for the development of the fund, and it will use the comparative analysis for the study of the main questions or aspects that it intends to address. The next two chapters (chapters 5 and 6) are dedicated to answer the questions posed in chapter 1 about the relationship between the FNDR and regional development in Chile, and to present and critically discuss on the experience of a similar fund (The European Regional Development Fund). This will set the ground for comparison between the Chilean case and the selected example.

## Chapter 5

# Key elements of a well/badly working system. The action of the FNDR

## Introduction

This chapter discusses the way the *Fondo Nacional de Desarrollo Regional* [Regional Development Fund of Chile] (FNDR) works. The analysis considers five aspects that cover most of the action of the fund. The first part discusses the concept and overall objectives of the FNDR as a regional development fund, the second has to do with the specific objectives of the fund; the third assesses the way funds are being allocated to the regions; the fourth describes the type of action and sectors of investment; and the last one explores the possible further actions for regional development that arise from the presence of a regional fund in the regions. The approach to these five elements is made in the form of questions that link each particular element with the overall notion of regional development. These questions are:

- Question 1: *What is the overall aim or concept underpinning the operation of the FNDR and how has this concept evolved during its twenty-five years of existence?* The FNDR fund was created under a very different context in 1974, compared to today's political and economic environment. After 10 years of operation the fund experienced a significant growth due to a loan from the Inter-American Development Bank (IDB) that, at the same time, introduced several modifications in the way the fund was to be run<sup>43</sup>.
- Question 2: *What are the objectives of the FNDR and how they are linked with regional development?* Under this question this work critically discusses the objectives of the FNDR and the way the fund has actually been used in order to stimulate regional development.

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<sup>43</sup> As established by *Ley 19,175, Orgánica Constitucional sobre Gobierno y Administración Regional* (LOGGAR), the law that created the Regional Government Institution and set up the objectives and tasks for the FNDR fund.

- Question 3: *Do the methods of allocation of FNDR funds all serve the specific objectives set up for the fund?* This section explores the different methods, variables and indicators employed for the allocation to the regions of the various parts of the fund.
- Question 4: *What are the types of action and the sectors of investment financed by the FNDR?* This question accounts in detail for the type of action and sectors of investment financed by the FNDR. It also discusses their relevance for regional development. Data for FNDR investment by sectors and regions is presented.
- Question 5: *What kind of actions, beyond the mere physical investment, are being pursued by the FNDR that may contribute to regional development?* This question examines whether unanticipated actions and results of FNDR action leverage investment and builds institutional and social capacity. Two particular examples, currently in use in other funds, are presented.

The identification of these particular aspects of the running of the FNDR fund will provide the key elements that this study intends to compare with those that exist in the European Regional Development Fund. This comparison appears in Chapter 7.

## 1 The concept of the FNDR

Within the action of the public sector, the Fondo Nacional de Desarrollo Regional (FNDR) is an instrument of at least three public policies: Regional Development and Decentralisation policy; Public Policy for Overcoming Poverty, and; Basic Social Infrastructure Supply (DIPRES, 1998). Some of these policy objectives of the FNDR go back to 1974, when the fund was set up. In its beginnings the fund was intended to support the development of the newly-created regions of the country. The aim was to ensure a balanced and harmonious equilibrium at the intra regional and inter regional level. According to DIPRES (1998), this objective comprised two dimensions: the supporting of the process of regionalisation, by strengthening regions as an alternative

to the metropolitan region of Santiago, and the improvement of the quality of life of, particularly, poorer people living in regions. The increase amount of investment in regions were supposed to attract people looking for a better quality of life and environment.

### 1.1 Historic account on the concept of the FNDR

The concept of the FNDR has experienced several changes since it was created. The fund was primarily conceived as an instrument for regional economic growth, according to priorities set up at the national level, in the areas of basic social infrastructure. In this sense, the FNDR was originally directed to the peripheral regions of the country and within them to those identified as such by the national policy for regional development, and, as Boisier as pointed out, following either the economic or the geo-politic rationale of the time (Boisier, 1992).

During the eighties the development strategy adopted by the military government again influenced the objectives of the FNDR. Boisier (1992) suggests out that the export-oriented economic model pursued by the government had a significant negative effect on the population of the regions. In fact, the differential success in competing internationally left many regions lagging behind in term of their relative development. This had severe effects, specially on the poorest areas of the regions. Since then the FNDR began to be used as an instrument for social policy as a way to overcome the negative social effects of the economic crisis and the structural adjustment of regions, abandoning the fund's original objective (Boisier, quoted in Universidad Austral, 1999).

This new orientation of the fund was reinforced in the contract with the Inter-American Development Bank (IDB) for the first FNDR Programme of 1985-1989. The second FNDR Programme, 1990-1994, is even more specific in addressing that policy. The contract with the IDB endorses this orientation pointing out that the Programme's objective is to finance investment projects designed to improve the living conditions of the poors. This was to be achieved through of the execution of investment projects intended to overcome the deficit or to rationalise the operation of basic services. DIPRES (1998) suggests that the contracts with the IDB for the three FNDR programmes have not always been consistent with the initial objective of the fund,

which is territorial development. On the contrary, the FNDR has progressively emphasised its orientation to the improvement and enlargement of the social infrastructure supply for the poorest sectors of the country.

Another shift in the objectives of the FNDR is pointed out by Universidad Austral, 1999 (UA, 1999) after SUBDERE<sup>44</sup> created the new 'Provision' for Productive Investment in 1998. UA (1999)<sup>45</sup> argues that although the amount of resources destined to this 'Provision' is not very significant, there is a clear re-orientation of the overall objective of the fund. SUBDERE itself, when declaring the objective of the 'Provision', refers to it as a 'transformation' of the fund. It is argued that the creation of this 'Provision' implies the delivery of additional resources to the Regional Governments. The overall idea is to transform this instrument into a real territorial development tool to allow regions to build up and carry out their own regional development strategies (SUBDERE, 1997; quoted in UA, 1999).

This shift is further sustained in the specific objectives behind the creation of this 'Provision'. SUBDERE declared that the launching of the 'Provision' for Productive Investment guarantees the existence of a minimum amount of resources for productive investment, eliminating so the competence with resources destined to social infrastructure. Although the distribution of this 'Provision' amongst regions does not include elements for economic compensation, SUBDERE points out that in the future these may be well taken into account (UA, 1999).

## 1.2 Problems/Controversies about the concept of the FNDR

Several controversies have been raised about the way the FNDR has been understood and utilised in Chile. UA (1999) identifies four controversies about the concept of the FNDR during the last –1995-1999– Programme (see also DIPRES, 1998).

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<sup>44</sup> Subsecretaría de Desarrollo Regional y Administrativo (SUBDERE). SUBDERE is the public office in charge of the allocation of FNDR funds to the regions of Chile.

<sup>45</sup> Universidad Austral (1999) is the most recent critical study on the variables of allocation and performance of the FNDR fund. This study, along with that by DIPRES (1998), are presented in detail in chapter 4.

- the first is related to the controversy of the FNDR as a policy instrument for decentralisation v/s the FNDR as a policy instrument for territorial compensation;
- the second discusses on the impact of the Provisions on the FNDR;
- the third deals with the objectives of the fund, and;
- the fourth discusses on the dichotomy people v/s territory.

The third and fourth contradictions identified by UA, as they have to do with the objectives of the FNDR and with the method of allocation of funds, will be analysed in the next sections of this chapter. The first two controversies are presented below:

a) The FNDR as a policy instrument for decentralisation v/s the FNDR as a policy instrument for territorial compensation.

UA (1999) argues that this question arises due to the fact that the FNDR is, in praxis, the investment budget of regions. The main characteristic of the fund is that decisions on the allocation of resources and sectors of investment are taken entirely within regions. This characteristic differentiates the FNDR from the rest of the existing regionalised investment funds.

This study confronts two different views on the subjects. The first one by DIPRES (1998), and the other from a statement of a former director of the *Subsecretaría de Desarrollo Regional y Administrativo* (SUBDERE) –the national office for regional development. According to DIPRES, the FNDR constitutes the most important financial instrument for the process of decentralisation and regionalisation of the country, without which such a process would just be an empty discourse. For Universidad Austral, this statement contradicts those who maintain that the relationship between decentralisation and regional development is not always a straight forward relation.

Gonzalo Martner, by then director of SUBDERE, argued that there was not a clear distinction between decentralisation and deconcentration, with all its budgetary and financial consequences, and the making of a regional development policy in favour of the less developed regions. With regard to FNDR, Martner declares that although many have suggested that this fund should be used as a deconcentration and decentralisation

tool, he strongly declares that is certainly not the main objective of the fund (UA 1999, p. 38 and 39).

As it will be seen when looking at the distribution of funds to regions, the FNDR is a fund used primarily for regional compensation. What one might question is whether the variables utilised for the distribution actually correspond to regional compensation measures, or, put in other words, what type of territorial compensation is being favoured with the actual allocation of resources. FNDR allocation tends to benefit peripheral low populated regions against more populated and poorer regions. Thus, territorial compensation is understood as an actions in favour of the most distant regions with respect to the capital city of Santiago (which is geographically located in the centre of the territory).

#### b) The impact of the 'Provisions' of the FNDR

As presented in chapter 4, the 'Provisions' of the FNDR are: Efficiency, Emergency, Mining Levies, Education Infrastructure, Rural Electricity, Drugs, Pre-Investment, and Productive Investment. Important from the second half of the 1990s, the 'Provisions' have made the FNDR to grow considerably compared to the rest of regionalised funds. In its study, UA highlights two aspects that cast doubts on the actual contribution of the 'Provisions' to the FNDR as a regional fund. The first suggests that since the 'Provisions' are pre-determined in terms of the type of investment they can actually finance, the actual contribution of them as a regional-based decision making investment is strongly questioned because they reduce the flexibility of the fund as a whole. According to Angulo "...such constraint would not exist due to the fact that the regions spend more in these sectors than the total of the money actually supply for them through Provisions". (Angulo, 1997; quoted in UA 1999, p. 39).

Nevertheless, although it is true that regions actually spend more money than the amounts provided in the 'Provisions' in sectors that already count with a 'Provision' (which means that they take money from other 'free' resources of the FNDR to direct them to sectors where 'Provisions' do exist), this would in any case limit regions in the sense that they do not have at their entire disposal the grand total of resources that constitutes the FNDR. 'Provisions' accounted for a 36% of the total resources of the FNDR in 1998.

## 2 The specific objectives of the FNDR

The specific objectives of the FNDR can be found in two official documents, the Law of Regional Government, *Ley N. 19,175 Orgánica Constitucional sobre Gobierno y Administración Regional*, (LOCGAR); and the Regulation (853/OC-CH) established between the Government of Chile and the Inter-American Development Bank (IDB) *Reglamento Operativo Préstamo 853/OC-CH Programa de Desarrollo Local FNDR-BID 1995-1999*” (*Reglamento Operativo 1995*) that sets up the objectives of the fund, the sectors to be financed and the procedures to be followed in the operation of the IDB part of the funds.

### 2.1 Objectives according to the Law

Article 73 of LOCGAR defines the FNDR as:

*“a programme of public investment, intended for territorial compensation destined to the financing of the social and economic infrastructure of regions, whose purpose is to attain an harmonious and balanced territorial development”.*

The law also establishes that the FNDR fund is to be made up of a portion of the total public investment expenditure as set up annually by the national budget bill, and a loan from the IDB. Resources are distributed to regions in specific fractions to each of them according to a methodology designed by SUBDERE.

Article 74 points out that the infrastructure projects, studies and programmes to be financed by the fund will have to be assessed and authorised by the national or regional offices of the Ministry of Planning<sup>46</sup>. This approval will be based on a technical-economical appraisal and, if the projects were to be financed by an external credit, they will have to follow the indications and requirements established by the terms of the contract of the loan between the Chilean Government and the international counterpart (the IDB in this case).

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<sup>46</sup> The decision whether a project is assessed at the regional or central level is based on the cost of the project. The central level reserves for itself the analysis of the largest and most expensive projects.

## 2.2 Objectives according to the IDB loan

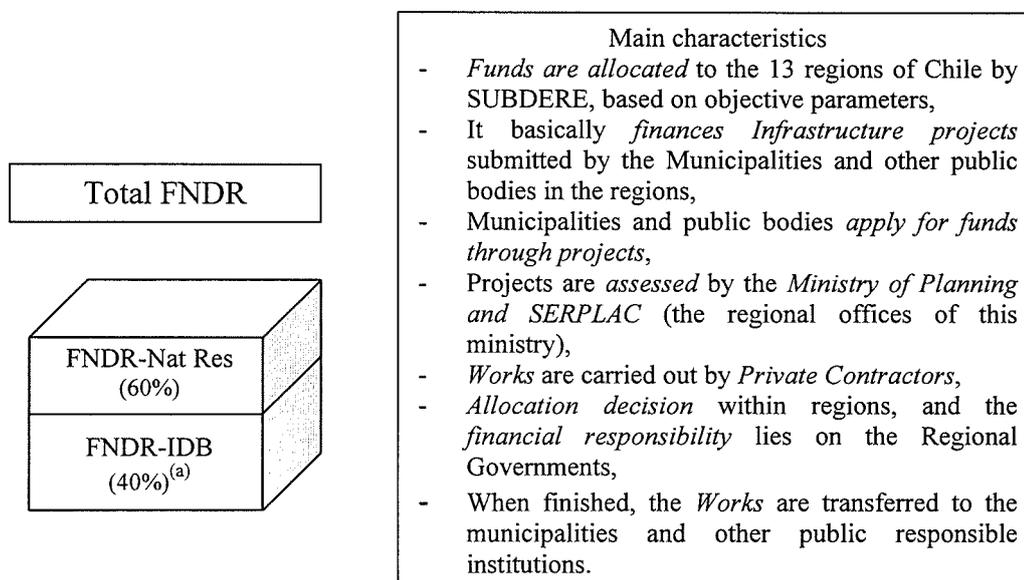
The Inter-American Development Bank (IDB) has participated co-financing the FNDR from 1985 in three consecutive loans (148/OC-CH of 1985-1989, 578/OC-CH of 1990-1994; and 853/OC-CH subscribed in 1995 for the period 1995-1999). The terms of the contract of the last loan between the IDB and the Chilean Government and the Regulations for the operation of the fund are contained in the working document *Reglamento Operativo 1995*. This document contains the rules as to the use and scope of the loan as well as the tasks of the FNDR-IDB, the areas in which the IDB part of the fund can be used for, and the responsibilities of the public bodies involved in its management.

For the 1995-1999 period, the Reglamento Operativo 1995 establishes that:

*“the aim of the Programme (FNDR-IDB) is to increase social welfare of the less favoured portion of the population by improving and widening the supply of existing infrastructure in the areas of Health, Education, Drinking Water Supply and Sewer Systems, Rural and Urban Roads, Domestic Electricity in rural areas and other sectors that might eventually be incorporated into the Programme. Beside, the Programme will also help to foster the development of Regional Governments”. It then adds that, “...it is also the Programme’s aim to contribute to the consolidation of the process of decentralisation of the country by financing projects conceived at the local and regional level”.*

Projects financed by FNDR resources are to be designed under the procedures established by the National System of Public Investment (SNI) and selected by the corresponding regional authorities (SUBDERE, 1995 *Reglamento Operativo 1995-1999*).

*\* Summary of the FNDR*



<sup>(a)</sup> IDB average participation in the three loans so far (from 1985 to 1999)

\* FNDR total in 1998 (IDB+National-Resources+Provisions)

- \$145,768,251,000 (Chilean pesos)
- Or, US\$ 289,128,902 (slightly over two hundred and eighty nine million dollars<sup>47</sup>).

\* People benefited

- The FNDR is intended to benefit around 40% of the Chilean population, that is, about 5,928,680 (in the year 1998<sup>48</sup>). FNDR investment per capita = US\$48.77/year.
- Considering as beneficiaries only the people living under the line of poverty in the country, to which the fund is supposed to be directed (21.7% of Chilean population) = US\$ 89.9/year.

### 2.3 Problems/Contradictions amongst the objectives of the FNDR

Apart from the changes in direction of the concept of the FNDR discussed earlier, several contradictions have been also identified in the objectives of the FNDR as they appear in the two official documents, i.e. LOCGAR and the Reglamento Operativo 1995.

<sup>47</sup> 1US\$ = 540 Chilean pesos in December 1998

<sup>48</sup> Out of 14,821,700 (Estimated to the year 1998 by the Chilean Statistical Office, INE 2000)

DIPRES (1998), and UA (1999) have recently evaluated the ambiguities, and by some, the contradictions that exist amongst the objectives of the FNDR (and consequently the need of developing appropriate mechanisms for the evaluation of the overall functioning of the fund and the consecution of its objectives). On the other hand, it is also not clear whether the emphasis of the action of the FNDR should be put on people or territories. These two contradictions are discussed below:

#### Problem/Controversy (a)

Ambiguity and contradiction on the definition of objectives for the FNDR, as they appear in the two official documents, LOCGAR and *Reglamento Operativo* 1995.

By looking at the objectives of the FNDR as stated in LOCGAR, these are really not explicitly enunciated, although they can be deduced from the statement of Art. 73 presented above. It is appropriate to say that no other part in LOCGAR refers more explicitly to the specific objectives of the FNDR. They do appear more clearly established in the *Reglamento Operativo* 1995 (the IDB Regulations for the 1995-1999 period), but again they are necessarily consistent with those stated in LOCGAR.

According to UA (1999), the definition of the overall objective of the FNDR, by LOCGAR, comprises two elements that constitute the keystones of the fund: 'territorial compensation' and 'territorial and balanced development of regions'. UA argues that the second of these directives represents the primary purpose of the fund and the basic principle that must guide the government and administration of the state.

The first problem on the understanding of the specific objectives of the FNDR, according to DIPRES, come from the wording of the objectives in the two official documents set for this purpose.

DIPRES argues that there is no logic in the structuring of the objectives nor in the language utilised. There is a confusion on the 'means' and the 'goals' as they appear mixed on the declaration of objectives. This can be clearly observed in the objective stated for the third phase of the credit from the IDB (*Reglamento Operativo* 1995). In fact, the objective stated makes equivalent the 'institutional development' and the 'financing of investment projects' that should be considered as 'means', and the 'social

and economic development’, and in particular the ‘improvement of the conditions of living of the poorest’ that should be considered ‘goals’.

Another important aspect highlighted by DIPRES is the lack of corresponding indicators for the evaluation of the achievement of the objectives of the FNDR. The measure of the success of the Programme have been, therefore, mostly based on the way the fund is being administrated, and especially in the level of the total expenditures at the end of each financial year, rather than in its actual impact as a regional development tool.

Many interpretations have been drawn from these two statement in terms of the possible number of objectives and the specific meaning of them. DIPRES argues that by looking at the objectives stated in LOCGAR and in the Reglamento Operativo 1995, there are clearly three objectives. According to DIPRES, these objectives have been treated with differential emphasis in the official documents concerning the subject.

The objectives identified by DIPRES (1998) from these two sources are:

**Objective 1:** to support the process of regionalisation and territorial compensation,

**Objective 2:** to improve the living conditions of low-income groups

**Objective 3:** to foster the institutional development of Regional Governments

At this point, it is important to make clear that these three objectives are the ones utilised in this study to carry on the subsequent comparisons, testing and analysis on the objectives of the FNDR. Having stated this, let’s look at the second contradiction of the objectives of the FNDR fund.

Problem/Controversy (b)

Territorial compensation v/s improving the living conditions of low-income groups **(objective 1 v/s objective 2)**.

From Chapter 3 we know which were the regions that exhibited the worse and the best economic and social indicators. These regions were labelled as the loser and the winner regions of the current strategy of development of the country (see reproduction of table 3.12 from chapter 3, below).

From Chapter 3  
Table 3.12: Winner and Loser Regions grouped by Economic and Social Performance (1986-1998)

	Absolute loser regions	Loser regions	Winner regions
Economic indicators	V, VI, VIII, XI, XII	I, IV, VII, IX, X	II, III, RM
Social indicators	VIII, IX	III, IV, VI, VII, X, XI	I, II, V, RM, XII
Overall performance	VIII	I, III, IV, V, VI, VII, IX, X, XI, XII	II, RM

The last row of this table summarises the overall performance of regions in these two sets of indicators. If FNDR funds were to be distributed according to the ‘territorial compensation’ objective (*objective 1*), there are plenty of regions to choose from, starting with region VIII (Biobío). However, whether the allocation of funds has followed this pattern is not clear, as it will be demonstrated below.

In fact, it has been argued (DIPRES, 1998) that the social justification in the action of the FNDR, i.e. the emphasis on poverty, and the search for a balanced economic development of regions (a concept that has traditionally been associated with territorial development), which have been the two most important justifications in the distribution of funds, bears an implicit contradiction. The reason for this is that in Chile the major concentration of population occurs in the central regions of the country (the ones that also concentrate the greater amount of poverty), which contrary to the objectives, receive the lowest per capita allocation of FNDR funds (see table 5.1 below).

Since LOCGAR defines the FNDR mainly as a fund for territorial compensation, to be used in the investment of social and economic infrastructure projects developed at the regional level, the emphasis has actually been placed in the support of the process of regionalisation and in the concept of territorial compensation. According to DIPRES, this means that there is total correspondence between objectives 1 and 2. However, the participation of the IDB co-financing the FNDR, has significantly modified the emphasis on these objectives.

Table 5.1 shows the allocation of FNDR resources per capita for all regions of Chile in 1994 and 1998 (at the end of the previous FNDR-IDB Programme and during the last Programme in operation). The third column presents the income distribution and the fourth the level of poverty compared to the national average.

Table 5.1: FNDR distribution, Income Distribution (Gini) and Poverty by region  
(Poverty: Index Average = 100)

	Region	FNDR per inhabitant (Country = 100.00)		Income Distributi on	Poverty (Country = 100.00)
		1994	1998	1998(a)	1998
I	Tarapacá	268.42	275.00	0.49	79.53
II	Antofagasta	234.21	233.93	0.53	65.13
III	Atacama	347.37	401.79	0.50	141.23
IV	Coquimbo	226.32	212.50	0.55	124.49
V	Valparaiso	68.42	62.50	0.53	93.49
RM	Santiago	13.16	14.29	0.58	76.60
VI	O'Higgins	147.37	132.14	0.53	115.10
VII	Maule	136.84	133.93	0.53	139.49
VIII	Biobío	60.53	62.29	0.59	147.04
IX	La Araucanía	155.26	146.43	0.63	156.98
X	Los Lagos	118.42	121.43	0.55	121.26
XI	Aysén	1536.84	1,528.57	0.59	75.11
XII	Magallanes	726.32	714.29	0.55	58.97
	<b>Country</b>	<b>100.00</b>	<b>100.00</b>	<b>0.58</b>	<b>100.00</b>

(a) Preliminary data

Source: Mideplan 1999a, and Mideplan Casen 1998

Table 5.2 below summarises the correlation between the allocation of the FNDR fund from 1994 to 1998 with the level of poverty by region as in 1998. Poverty per region has changed during this five year period, with poverty for 1998 having decreased significantly from that of 1994. FNDR allocation, on the other hand, and except for 1994 where a different methodology was being used, has not changed. The most important feature of the correlation indices is the figure for 1998 that recorded the

highest negative value. This means that funds were allocated in greater amounts to less poor regions.

Table 5.2: FNDR per Capita and Poverty per Region Correlation

	Correlation Coefficient	Significance (2-tailed)
1994	-0.396	0.181
1995	-0.352	0.239
1996	-0.308	0.306
1997	-0.385	0.194
1998	-0.434	0.138

Figure 5.1a and 5.1b, below group regions above or below the national average in terms of the three indicators presented in Table 5.1 (figures for 1998 were used in FNDR allocation data). In both cases, the most populated regions of central Chile, Valparaíso, Santiago and Biobío are below the national average in the share of FNDR funds allocation. These regions are the ones that concentrate the largest number of poor people, although in some cases they are above average in terms of income distribution (Santiago and Biobío) or below average in poverty levels (Valparaíso and Santiago).

		INCOME DISTRIBUTION	
		Below Average	Above Average (Worse Income distribution)
FNDR PER CAPITA	Above Average	Tarapaca, Antofagasta Atacama, Coquimbo O'Higgins, Maule Los Lagos, Magallanes	La Araucanía  Aysén
	Below Average	Valparaíso,  (Santiago)	Biobío,  Santiago

Figure 5.1a: FNDR and Income distribution

The peripheral regions of the north and south macro zones are all above the average in FNDR per capita allocation. Some of these regions are also above the national average in income distribution and below the average in poverty level, which means that although they are not problem regions in terms of these two indicators they still get a greater share in FNDR allocation.

Thus, FNDR allocation is clearly more oriented to territories than to low-income groups. Regional allocation of funds benefits more, therefore, peripheral less populated regions with less disperse income distribution and with less severe poverty problems than those of central Chile that exhibit the greater economic and social problems.

		POVERTY	
		Below Average	Above Average (more poverty)
FNDR PER CAPITA	Above Average	Tarapacá, Antofagasta, Aysén, Magallanes	Atacama, Coquimbo, O'Higgins, Maule, La Araucanía, Los Lagos
	Below Average	Valparaiso, Santiago	Biobío

Figure 5.1b: FNDR and Poverty

### Problem/Controversy (c)

Fostering the institutional development of Regional Government v/s territorial compensation and improving the living conditions of low-income groups (**objective 3 v/s objectives 1 and 2**).

In the previous Programmes I and II, DIPRES noticed an emphasis in favouring the poorest areas of the country. On the third programme, however, a fundamental shift

could be recorded. In the III Programme, The IDB Regulation for the FNDR stated that another objective of the fund was to foster the institutional development of the Regional Governments' (**Objective 3**), as well as to continue supporting the previous two objectives, with emphasis, this time, on the investment in projects originated at the regional and local level.

The introduction of this new objective by the IDB added a new preoccupation for the FNDR. According to DIPRES (1998), this is a change where the FNDR would not just be a fund for social investment, where the beneficiaries were the people who actually use the resulting infrastructure of these investments. Under this new objective the fund would also have the objective of strengthening regional public institutions where the final beneficiaries would be the institutions that are the object of this initiative.

The supply of basic social infrastructure, which can be said to be consistent with the objectives of improving the living conditions of low-income groups (**Objective 2**), has largely dominated over the other two objectives. What is not clear is the compromise of the FNDR with the objective of institutional development, which seems to be much more addressed in the last FNDR Programme (period 2000-2005). See [Appendix 4](#).

## 2.4 Summary and conclusions

### On Problem/Controversy (a)

- As there are no clear indicators or goals associated to the different objectives of the FNDR, assessing their achievement is a difficult task. According to DIPRES (1998) the first objective, 'regionalisation and territorial compensation', has been successfully achieved during the years of existence of the FNDR fund. The fact that the amount of resources has experienced a real increase over the years and that these have been mainly allocated to the peripheral regions of the country is a clear indication of this success.

As it has been suggested by several studies before (DIPRES, 1998; Universidad Austral, 1999; Boisier, 2000), it is necessary to re-draw and re-phrase the objectives of the FNDR in order to differentiate, correctly, the 'means' and the 'goal' declared in the two official documents mentioned. By doing so, it will be easier to increase the level of

efficiency and efficacy of the fund, and, at the same time, to facilitate future evaluations on the performance of the fund.

#### On Problem/Controversy (b)

- The question whether the FNDR is oriented to territories rather than to low-income groups is, however, not a real controversy. It is true that the fund is oriented to peripheral less densely populated regions, but within these regions the FNDR does benefit the poorest segments of the region's population.

- Therefore, according to DIPRES, the objective of focusing investment on poor people has been achieved. The study found that the goods and services associated to the actions of the Programme have actually reached the less favoured people of the regions. Nevertheless, DIPRES questions whether this money could have been used to benefit a larger number of people by focusing its action on more densely populated areas of the country, that is, the central regions of the country instead of the peripheral ones.

For this reason, the allocation of funds from the central government (SUBDERE) should be re-directed in either of these two directions in order to avoid the contradictions that still remain. If the main interest is people, funds would be better used by focusing its action where the larger amounts of poverty exist (the most populated regions of central Chile).

Regions of central Chile, although receiving smaller amounts of resources from the FNDR, enjoy of much larger amounts of resources through other public funds on the areas of housing, health, etc., together with more private investment. This is an influential argument in favour of the idea of allocating FNDR funds preferentially to peripheral regions, as it occurs today.

#### On Problem/Controversy (c)

- With regard to the third objective, 'institutional development', although several programmes have been financed to improve the technical skills of the public servants of the Regional Government and other public offices involved in the administration of the FNDR, there are no clear indications as to whether these programmes have been successful or not. Given the short period of time since this objective was set up, more

specific goals will have to be pursued in order to facilitate future evaluations. DIPRES' study highlights the importance of this objective for regional development due to the increasingly number of responsibilities that are being given to Regional Governments.

With respect to the disagreement of the objectives of the FNDR, a similar controversy existed in the case of the *Fondo de Compensación Interterritorial* [the Regional Development Fund of Spain] (FCI), before this fund were assimilated to the ERDF at the beginning of the 1990s. According to Castells (1992a), the two objectives of the FCI: a) the reduction of the imbalances in economic wealth among the Spanish regions, and b) the financing of the services that were transferred from the central to the autonomic communities, were not correlated and therefore not able to appropriately satisfy both aims at the same time. The reform of the FCI of 1990 overcame this controversy by explicitly subdividing the fund into two interrelated parts, each of which was assigned an specific amount of resources in the budget of each year (Castells, 1992b). The law that accounted for these changes also established the method of allocation of resources among the eligible regions.

### 3 Method of allocation of funds to regions

Contrary to the case of the FCI, the FNDR is allocated to all the thirteen regions of Chile. For allocation purposes the FNDR is divided into two main groups: the FNDR-IDB Programme (FNDR-IDB plus FNDR-National Resources), and the Provisions of the FNDR. The FNDR-IDB Programme is allocated to the thirteen regions of Chile according to two different criteria. First, 90% of the fund is distributed according to socio-economic and territorial parameters. Second, the remaining 10% is distributed according to the concepts of Efficiency and Emergency (both concepts will be defined below in this section). This general division is established by the Law of Regional Governments (LOCGAR). Article 75 of this law establishes that the amounts to be allocated to the regions that correspond to the 90% of the FNDR are to be stated in the public budget bill of every year and its distribution will be made considering two aspects: the socio-economic dimension and the territorial dimensions of each region

with regard to the national context. According to LOGGAR, the methodology to be used for these purposes is to give these two dimensions the same weight.

The Provisions of the FNDR: Education infrastructure, Rural electricity, Mining, Drugs, Pre-investment, Productive Investment and the Compensation fund for Water and Sewer systems are allocated by SUBDERE in conjunction with the interested ministry (Education, Energy, Mining, etc.). The methods of allocation of the Provisions are not examined in this work, although the overall effects of the existence of the Provision is discussed on the analysis of the allocation of the FNDR.

### 3.1 Methods of allocation

- Allocation of the 90% of the FNDR
- Allocation of the 10% of the FNDR
  - Allocation of the Provision of Efficiency
- Allocation of the other Provisions

#### 3.1.1 Allocation of the 90% of the FNDR

##### Dimensions and Variables utilised

- a) The socio-economic dimension of the region is to be measured using variables that will, at least, consider the infant mortality rate, the percentage of people living under the poverty line, the per capita regional product, and others conditions related to the quality of life, health, education, and environment of the regions (Art 75);
- b) The territorial dimension is to be measured through out variables that will consider, at least, the population dispersion, rurality, ecological deterioration, differences in the cost of road construction, and the distance from the region to Santiago (Art 75).

Data to be utilised in the different variables employed in the methodology of allocation of resources will be that supplied for the corresponding Ministries and the National Institute of Statistics (INE), or, if appropriated, these will be taken from recognised international institution.

The current methodology (in operation in 1999) was designed by SUBDERE in 1995 on the basis of LOCGAR directions. This methodology considers the utilisation of eleven variables for the Economic and Social Dimension and six for the Territorial Dimension with data dis-aggregated at the regional level.

#### Economic and Social dimension (Variables)

- 1) Infant mortality rate  
Number of death amongst children under one year of age over one thousand born alive;
- 2) Poverty level  
Percentage of population under the line of poverty (measured in term of income per head according to the methodology of the Ministry of Planning).
- 3) Unemployment  
Annual average unemployment in percentage
- 4) GDP per capita  
Regional GDP/region's population (1/GDP per capita)
- 5) Professional attention at birth  
Percentage of birth attended by professionals (100-professional attention)
- 6) Inhabitants per physician  
Total population/number of physicians ( Tot pop/phys\*1000)
- 7) Inhabitant per beds in hospital  
Total population/number of beds in hospitals
- 8) Infant malnutrition  
Nutritional state of children of less than 6 years of age. Based on the indicators weight and height, according to the WHO standards
- 9) Education  
Attendance to Primary and Secondary education in percentage (100-Attendance)
- 10) Access to Basic Services  
Percentage of households with access to drinking water, sewer systems and electricity (100- Access to Basic Services)
- 11) Overcrowding  
Percentage of households with three or more persons per single room in each house

#### Territorial Dimension (Variables)

- 1) Population dispersion  
Inhabitants/square kilometres
- 2) Rurality  
Percentage of people living in rural areas
- 3) Ecological Deterioration  
Deterioration of the natural resources, of the social environment, and environmental pollution.
- 4) Costs of Road Construction  
The actual cost of constructing a kilometre of road utilising the same standard for all regions
- 5) Costs of Building Construction  
Total cost/total surface constructed, including the cost of land (cost/m<sup>2</sup>)
- 6) Distance to the Capital City  
Distance from the capital's regions to Santiago in kilometres

Based on the use of these variables, table 5.3 below shows the share each of the thirteen regions of Chile received in the annual allocation of resources in 1997. The least populated region of the country, Aysén, received the greatest proportion of the fund compared to Santiago, the most populated region, that received the lowest amount of resources in absolute terms.

Table 5.3: Distribution of 90% of the FNDR, 1997

	Region	Distribution of 90%
I	Tarapacá	7.02
II	Antofagasta	7.22
III	Atacama	7.01
IV	Coquimbo	8.14
V	Valparaiso	6.50
RM	Santiago (b)	6.07
VI	O'Higgins	7.21
VII	Maule	8.24
VIII	Biobío	8.22
IX	La Araucanía	8.38
X	Los Lagos	8.60
XI	Aysén	9.59
XII	Magallanes	7.80
	Country	100.00

Source: Universidad Austral (1999)

### 3.1.2 Allocation of the 10% of the FNDR

The allocation of the remaining 10% is subdivided into two Provisions: Efficiency and Emergency. Article 76 states that these are to be allocated according to the following criteria:

- a) 5% will be allocated as an stimulus to efficiency, considering, at least, the ratio between the actual expenditure of the region and the total cost of the projects (considering only those with positive evaluation for the current year, or the RS projects<sup>49</sup>);

<sup>49</sup> RS project is a project already assessed and approved by the Ministry of Planning (at the regional or central level).

- b) 5% is to be kept by SUBDERE ( at the national level) for emergencies<sup>50</sup>. This part of the fund can be delivered any time through out the year as a response to an emergency in any of the regions. There is no methodology to allocate this Provision.

#### Allocation of the Provision of Efficiency

According to Article 76 of LOCGAR the distribution of the 5% corresponding to the Provision of Efficiency has to include at least:

- the ratio between the actual expenditures of a current year and the total FNDR budget of the previous year;
- the sum of the costs of all the projects that show a positive evaluation for the given year (the RS projects)

Beside this minimum requirements established by law, SUBDERE has considered a number of other variables. The number of variables considered have experienced few changes over the years. Table 5.4 below present the variables considered for the years 1996, 1997, and 1998.

Table 5.4: Variables used in the distribution of the Provision of Efficiency

1996	1997-1998
- Percentage of accumulated expenditures measured every three months (50%)	- Total expenditure at the end of the year as a ratio of the final budget (30%)
- Percentage of funds allocated to the poorest municipalities (15%)	- Final actual expenditure as a ratio of the Programme cash flow (20%)
- Projects in the category of RS as a percentage of the initial budget of the region (15%)	- RS projects (in costs) as a percentage of the initial budget (20%)
- RS Projects, total cost (10%)	- Actual monthly expenditure as a ratio of the Programme monthly cash flow (15%)
- Percentage of resources employed to finance Basic Studies, Pre-investment, and Engineering Designs (10%)	- RS projects (total cost)
	- Regularity in the expenditure flow

Source: Universidad Austral, 1999 and SUBDERE

<sup>50</sup> Emergencies are qualified as such by SUBDERE. Projects financed by this Provision go from the construction of schools or health premises that have collapsed due to fire or other natural disasters to the acquisition of supplies for these same sectors (Education, Health) or others eligible sectors by the fund.

Table 5.5: FNDR, Distribution of funds for Efficiency

	Region	1996	1997
I	Tarapacá	6.93	7.88
II	Antofagasta	12.46	5.94
III	Atacama	10.14	11.00
IV	Coquimbo	9.29	8.69
V	Valparaiso	8.44	9.22
RM	Santiago	7.43	6.28
VI	O'Higgins	4.99	8.79
VII	Maule	1.47	8.14
VIII	Biobío	3.75	3.45
IX	La Araucanía	7.17	9.72
X	Los Lagos	9.71	6.97
XI	Aysén	9.39	6.84
XII	Magallanes	8.83	7.07
	Total	100.00	100.00

Source: Adapted from Universidad Austral, 1999

The amounts of resources can differ greatly year-over-year in the allocation of this Provision because of the nature of the variables utilised and the technical expertise of the regional personnel in charge of the administration of the fund. Main variation between 1996 and 1997 occurred in Antofagasta, O'Higgins and Maule (Table 5.5). The indicators considered in the allocation of this Provision are so clearly indicated and known by all regions that achieving a poor performance is the entire responsibility of the region affected.

### 3.1.3 Allocation of the other Provisions of the FNDR

The rest of the Provisions of the FNDR (apart from Efficiency and Emergency) altogether account for over 36% of the total FNDR investment in 1998. Education infrastructure and Rural electricity represent almost two third of this percentage.

As mentioned above, the allocation of the Provisions, other than Efficiency and Emergency, is done by SUBDERE and the interested ministry that supply the funds (Education, Energy, Mining, etc). Sectoral rather than regional criteria are utilised.

The most interesting feature on the existence of the Provisions, to the effects of this work, is their growing importance within the FNDR fund. Table 5.6 below illustrates the increasingly importance of the Provisions, both in term of their number and their

importance in the total resources of the FNDR. In 1994 four Provisions accounted for a little over 18% of the total budget while in 1998, having more than double their number, they represented over 36% of the total fund.

Table 5.6: FNDR-National Resources (Provisions) and FNDR-IDB

Provisions	1994		1996		1998	
	MMS	%	M\$	%	M\$	%
Efficiency	3,883	4.07	4,140	3.72	4,572	3.14
Emergency	3,883	4.07	4,140	3.72	4,572	3.14
Mining Levies	494	0.52	1,385	1.24	2,318	1.59
Education Infrastructure	9,902	10.37	16,057	14.42	28,594	19.62
Rural Electricity			3,197	2.87	4,769	3.27
Drugs			11	0.01	10	0.01
Pre-Investment					1,055	0.72
Productive Investment					2,900	1.99
Compensation Fund for Water & Sewer Systems					4,000	2.74
<b>FNDR-Nat. Resources</b>	<b>18,162</b>	<b>19.02</b>	<b>28,928</b>	<b>25.98</b>	<b>52,790</b>	<b>36.21</b>
<b>FNDR-IDB+Inv.</b>	<b>77,338</b>	<b>80.98</b>	<b>82,435</b>	<b>74.02</b>	<b>92,979</b>	<b>63.79</b>
<b>Menores</b>						
Total FNDR Investment	95,499	100.00	111,363	100.00	145,768	100.00

Source: Adapted from Universidad Austral (1999)

Note: Millions of Chilean pesos of 1998

### 3.2 Final allocation to regions

As a result of the application of the methodologies describe above, the regions of Chile received the following amounts of resources in recent years. Table 5.7 shows the differences between the initial allocation of the 90% and the final outcome after including the other 10% and the rest of the Provision of the FNDR.

Table 5.7: 90% of FNDR allocation and final outcome of FNDR-total (1997) and population per region

Region	Allocation of 90%	Final allocation (FNDR-Total)	% Population <sup>(a)</sup> per regions	FNDR/Pop (in %)
I Tarapacá	7.02	9.26	2.62	3.53
II Antofagasta	7.22	8.33	3.08	2.70
III Atacama	7.01	7.29	1.80	4.05
IV Coquimbo	8.14	6.92	3.80	1.82
V Valparaiso	6.50	6.16	10.26	0.60
RM Santiago (b)	6.07	8.79	40.12	0.22
VI O'Higgins	7.21	6.79	5.19	1.31
VII Maule	8.24	6.66	6.02	1.11
VIII Biobío	8.22	10.25	12.73	0.81
IX La Araucanía	8.38	7.27	5.75	1.26
X Los Lagos	8.60	9.83	6.98	1.41
XI Aysén	9.59	6.85	0.62	11.05
XII Magallanes	7.80	5.60	1.04	5.38
Total	100.00	100.00	100.00	1.00

<sup>(a)</sup>Population (Estimated 2000) INE, 2000.

Source: Universidad Austral, 1999

The first column shows the FNDR resources that would have correspond to each region by the simple distribution of funds according to the law (90%). The second column presents the final distribution of resources after including the 10% and the rest of the Provisions. Thus, the difference between these two first columns show the impact of the Provisions in the final allocation of funds. Table 5.7, above, also presents the share of population of each region (column 4) and the ratio between the regions shares in FNDR funds (final distribution) and population with respect to the country's total in each variable (column 5).

Figures in column 5 are calculated by dividing the FNDR final allocation (column 3) by the percentage of population of each region with regard to the national total (column 4). As the total for each of these two column sums 100 (100.00 per cent), the result for the country is 1.00 (one). Thus, figures for each regions in column 5 represent the regional variance respect to the national average. Three regions present figures below 1.0, Valparaiso, Santiago and Biobío which indicate a below average availability of FNDR funds. The larger the figure in this column indicates a greater per capita FNDR.

The way the 'Provisions' impact on the final distribution of the FNDR was demonstrated by Universidad Austral (1999) by analysing the variation between the initial distribution and the final allocation after including all the Provisions.

In Table 5.8 below, the distribution of 90% according to the methodology is equalled to 1 for each region. Thus, the figures for the four years represent the variations from the initial to the final distribution. For 1997, the regions of Santiago, Tarapacá, and Biobío (RM, I and VIII) for example exhibit the most significant gains, while the regions of Aysén, Magallanes, and Maule (XI, XII and VII) are the less favoured for this late outside methodology distribution. It is possible to say that, in general, the introduction of the Provisions tend to benefit the most populated regions of the country.

Table 5.8: Increase in the final distribution of the FNDR after including the Provisions, 1994-1997 (90% = 1.00)

	Region	1994	1995	1996	1997
I	Tarapacá	2.02	2.24	2.32	2.08
II	Antofagasta	1.82	2.10	2.12	1.83
III	Atacama	1.59	1.52	1.83	1.65
IV	Coquimbo	1.62	1.33	1.95	1.35
V	Valparaiso	1.50	1.48	1.69	1.50
RM	Santiago	2.15	1.56	1.82	2.29
VI	O'Higgins	1.38	1.48	1.54	1.49
VII	Maule	1.24	1.36	1.49	1.28
VIII	Biobío	1.64	1.77	2.08	1.97
IX	La Araucanía	1.30	1.36	1.57	1.37
X	Los Lagos	1.59	1.55	1.90	1.81
XI	Aysén	1.13	1.17	1.43	1.13
XII	Magallanes	1.40	1.38	1.44	1.14
	Country	1.53	1.56	1.82	1.58

Source: Universidad Austral, 1999

### 3.3 Importance of the FNDR within regions

The total public investment in regions varies considerably depending on their size and population. The importance of the FNDR within total public investment in regions, therefore also varies considerably from one region to the other (Table 5.9). For the less populated regions of the 'north and south macro zones' of the country, for example, the FNDR represents over a fourth, and even a third, of the total public investment. For the regions of the centre the FNDR becomes less important, with Valparaiso and Santiago showing figures of 7 and 3 per cent of their total investment respectively.

There is not much variation in the period shown with some regions gaining or losing a point in the importance of the FNDR within total public investment. As the FNDR allocation provides almost the same absolute amounts of resources to all the regions of the country (see Table 5.7 above), the enormous differences in the weight of the FNDR within regions, compare to each other, come from the difference in term of their population and size and therefore in the total amount of public investment devoted to them.

Table 5.9: Participation of FNDR in total Regional Investment (%) 1994-1996

	<b>Region</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>
I	Tarapacá	22.80	19.48	22.11
II	Antofagasta	25.38	20.65	22.39
III	Atacama	23.31	20.68	26.35
IV	Coquimbo	22.35	12.14	17.70
V	Valparaiso	7.09	5.40	7.85
RM	Santiago	3.00	2.58	3.17
VI	O'Higgins	15.36	10.89	11.44
VII	Maule	11.94	12.25	11.98
VIII	Biobío	7.85	7.01	6.99
IX	La Araucanía	13.23	13.59	12.10
X	Los Lagos	12.84	9.18	10.01
XI	Aysén	34.35	28.02	37.05
XII	Magallanes	26.61	21.95	23.47

Source: Subdere, 1999

The central regions of Santiago, Biobío and Valparaiso (VIII and V) are the three most populated of the country, while the peripheral regions of Aysén, Magallanes, and Antofagasta (XI, XII and II) are the least densely populated. Santiago, in which there is a concentration of 40.1% of the population of the country attracts most of the public (as well as private) investment. Therefore, the FNDR represents only a small proportion of that total. In contrast, for Aysén (with only 0.6% of the population of Chile) the FNDR represents more than a third of its total public investment.

### 3.4 Summary and conclusions

#### Problems with the methods of allocation of FNDR funds

##### - The objectives stated by law v/s the allocation of the Provisions

This problem arises because the resources of the 'Provisions' are not allocated to regions according to the variables and indicators established for the FNDR by law. These variables represent the social, economic, and territorial differences among regions that the fund intends to precisely tackle. As the 'Provisions' are incorporated into the FNDR after this has been allocated to regions according to the methodology, the final amount each region receives is therefore significantly different of that intended by the methodology. In real terms, this means that the '90%' of the FNDR that is allocated using the objective socio-economic and territorial variables is actually only a 63.79% of the total FNDR fund (figure for 1998. See Table 5.6 above).

Quoted by UA (1999), Angulo (1997) rejects the existence of this contradiction arguing that the 'Provisions' more than been part of the FNDR should be understood as parallel mechanisms for regional investment, assimilated to the FNDR but not an integrated parts of it.

- The decentralised character of the FNDR v/s the Provisions

It is a fact that the existence of the Provisions restricts the capabilities of regions to use the FNDR fund as they wish. This occurs because the Provisions have to be used in the economic sectors for which they have been designed. As the Provisions represent over 36% of the total FNDR (figures for 1998) this is a matter of great concern for the Regional Governments who have seen the FNDR actually grow but on the more restricted funding side of the Provisions.

Angulo argues that this restriction is not real due to the fact that regions actually spend more in the economic sectors served by the Provisions than has in fact been allocated to each of them (Angulo 1997, quoted in UA, 1999). This may be true, but the restriction for the Regional Governments still exist, and this would be proved if they decided to used FNDR fund for a different purpose.

- The dichotomy people v/s territory

The fact that the less populated regions of the country receive more funds than the most densely populated ones has been a matter of long discussion in Chile. An example from UA (1999) reports SUBDERE arguing that this apparent contradiction is justified because the allocation method allows the regions a new social actor into the political arena. "The important thing is to consider regions not in terms of their number of inhabitants, but in terms of the territory they represent" (SUBDERE, 1991)<sup>51</sup>.

- The poor definition of the variables used

This problems was pointed out by UA (1999) and has to do with the following three aspects about the variables and indicators utilised in the method of allocation of FNDR funds.

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<sup>51</sup> Quoted in Universidad Austral (1999).

The fact that the two dimensions (socio-economic and territorial) have the same weight within the method of distribution of funds (50% each) means that each of the six variables of the territorial dimension have a relatively higher weight compared to the eleven variables considered in the socio-economic dimension. This is, therefore, a clear bias in favour of the territorial dimension.

This is, however, not a problem when looking at one of the main objectives of the FNDR. The overall objective of the FNDR, defined in LOCGAR, states that the fund is “intended for territorial compensation” which would explain its marked orientation towards territories rather than towards socio-economic or population indicators.

The second concern expressed by UA (1999) is that the indicators used in the methodology primarily refer to quantity rather than to quality. What actually explain this is that availability of quantitative data at the regional level is limited.

Redundancy in the use of indicators is the third problem identify by Universidad Austral. UA demonstrated, through factorial analysis, that the first three factors on the socio-economic variable explain an 80.3% of the variance, and 91.2% on the territorial variable respectively. A closer look at the indicators in use would eliminate the less significant ones and propose others that would better explain the differences amongst regions.

#### 4 The types of action and the sectors/areas of investment

This section presents and critically discusses the type of actions and the sectors of investment of the FNDR. The type of actions and the sectors financed by the fund, it will be argued, pose a serious limitation to the overall objective of the FNDR as a regional development fund.

#### 4.1 Types of actions

The FNDR is used to finance, basically, four types of action, of which infrastructure investment is by far the most important. These actions are:

- Infrastructure;
  - Studies;
  - Programmes;
  - Others (pre-investment studies, engineering and designs, acquisition of land, technical assistance and supervision).
- 
- Infrastructure investment involves the construction, replacement, and upgrading and rehabilitation of public buildings, roads, and other public facilities;
  - Studies, includes studies of a general nature concerning regional development such as natural resources surveys, evaluations and analysis of variables affecting regional growth and development, etc;
  - Programmes, corresponds to the financing of long term ‘programmes’ on sectors such as agriculture and fishing. These programmes do not include investment in infrastructure, but equipment and the acquisition of vehicles can be included under this item;
  - Others, includes the financing of plans and designs for the construction of building and other facilities, technical assistance, acquisition of grounds for the location of infrastructure projects, and supervisions.

Table 5.10 below, shows the expenditures by type of action for the period of four years from 1994 to 1997. The most distinctive aspect in these series is the overwhelming domination of the category Infrastructure and Programmes investment. Although there was no dis-aggregated data available for Infrastructure and Programmes, which appear together in the figures, infrastructure alone accounts for more than 90% of each of these

figures<sup>52</sup>. Studies and Pre-investment, and Engineering Designs have grown more slowly than expected growing from 1.24% to 2.49%, and from 1.01% to 1,79%, respectively in the period shown. A larger investment in Studies and Engineering Designs by a region means a greater share in the distribution of the Provision of Efficiency<sup>53</sup>.

Table 5.10: FNDR, Participation per type of action (%) 1994-1997

Type of Investment	1994	1995	1996	1997
Projects (Infrastructure) and Programmes	96.43	94.54	93.53	92.76
Studies and Pre-investment	1.24	1.99	2.32	2.49
Engineering Designs	1.01	1.68	1.69	1.79
Other Investments <sup>(a)</sup>	1.32	1.79	2.47	2.96
Total	100.00	100.00	100.00	100.00

Source: Universidad Austral, 1999

<sup>(a)</sup> Or *Inversiones Menores* (Minor Investments): Corresponds to a maximum of 2% of the total budget of one year that the *Intendente*, the president of the Regional Government, in agreement with the Regional Assembly, may assign to a variety of small projects or basic studies that do not follow the timetable than the rest of the projects.

Within the category of ‘Other investments’, which is fixed at a maximum of 2% of a region total FNDR budget, only small scale infrastructure projects, acquisition of vehicles for health and security (police and fire fighters) sectors, as well as studies can be financed. Some regions have, however, managed to provide money from this item to technical assistance and supervision, which has largely been seen as a serious lack in the projects of the FNDR. The rapid growth of this item in the period shown in the table is explained by its importance as a handy tool for the Regional Executive and Assembly to allocate money to small projects of great impact amongst voters, particularly in pre-electoral years.

#### 4.2 Sectors/areas of investment

The main economic sectors on which the FNDR resources can be utilised for are mostly determined by the terms of the agreement with the IDB for the FNDR-Programme.

<sup>52</sup> The reason for this is that Projects and Programmes are registered under the same identification number in the accountant bill. Separating these two items is, therefore, a matter of manual work. The number of programmes financed are in a 1 to 20 ratio to Infrastructure Projects.

<sup>53</sup> SUBDERE encourages regions to increase the investment in these actions in order to improve the quality of infrastructure projects.

Altogether, the FNDR can finance any project in almost any sector as long as there exists a methodology for the evaluation of such a project. As will be shown below (see Table 5.11) the economic sectors eligible by the FNDR-IDB account for most of the investment of the FNDR. For this reason, the analysis of the sectors of investment of the FNDR will be limited to the sectors eligible by the IDB.

The FNDR-IDB can be used in three of the type of actions identified above: Infrastructure investment, Studies plus all the actions under the category Others. Thus, the FNDR-IDB finances the construction of civil works, acquisition of equipment, the costs of technical studies, environmental impact studies, designs, and it also includes the services of supervision and consultation for the following economic sectors.

- Education;
- Health;
- Drinking Water;
- Sewer systems;
- Rural Roads;
- Urban Roads;
- Rural Domestic Electricity;
- Other sectors (domestic rural drinking water, construction of new roads, generation and distribution of electricity in peripheral rural areas, flood deterrents, rural telephony, and small fishing ports).

These sectors have been present in the three consecutive FNDR-IDB Programmes since 1985, when the first loan from the IDB was signed. The category 'Other sectors' that appears at the end of the list was introduced in 1995, although little has been done in this area.

Economic sectors and eligible type of investment:

a) Municipal Education facilities:

Construction, replacement, upgrading, expansion, outfitting, rehabilitation, and acquisition of equipment for public primary and secondary schools. It also finances libraries in schools and accommodation for Head Teachers in isolated rural schools.

Since 1996 the programme has financed comprehensive rehabilitation programmes rather than individual projects.

b) Health

Construction, replacement, upgrading, expansion, outfitting, rehabilitation or standardisation of primary health care; and acquisition of equipment for public health facilities oriented to primary attention in urban and rural areas. It is also permitted the acquisition of ambulances, and other motor-transportation vehicles for rural areas.

c) Water and Sewer Systems

Construction, expansion, service level improvement and rehabilitation of integrated drinkable water supply and sewage disposal systems for urban communities, as well as civil works and equipment for systems to collect and dispose of household solid waste.

d) Roads

The improvements of general standard of roads including the rehabilitation of secondary, communal or regional rural roads, provision of paved roadways, pavements, kerbing, bridges, tunnels, traffic lights and signage on secondary urban streets, and the construction of new roads.

e) Rural domestic electricity

Construction of new grids or expansion of existing ones to supply low-income rural communities with electricity, as well as the installation of means for electric power generation and equipment for the distribution of energy for isolated communities.

f) Other sectors and types of projects

- Equipment for public telephones in rural communities;
- Construction and expansion or upgrading of flood protection work in low-income residential areas, as well as work for channelling rivers, streams and canals, including lateral protection works, dikes and retaining walls;
- Protection works, docks, ramps storage facilities, services, repair shops and areas for the sale of products for small-scale fishing coves.

g) Other activities to be financed by the FNDR-IDB

- Pre-investment studies: Pre-feasibility and feasibility studies, diagnostic studies and environmental impact assessment,
- Engineering and design: Final design of projects and engineering consultancy ,
- Lands: Acquisition of pieces of land to provide buildings for educational and health projects, etc.
- Supervision: The FNDR-IDB also finances the services of consultancy to help the Technical Units (usually municipalities and regional offices of national ministries) and the Regional Government in the supervision of works.

Table 5.11 below shows the investments per sector for a period of four years from 1994 to 1997. Overall, there is a steady decline in the amount of resources devoted to the FNDR-IDB in favour of the FNDR-National Resources. Education is by far the most important sector of the FNDR in which almost a total of 38% of the investment in 1994 is concentrated, and just over 30% in 1997. The second most important sector is Health, which attracted 20% of the total investment in 1994, although there is a drastic reduction to 8% in 1997. A similar situation is evident with reference to the investment in Urban Roads, where investment fell from 13.41% to 8.31% in the same period.

Table 5.11: Importance of the Economic Sectors financed by the FNDR (%) 1994-1997

Sector	1994	1995	1996	1997
Education	37.91	30.87	33.68	30.37
Health	20.00	11.72	9.72	8.01
Urban Roads	13.41	15.61	14.25	8.31
Rural Domestic Electricity	4.31	12.17	9.25	12.51
Rural Roads	3.43	4.76	6.42	13.29
Sewer systems	6.70	5.82	5.61	5.57
Water Supply	3.26	3.38	3.87	3.11
Engineering Designs	1.01	1.68	1.69	1.79
<b>Total FNDR-IDB</b>	<b>90.04</b>	<b>86.01</b>	<b>84.49</b>	<b>82.95</b>
Justice	1.96	1.29	1.38	1.84
Basic Studies	1.24	1.99	2.32	2.49
Agriculture	0.94	1.41	1.19	2.24
Police and Security	0.87	1.61	2.59	1.92
Other sectors <sup>(a)</sup>	2.61	1.66	1.01	1.45
'Inversiones Menores'	1.32	1.79	2.47	2.96
'Multisectoral'	1.01	4.25	4.55	4.15
<b>Total FNDR-National Resources</b>	<b>9.96</b>	<b>13.99</b>	<b>15.51</b>	<b>17.05</b>
<b>FNDR-Total</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>

Source: Source: Adapted from Universidad Austral, 1999

<sup>(a)</sup> This item groups other sectors that individually represent less than 0.7% of the total. It includes Mining, Fishing, Communication, Housing.

There are other significant changes in investment in Rural Electricity and Rural Roads, although these are in increase rather than in decline. These sectors tripled in importance from 1994 to 1997, increasing from 4.31% to 12.51%, and 3.43% to 13.29% respectively. The Sewage Systems and the Water Supply sectors had little change in the level of investment and maintained their relative importance within the FNDR.

In the FNDR-National Resources section, the most significant change in investment was within the Multisectoral sector. The remaining sectors present important changes in relative terms but still attracted a very low percentage of the total investment of the FNDR.

Unfortunately dis-aggregated data were not available after 1997, because in 1998 a new Provision was created that, although still very limited, has profoundly transformed the historic 'infrastructure character' of the FNDR. This is the Provision on Productive Investment (which is part of the FNDR-National Resources) that in its first year of operation amounted for almost 2% of the total FNDR.

Table 5.12 summarises the changes from 1994 to 1997 by source of fund and by sector. Apart from the downward trend observed in the FNDR-IDB and the upward in the FNDR-National Resources, as a compensation for the loss in the first one, the most remarkable features of these variations are the big changes in only a few sectors. The explanation for this break with the traditional trend comes from the differential behaviour amongst regions that have directed FNDR resources to sectors different to the traditional ones. This concentration on particular sectors represents a new understanding of the FNDR by the regions, and consequently in the use they make of the funds.

Table 5.12: Changes per sector 1994, 1997 (1994 = 100)

Sector	1997
Education	80.11
Health	61.97
Urban Roads	40.05
Rural Domestic Electricity	83.13
Rural Roads	290.26
Sewer systems	387.46
Water Supply	95.40
Engineering Designs	177.23
<b>Total FNDR-IDB</b>	<b>92.13</b>
Justice	93.88
Basic Studies	200.81
Agriculture	238.30
Police and Security	220.69
Other sectors <sup>(a)</sup>	55.56
Inversiones Menores <sup>(b)</sup>	224.24
Multisectoral	410.89
<b>Total FNDR-National Resources</b>	<b>171.18</b>

Source: Universidad Austral, 1999

<sup>(a)</sup>It contains sectors such as Fishing, Mining, Communication, Housing, Culture, etc. that individually are below a 0.7%.

<sup>(b)</sup>It groups a large number of actions from construction of small facilities to acquisition of equipment and vehicles.

#### 4.3 Main sectors of investment by region

Regions tended to follow similar patterns in terms of the preferred sectors of investment in 1994. This situation has, however, changed in recent years. Table 5.13 shows the changes of the relative importance of the three main sectors of investment from 1994 to 1997 (Education and Health plus Urban Roads or Sewer Systems, depending on the region). At the beginning of this period, 71.32% of the investment was concentrated in three sectors in the country as a whole, with two regions (Valparaiso and Santiago) spending over 80% in just three sectors. In 11 out of 13 regions Education is the most important sector in 1994.

Table 5.13: FNDR, Changes in the three main sectors of investment by region (1994-1997)

	<b>Region</b>	<b>1994</b>	<b>%</b>	<b>1997</b>	<b>%</b>
I	Tarapacá	Education, Health, Urban Roads	77.26	Education, Rural Roads, Health	64.09
II	Antofagasta	Education, Health, Urban Roads	68.70	Rural Roads, Education, Urban Roads	70.56
III	Atacama	Education, Health, Urban Roads	66.70	Water Supply, Education, Multisectoral	61.65
IV	Coquimbo	Education, Health, Sewer Systems	69.79	Education, Rural Roads, Sewer Systems	60.11
V	Valparaiso	Education, Health, Sewer Systems	86.11	Education, Urban Roads, Health	72.38
RM	Santiago	Education, Health, Water Supply	96.75	Education, Health, Multisectoral	75.08
VI	O'Higgins	Education, Sewer Systems, Urban Roads	70.05	Education, Rural Roads, Sewer Systems	62.87
VII	Maule	Education, Health, Sewer Systems	73.67	Education, Rural Electricity, Rural Roads	66.88
VII I	Biobío	Education, Health, Rural Electricity	72.66	Education, Rural Electricity, Health	79.51
IX	La Araucanía	Education, Health, Rural Roads	65.09	Rural Electricity, Education, Rural Roads	67.90
X	Los Lagos	Education, Health, Urban Roads	78.46	Rural Electricity, Education, Rural Roads	77.68
XI	Aysén	Urban Roads, Education, Health	76.59	Rural Roads, Education, Urban Roads	72.98
XII	Magallanes	Urban Roads, Education, Health	76.81	Urban Roads, Sewer Systems, Education	68.60
	<b>Country</b>	<b>Education, Health, Urban Roads</b>	<b>71.32</b>	<b>Education, Rural Roads, Rural Electricity</b>	<b>56.17</b>

Source: Subdere 1999

By the end of the period, only 56.17% of the total investment of the country was concentrated in the 3 most important sectors. Only three regions increased their concentration in three sectors, Antofagasta, Biobío and La Araucanía (II, VIII and IX), in the remainder there was significant decline. An important feature of these changes is the decline in the importance of Education in four regions, in favour of sectors that were apparently more closely related to the regions specific problems. Education is replaced by Rural Roads and Rural Electricity in the more urban northern and rural southern regions of the country.

This shift can be explained by the fact that by 1994 70% of the FNDR- Programme was being financed by the IDB loan (Credit 578/OC-CH 1990-1994) while in 1997, under a subsequent credit (loan IDB 853/OC-CH 1995-1999) the IDB share accounted for only 15%. However the same restrictions were imposed by the IDB in the last credit, the regions felt they should explore different alternatives although keeping themselves

within the overall framework of sectors eligible by the FNDR-IDB. Another reason for the changes is that by 1997 regional priorities of investment were set up by the just created Regional Governments, in full operation at that time, following the demands of local governments and community rather than set by the national policies of the authorities in Santiago, as it was before 1995.

This period saw the emergence of sectors, that although they had existed through out the three IDB loans, had never been so important before. This was the case for Rural Roads and Rural Electricity. Rural Roads was one of the three main sectors of investment in 8 regions in 1997, compared to one in 1994, La Araucanía. Similarly, Rural Electricity was most important in four regions in 1997 compared to one, Biobío, in 1994. The urban regions located in the desert territory of the north saw the opportunity to improve the quality of city roads, while the southern rural regions used the FNDR resources as a mean for providing domestic electricity to the scattered households of the temperate and cold plains and mountains of the Lake District.

#### 4.4 Summary and conclusions

Summary about the type of action carried out:

- Only four actions are carried out by the FNDR. Of these, Infrastructure investment represents over 90% of the total FNDR investment;
- The preference for Infrastructure investment is a response to the kind of sectors eligible for the fund. The kind of sectors and the preference for infrastructure has to do with the time in which the FNDR-IDB Programme began in the mid 1980s. The 1980s started to see the impact of the neo-liberal economic model both in terms of its success in macroeconomic indicators and in the deterioration of social indicators. The FNDR, thus, started to play its role in compensating the social costs of the economic model implemented in the country, and the IDB, on the other hand, that wanted to make sure that its money was to be used in something noticeable (infrastructure projects);
- The type of Infrastructure investment of the FNDR is not infrastructure to stimulate productive investment or competitiveness. The infrastructure projects financed by

the fund is said to be related to the concept of 'equal opportunities', in this case by providing the access to basic services on education, health, and other basic needs;

- Although the category 'Others' includes various actions, these are not very important due to the small amount of resources devoted to them (less than 3% of the total FNDR);

About the sectors of investment:

- This, again, small number of economic sectors, basically seven, financed by the FNDR is a direct consequence of the agreement with the IDB for the FNDR-Programme. These seven principal sectors have been present in the FNDR since the first credit (1985-1989);
- The category 'Other sectors' has not attracted much resources, mainly due to the high amount of money destined to the 'traditional sector' (the seven sectors);
- The marked preference for investing in the sectors of Education and Health is a response to the deficit generated after the transference of these sectors from the central (ministerial) level to the local (municipal) administration. In this process responsibilities were transferred, but not resources;
- The IDB represented only 15% in the FNDR-Programme of 1995-1999, nevertheless, the fund as a whole has continued to be mainly used ( over 80% in 1997) to financed IDB eligible sectors;
- The tendency for many years in the regions was to follow the same pattern of investment in terms of the sectors to which resources were mainly devoted. In recent years, however, regions have started to see the FNDR a real instrument for the development of their most precarious areas. This can be seen for example in the northern and southern regions that have started to direct the action of the fund to other sectors rather than to Education and Health;
- Special attention has to be given to the 'Productive Investment' sector. This sector, introduced in 1998, although attracting only 2% of the total FNDR investment, is a complete change of direction of what have been the traditional sectors of the FNDR. After this, the FNDR can not be considered exclusively a fund for infrastructure investment.

The main problems with regard to the type of action and sectors of investment of the FNDR, as a fund for regional development, can be summarised as follows:

- Reduced number of actions carried out,
- Overwhelming weight of infrastructure investment within the already limited number of possible actions,
- Infrastructure investment exclusively oriented to the supply of social services
- Reduce number of economic sectors eligible by the fund,
- Restrictions for exploring new initiatives of investment for regional development,
- Regional governments cannot dispose of the whole amount of FNDR resources for regional development initiatives because of the lack of resources in other sectors it has to oversee, basically Education and Health.

The wide range of possibilities offered by a regionalised fund like the FNDR is limited by the problems exposed above. Some of these problems, as it has been shown above, have their origin in restrictions imposed by the terms of the contract with the IDB Bank, but the majority of them have more to do with a certain incapacity to respond to the challenges that the present state of development of the country poses on regions.

## 5 Further actions for regional development

One of the greater success of the FNDR has been the investment in the construction of electricity projects. Electricity projects consist of the construction of grid or the expansion of existing ones to supply low-income rural communities with electric energy. These projects also consider the installation of electric power generation and distribution of energy for isolated communities. The success of these projects have to do not only with the provision of a basic and necessary service but also with the way these projects are carried out<sup>54</sup>.

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<sup>54</sup> Apart from the fact that due to the action of the FNDR fund in this sector the deficit in domestic electricity supply in rural areas has gone down, going from around 50% to less than a 25% in ten years, from 1990 to the year 2000.

Electricity projects are financed by three parties: the FNDR, the Electricity Companies and the Interested Local Communities. As a result: a) funds for regional development have multiply; b) public and private sector have come together after a common interest and objective; and, c) Communities have learnt to organised themselves to face common problems. No other sector of the FNDR is handled in this way. On the contrary, FNDR fund finances single isolated sectoral projects where no other major value added is generated because of this action.

A similar recent experience, although not yet evaluated, is that of the *Convenios de Programación*, a programming document between a Regional Government and one or more ministries for a project or group of projects that for the magnitude of its investment require the co-financing of more than one party. These type of actions have permitted to accomplish tasks that otherwise would have been impossible to pursue by a single fund or party. These multiparty actions have, at the same time, stimulated co-operation and co-ordination amongst sectors and Regional Governments.

As the FNDR action is based on a sectoral project-by-project approach, the chance of having an unexpected relevant outcome is lower that if fund were used in a more comprehensive manner. Other actions that may be associated to the use of investment funds could stimulate regional development, beyond that of the single benefice of counting with a specific infrastructure project. The assumption behind this argument is that, indeed, a regional fund can provide more for regional development than the mere results if its physical results.

The question whether a regional fund can contribute to regional development, beyond the mere action of its investment in physical or other type of investment, will be answered in Chapter 7, when comparing the action of the FNDR with that of the ERDF. One of the expected outcomes of that chapter is to see to what extent the European Structural Funds are being used in a way that may favour regional development through actions that stimulate the regions own capacities and potentialities.

## Chapter 6

# The European Regional Development Fund (ERDF)

### Introduction

This chapter describes and analyse the main features of the European Regional Development fund (ERDF) of the European Union. The analysis of this fund will provide the basis for carrying out the comparison with the Regional Development Fund of Chile (FNDR).

The chapter comprises five major parts. The first, corresponds to an introduction of the European Union (EU), its institutions and the main bodies that deal with regional policy and the administration of the ERDF. The second part presents and discusses on the European Union Regional Policy with emphasis on the latest development on regional policies and instruments. The third part presents the main policy instrument for regional development, i.e. the Structural Funds and particularly the European Regional Development Funds (ERDF). This section presents the main objectives and tasks of the ERDF, the type and sectors of investment, and the way funds are allocated to regions. Part fourth presents a critical analysis on the achievements of regional policy in the regions of Europe. Finally, part fifth summarises the main contents of previous sections and draws some conclusions on the main features of EU regional policy and the operation of the funds.

### 1 The European Union Institution

The European Union (EU) is the result of a process of co-operation and integration which began in 1951 with a treaty establishing the European Coal and Steel Community (ECSC) between six countries (Belgium, Germany, France, Italy, Luxembourg and the Netherlands). The 1951 Treaty was the first major step into an increasingly wider process of integration taken short after the end of the Second World War. In fifty years, the EU has had four waves of accessions (1973: Denmark, Ireland and the United Kingdom; 1981: Greece; 1986: Spain and Portugal; 1995: Austria, Finland and Sweden). At present, the EU has fifteen Member States. For the 2000-2006 period the

European Union is preparing for its fifth enlargement to incorporate six Eastern and Southern European countries. The total population of the fifteen European Union's countries is of around 374 million citizens<sup>55</sup>.

### 1.1 Purpose of the European Union

The European Union's mission is to organise relations between the Member States and between their peoples on the basis of solidarity. The main objectives of the Union are:

- to promote economic and social progress (the single market was established in 1993; the single currency was launched in 1999 and will be implemented in 2002 for 12 member states, excluding the UK, Sweden and Denmark);
- to assert the identity of the European Union on the international scene (through European humanitarian aid to non-EU countries, common foreign and security policy, action in international crises; common positions within international organisations);
- to introduce European citizenship (which does not replace national citizenship but complements it and confers a number of civil and politic rights on European citizens);
- to develop an area of freedom, security and justice (linked to the operation of the internal market and more particularly the freedom of movement of persons);
- to maintain and build on established EU law (all the legislation adopted by the European institutions, together with the founding treaties).

### 1.2 The institutions of the European Union

The European Union is built on an institutional system. The Member States delegate sovereignty for certain matters to independent institutions which represent the interest of the Union. There are five institutions involved in running the European Union: the European Parliament (elected by the peoples of the Member States), the Council (representing the governments of the Member States), the Commission (the executive

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<sup>55</sup> Estimated figure for the year 2000

and the body having the right to initiate legislation), the Court of Justice (ensuring compliance with the law), and the Court of Auditors (responsible for auditing the accounts).

\* Other bodies

These institutions are supported by other bodies: the Economic and Social Committee and the Committee of the Regions (advisory bodies which help to ensure that the positions of the EU's various economic and social categories and regions respectively are taken into account); the European Investment Bank (EU financial institution) and the European Central Bank (responsible for monetary policy in the euro-area) and; the European Ombudsman (dealing with complaints from citizens concerning maladministration at European level).

### 1.3 European Union' bodies dealing with regional policy

\* Directorate General (DG XVI) for Regional Policy

The Directorate-General for Regional Policy is the department of the European Commission that is responsible for European action in support of the socio-economic development of the least-favoured regions of the European Union (in accordance with Articles 158 and 160 of the Treaty).

Regional development policies and programmes make an essential contribution towards stability in the European Union. They aim to promote a high level of competitiveness and employment by helping regions that are less prosperous or suffering from structural problems to generate sustainable development and adapt to new conditions on the labour market and to global competition.

The main responsibilities of the DG for Regional Policy are the management of three major funds:

- the European Regional Development Fund (ERDF), which operates in all fifteen Member States;
- the Cohesion Fund, which contributes to environmental and transport projects in the four Member States whose GNP is less than 90% of the Community average (Spain, Portugal, Greece and Ireland);

- the Instrument for Structural policies for Pre-Accession (ISPA), which helps the central and eastern European countries applying for membership to improve the environmental situation and develop transport networks.

\* The Committee of the Regions

The Committee was created by the Maastricht Treaty in 1991. The Maastricht Treaty states that the Committee of the Regions must be consulted as a matter of course on all areas likely to have repercussions at local or regional level. The responsibilities of the Committee were initially limited to five areas: economic and social cohesion, trans-European infrastructure networks, health, education and culture. The Commission and the Council are obliged to consult the Committee before taking measures in those areas.

\* Committee on Regional Policy Transport and Tourism (of the European Parliament)

The Committee on Regional Policy is one of the seventeen permanent committees of the Parliament. It has 59 members and is responsible for matters relating to: Cohesion policy, the relationship with regional and local authorities, the common policy on transport, and the community action on tourism.

The main issues on the cohesion policy have to do with: structural policy for the convergence of national economies, the economic and social cohesion, the balance and sustainable development of the Union and the reduction of regional social and economic imbalances.

#### 1.4 The Resources of the European Union

##### The Revenue of the European Union

The financial system of the EU has passed through several stages since the founding of the ECSC in 1951. From 1952 the ECSC has had its own resources. Subsequent reforms have transformed and defined the Community's own resources. As agreed at the Edinburgh European Council, a new Decision on the system of own resources was adopted on October 1994. Finally, the new resources Decision entered into force with effect from 1 January 1995 after had been ratified by all the Member States in 1996.

The Community's own resources are:

- Agricultural duties and sugar and isoglucose levies

Agricultural duties have replaced agricultural levies. Agricultural duties are imposed on imports products coming from non-member countries and are designed to offset the difference between world prices and the price levels which it has been agreed to apply within the Community (principle of Community preference).

- Custom duties

These derive from the application of the Common Customs Tariff to the customs value of goods imported from non-member countries.

- VAT resources

These derive from the application of a uniform rate to each Member State's VAT base. Since 1988, the uniform rate is found in applying a 1.4% rate to the VAT base and deducting the gross compensation paid to the United Kingdom. A Member State base must not exceed 55% of its GNP. Under new regulations VAT rate has been gradually reduced to 1.0% and the capping rate to 50% in 1999.

- the Fourth resource

This category of revenue was also created in 1988. This resource is based on GNP and is derived from the application of a rate to the sum of the GNPs of all the Member States.

Table 6.1: Financing of the General Budget by Member State (1997)

Country	%
Belgium	3.8
Denmark	2.0
Germany	28.7
Greece	1.5
Spain	6.9
France	17.8
Ireland	0.9
Italy	12.4
Luxembourg	0.2
The Netherlands	6.2
Austria	2.6
Portugal	1.2
Finland	1.4
Sweden	2.8
United Kingdom	11.4

Source: European Communities (1998)

## The expenditure of the European Union

The expenditure of the European Union has considerably increased and diversified in the course of the European integration (European Communities, 2000). For the year 2000 the total expenditures of the Union (preliminary data) reached the amount of EURO million 93,323. Of this figure, EURO million 32,678 (35.02%) corresponds to the action of the Structural Funds (see figure below)<sup>56</sup>.

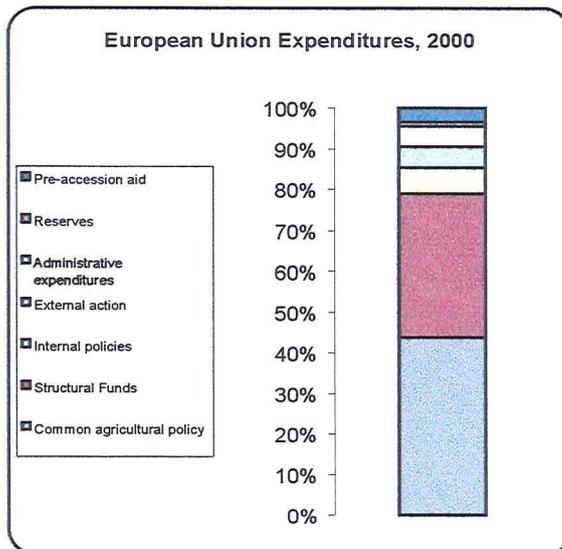


Figure 6.1: European Union Expenditure in the Year 2000

Source: European Communities, 2000

## 2 Regional Policy in the European Union

### The Problems

There exist considerable regional economic disparities in the European Union, in terms of GDP and GDP per capita, employment, and in particular declining areas. As Armstrong and Taylor (2000) have stated, in 1996 GDP per capita ranged from 193 per cent of the EU average in Hamburg (Germany) to only 44 per cent in Ipeiros (Greece). A similar situation appears when looking at the rate of unemployment of different areas in the Union. In 1997, unemployment rates ranged from a massive 32.0 per cent in Andalusia (Spain) to a mere 2.5 per cent in Luxembourg.

<sup>56</sup> EURO 1 = US\$ 0.89 (March 2001)

On the other hand, a wide variety of different types of areas with severe problems are encountered in the EU. These areas with severe problems correspond to depressed industrial areas, areas of severe urban poverty and decline, border areas which have suffered as a result of the dismantling of frontier controls, and depressed rural communities. In terms of spatial distribution, the territorial unit (countries, regions) in the European Union tend to present similar patterns to those found in other parts of the world.

In order to cope with these regional imbalances, from its establishment the European Union has tried to adopt measures in favour of a more integrated Europe. In fact, the emergence and development of the EU has had significant effects on individual regions in the Community, both from particular policies designed to deal with particular problems, and from the effects of major macroeconomic measures intended for the Union as a whole. The first case would correspond, for example, to the action of specific funds such as the ERDF and the Structural Funds in more general terms. The second case has to do with the effect that measures such as the adoption of the Single European Market (SEM), the European Monetary Union (EMU), and the Eastern Enlargement (EE) have on the patterns of regional disparities.

Since the interest of this study is focused on regional policy and in particular on the action of regional funds, only this area will be presented and discussed in detail ahead. For this reason, the emphasis will be put on the specific regional policies of the EU, as stated in Agenda 2000, and in the action of the Structural Funds on the regions of the Community.

### EU Regional Policy

Although regional policy was not recognised as a distinct policy area in the founding treaties of the European Community, as European integration progressed regional policy instruments were developed to complement the Member States' efforts on regional matters at European level (EU Committee of the Regions, 1999). Initially European regional policy meant co-ordinating the Member States' regional policy measures at the European level.

Williams (1996), suggests that regional policy is most directly associated with the accession of the UK in 1973, although in a sense this can be traced back to the original foundation of the European Coal and Steel Community (ECSC). Nevertheless, “the approval in principle for a regional policy as part of the accession agreement was reached at the Paris Summit in 1972, and the ERDF was set by the Council of Ministers in December 1974 with the ‘objective of correcting the principal imbalances in the Community resulting from agricultural preponderance, industrial change and structural employment’” (p. 69). “One specific budgetary reason for creating the ERDF was to encounter the acknowledge imbalance arising for the UK from the arrangements for the Common Agricultural Policy (CAP) which were expected to give Britain limited benefits (Shackleton, 1993, cited in Williams, 1996, pp 69-70).

In order to ensure compatibility of regions competing with each other in regional policies and the development of specific instrument for promoting their own regional policies the European Commission developed the Nomenclature of Territorial Units for Statistics (NUTS) which it uses to manage its regional policy activities. In 1986, Regional policy was given a treaty basis in the Single European Act (Art. 130a of the EC Treaty). Under this article the Community undertook to strengthen economic and social cohesion by narrowing differences in level of development between the different regions.

The first regional policy instrument adopted to cope with the increasing involvement in regional matters was the European Regional Development Fund in the mid 1970s. Since then a large number of different instruments have been developed, with the Structural Funds playing a pivotal role. The introduction of the partnership principle in 1988 is said to be a decisive turning point on regional policy implementation, because it has enable to local and regional authorities to be directly involved in developing this policy area (EU Committee of the Regions, 1999).

The need for regional policy in the EU

As it may be expected, the accession of the poorest countries from the periphery into the European Union has led to a widening in regional disparities. This has been reinforce in a period of rapid structural changes due to the differential impact that SEM, EMU and EE have had on the different regions of the EU.

Armstrong and Taylor (2000) argue that the creation of the EU has given rise to a number of serious regional problems. Discussing on the argument for and against the involvement of an EU regional policy, these authors highlight four as the main arguments in favour of a role for the EU.

- The EU can ensure that regional policy spending by member states is more closely matched to the severity of the problem faced,
- The EU can greatly improve the co-ordination of regional policy,
- An EU regional policy offers a mean by which any one member state can legitimately become involved in solving the regional problems of other member states,
- EU regional policy is necessary if further integration is to be sustained<sup>57</sup>.

Arguments against EU involvement in regional policy have to do with the degree to which the EU should involve in member countries own regional policies. No arguments are presented against the EU participation in regional policy but only in the intensity of its involvement.

## 2.1 EU Regional Policy in 2000-2006. The 5<sup>th</sup> Reform of the Structural Funds

The reforms for the period 2000-2006, contained in the Agenda 2000 package, correspond to the 5<sup>th</sup> reform of the Structural Funds. After the setting up of the ERDF in 1975 the Structural Funds have undergone five structural reforms.

- the 1<sup>st</sup> reform was carried out in 1979 and covered the operational period 1980-1983. This reform saw the introduction of the seven Community scheme;
- the 2<sup>nd</sup> reform, for the period 1984-1987 stated that the aim of the fund was “the correction of the principal regional imbalances within the community through participation in the development and structural adjustment of regions whose

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<sup>57</sup> Armstrong and Taylor argue that this is one of the weakest arguments for EU involvement in regional policy because there is little evidence that regional problems have prevented member states for agreeing to further development of the EU (p. 323).

development is lagging behind and in the conversion of declining industrial regions” (Committee of the Regions, 1999 p. 1);

- the 3<sup>rd</sup> reform of the Structural Funds (period 1988-1993) introduced the four principles: additionality, partnership, co-ordination and, programming;
- the 4<sup>th</sup> reform (1994-1999) saw the extension of the Structural Funds with broader range of resources and the setting up of the Cohesion Fund;
- the 5<sup>th</sup> reform –Agenda 2000–, for the period 2000-2006, is drawn under the prospects of enlargement and greater concentration of assistance.

### The General Regulations

The new Regulations for the 2000-2006 period have been developed around the following principles:

- \* the need to maintain financial solidarity and greater cost-effectiveness in the new programming period,
- \* the desire for a new partnership between the Commission and the Member States, comprising a clear division of responsibilities between the two parties,
- \* the promotion of four basic Community priorities:
  - sustainable economic development
  - competitiveness and innovation
  - employment and human resources
  - equality of opportunity between men and women

At a more specific level the General Regulations set up a series of guiding principles which underpin the overall context of all Structural Funds. These are:

#### \* Greater Concentration

Fewer objectives, (3), than previous periods, when there were 5. Of these, two are region-based (Objectives 1 and 2), while the third is horizontal, a human resource-focused measure.

#### \* Simplification and decentralisation

this has to do with a) the expansion of the partnership principle beyond national and regional authorities to include local authorities and social and economic partners; and b) with a clearer division of responsibilities of the different actors. Decentralisation plays,

under this principle, an important role as decentralising as much as the Structural Fund programmes as possible.

\* Improved efficiency

Clarifying responsibilities and decentralisation should lead to greater efficiency

\* More effective controls

Improved procedures for checking Structural Fund assistance and more reliable financial inspection are to be put in place in this new programming period.

### Agenda 2000

Agenda 2000 is an action programme whose main objectives are to strengthen Community policies and to give the European Union a new financial framework for the period 2000-2006 with a view to enlargement. The Agenda 2000 legislative package was conceived at the Madrid European Council in 1995 and it was launched in 1999 in the form of twenty legislative texts relating to four priority areas:

- Continuation of the agricultural reforms;
- Increasing the effectiveness of the Structural Funds and the Cohesion Fund by greater thematic and geographic concentration of projects on specific objectives and geographical areas and thus improving management;
- Strengthening the pre-accession strategy for applicant countries, and;
- Adopting a new financial framework for the period 2000-2006 in order to meet the challenges of enlargement and budgetary discipline.

Of all four priority areas, this study will focus on the Structural Funds measures (second priority area). The Berlin European Council stressed that improving the effectiveness of the Structural Funds and the Cohesion Fund was the cornerstone of the Agenda 2000 reforms (EU, Agenda 2000). Before introducing the Structural Funds, and in order to set up the context under the use of these funds, the main features of the regional policy reforms of Agenda 2000 will be presented.

### 3 The Structural Funds and the Cohesion Fund

The term Structural Funds covers a system of four distinct, inter-linked funds, each of them fulfilling a specific role. They are the European Social Fund (ESF), the European Agricultural Guidance and Guarantee Fund (EAGGF) Guidance Section, the Financial Instrument for Fisheries Guidance (FIFG), and the European Regional Development Fund (ERDF).

The Cohesion Fund was created by the Maastricht Treaty in 1993 for strengthen economic and social cohesion. It is intended to help the least prosperous countries of the Union. The four beneficiary countries for the 2000-2006 period (as before) are Spain, Portugal, Greece and Ireland. The Cohesion Fund's budget for 2000-2006 is EUR 18 billion.

The importance given to the role of the Structural Funds in pursuing the objective of economic and social cohesion in the Union means ensuring that structural assistance will be more concentrated both in geographical terms and in terms of the object of assistance. It also means improving the management of the funds. The structural policy measures of the Agenda 2000 package aim to meet two challenges (objectives):

- \* to improve the effectiveness of the structural policy instruments so that economic and social cohesion can be achieved;
- \* to ensure that structural policy plays a continuing role in the Union's future enlargement.

The prospect of Union enlargement, one of the main reasons for the Agenda 2000 reforms, considers the inclusion of eleven countries of central and eastern Europe. The countries applying to join the EU are: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia, plus Cyprus, from the Mediterranean. The inclusion of these countries is said to raise serious problems for economic and social cohesion, given the considerable development lag in their regions compared to the current 15 Member States.

Enlargement will therefore pose some problems of adjustment for both regions and sectors that will require adequate preparation. As part of Agenda 2000, the Commission included recommendations on reinforcing the applicant countries' preparations. The six countries considered in the first wave of accession: Cyprus, Czech Republic, Estonia, Hungary, Poland and Slovenia will have EURO 21.84 billion through various instruments for this purpose.

In all, the new regulations of the Structural Funds make the Community aid to concentrate on three priority objectives:

Objective 1 (*lagging regions*<sup>58</sup>) promotes the development and structural adjustment of regions whose development is lagging behind, i.e. whose average per capita GDP is below 75% of the European Union average (including the French overseas departments, the Azores, Madeira and the Canary Islands). The per capita GDP to be measured in purchasing power parities and calculated for the last three years available on 26 March 1999 (CR 1260).<sup>59</sup>

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- Two thirds of the Structural Funds operations come under this objective,
- Around 20% of the Union's total population is covered from measures taken under objective 1.

The strict application of the new Objective 1 eligibility criteria excluded former regions eligible under the previous objectives 1 and 6 from the period 1994-1999. Some of these regions were considered by additional allocations for 'particular situations' in the so called Objective 1 phase-out regions.

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<sup>58</sup> The identification of 'regions' and areas, in the context of the European Union, is based on the common system of classification of the regions, referred to as the 'Nomenclature of Territorial Statistical Units (NUTS)' established by the Statistic Office of the European Communities in co-operation with the national institutes for statistics.

<sup>59</sup> As an indication, the average GDP of the European Union by the year 2000 is of around US\$ 22,000 EU, 2000).

Table 6.2: Objective 1 coverage 2000-2006 period (% of population)

Country	Period 2000-2006	Phase-out 2000-2005
Belgium	0.0	12.7
Denmark	0.0	0.0
Germany	17.3	1.6
Greece	100.0	0.0
Spain	58.5	1.3
France	2.7	1.9
Ireland	26.6	73.4
Italy	33.6	0.6
Luxembourg	0.0	0.0
The Netherlands	0.0	1.8
Austria	3.4	0.0
Portugal	66.6	33.4
Finland	21.0	0.0
Sweden	5.1	0.0
United Kingdom	8.6	3.5
TOTAL (EU15)	22.2	3.4

Source: Adapted from Wislade (1999)

- Objective 2 (*economic and social conversion of regions in structural crisis*) contributes to the economic and social conversion of regions in structural difficulties other than those eligible for objective 1. It covers areas facing the need for economic diversification (areas undergoing economic change, declining rural areas, depressed areas dependent on fisheries and urban areas in difficulty).

- Around 18% of the Union's population will be covered by this objective. Indicatively 10% in industrial areas, 5% in rural areas, 2% in urban areas and 1% in areas dependent on fishing;

The most important change observed in the designation of objective 2, compared to the former objectives 2 and 5b of the previous period, have to do with changes in the emphasis in concentration through the application of population ceilings from the outset. In consequence, in the new programming period the coverage for Objective 2 is essentially centred around restricting overall coverage whilst ensuring that the proposed cutbacks were distributed equitably (Wislade, 1999).

Table 6.3: Objective 2 coverage 2000-2006 period (% of population)

Country	Period 2000-2006	Objective 1 Phase-out in Objective 2 in 2006
Belgium	12.4	5.7
Denmark	10.2	0.0
Germany	12.6	0.0
Greece	0.0	0.0
Spain	22.2	1.3
France	31.3	1.9
Ireland	0.0	10.8
Italy	12.9	0.6
Luxembourg	28.3	0.0
The Netherlands	15.0	0.0
Austria	24.7	0.0
Portugal	0.0	4.6
Finland	30.9	0.0
Sweden	13.8	0.0
United Kingdom	23.5	0.1
TOTAL (EU15)	18.2	0.9

Source: Adapted from Wishlade (1999)

- Objective 3 (*development of human resources*) gathers together all the measures for human resources development outside the regions eligible for objective 1. It is the reference framework for all the measures taken under the title on employment in the Treaty of Amsterdam and under the European Employment Strategy.

In all, the Structural Funds eligibility will fall from 51 per cent of the Community population of the previous period to a 35-40 per cent in the 2000-2006 period. Other major changes had to do with grater concentration in terms of the proportion of the territories covered, and on the coherence of national and Community assisted areas.

The main characteristics of the 2000-2006 period (or the fifth structural reform) are the new responsibilities of regional and local partners, the redefinition of the Community's role in various stages of the process, and the decentralised character of the decision making process on the spending of the money.

With respect to financial management, the 1999 reforms have established a wider range of types of financial assistance in the form of 'venture capital holdings', 'loan guarantees', 'interest rate subsidies', and other types of financial arrangements.

The new regulations also provide for four Community Initiatives (a reduction from the previous 13 to 4 new Community Initiatives). Such a reduction is not that impressive because many of the previous Community Initiatives are contained in the 4 new proposed. Anyhow, Community Initiatives complement priority objectives and help provide a solution to problems that have a particular impact on the EU. Programmes have to be drawn up on the basis of guidelines set out by the Commission. Funding for these programmes is divided between all the Structural Funds, except the fisheries fund (FIFG):

- INTERREG III consists of three sections: 1) crossborder co-operation, i.e. promoting integrated regional development between border regions; 2) transnational co-operation, contributing to an integrated and harmonious territorial development across the EU; 3) reinforcing interregional co-operation and improving the policies and techniques of interregional economic development;
- LEADER encourages and supports integrated strategies for local rural development. According to EU guidelines there is a strong emphasis on co-operation between rural areas;
- EQUAL provides for the development of new ways of combating discrimination and inequality as regard access to the labour market;
- URBAN has two major objectives: 1) to promote innovative strategies for the social and economic regeneration of small and medium-sized towns and villages, and urban areas in crisis in larger conurbations; 2) to reinforce and exchange knowledge and experience on regeneration and sustainable urban development in the EU.

### 3.1 The ERDF, the main component of the Structural Funds

What follows is a detailed presentation of the ERDF operations and the main stages in the preparation of programmes. This presentation includes: the definition of the fund, the principles under its operation, the specific objectives the fund pursues and the main tasks it has to accomplish. Then, it is presented the way through which the fund are allocated to the selected regions, and ends up with a description of the way the ERDF works at the pre-investment stage. That is, the procedures followed by the national and regional authorities when applying for funds to the Commission.

## Definition of the ERDF

Set up in 1975, the European Regional Development Fund (ERDF) was the first regional policy instrument to cope with the European Community's involvement in regional matters. At present the ERDF is a component part and interact together with the rest of the Structural Funds.

Article 160 of the Treaty provides that the European Regional Development Fund (ERDF) is intended to help redress the main regional imbalances in the Community. The ERDF therefore contributes to reducing the gap between the levels of development of the various regions and the extent to which least-favoured regions and islands, including rural areas, are lagging behind (European Communities Official Journal, Regulation [EC] N. 1783/1999). Under numeral (4) of the same Regulation it is stated the preoccupation of the ERDF in the context of its task of promoting regional development, harmonious, balanced and sustainable development of economic activity, competitiveness, employment, equality between women and men and, protection and improvement of the environment.

The 2000-2006 EU regional policy reforms give directions as to the use of all Structural Funds and the Cohesion Fund. Activities under the ERDF are governed by the Structural Funds Regulations and implementation principles (programming; partnership; additionality and; management, monitoring and evaluation). Resources are allocated under on the basis of programming periods. The present programming period runs from 2000-2006.

Article 2(2) of Council Regulation (EC) N. 1260/1999 provides that the main task of the ERDF is to contribute to the attainment of Objectives 1 and 2; whereas Articles 20 and 21 of the same Regulation provide that the ERDF also contributes to financing cross-border, transnational and interregional co-operation as well as to economic and social regeneration of cities and urban neighbourhoods in crisis under the Community Initiatives. Articles 22 and 23 state that it is to support innovative measures at Community level and technical assistance measures.

### 3.1.1 Principles under the operation of the ERDF

Since 1989 the work of the Structural Funds has been based on four principles, which were strengthened by the revised regulations adopted in 1993 and again revised and specified in greater detail in the Agenda 2000 reforms. For the 2000-2006 period these principles are Programming; Partnership; Additionality; and Management, monitoring and evaluation.

#### *- Programming*

Programming involves the preparation of multiannual development plans. The plans are undertaken through a partnership-based decision-making process, in several stages, until the measure are taken over by the public or private bodies entrusted with carrying them out. According to Williams (1996), the idea of programme funding was a response to the perceived needs both to Europeanise the ERDF as well as to ensure that its funds were used to pursue a properly thought-out strategy for regional economic development rather than to support an ad-hoc selection of individual projects.

Under the provisions of the general Regulation on the Structural Fund, the programming period covered is 7 years for all the objectives (2000-2006), although adjustments will be possible depending on the mid term review considered to the effect. The programming period for the current period began on 1 January 2000.

The development and conversion plans are first submitted by the Member States. The plans are based on national and regional priorities and include:

- A precise description of the current situation in the region (disparities, lags, development potential);
- A description of the most appropriate strategy for achieving the stated objectives;
- Indications as to the use and form of the contribution from the funds.

#### Content of the programming

For Objectives 1, 2 and 3 (1 and 2 correspond to the operation of the ERDF), the plans submitted shall be based on national and regional priorities and take into account the

indicative guidelines on relevant and agreed Community policies published by the Commission. The guidance is published in the Official Journal of the European Communities. The plans should include:

- a description, quantified when it corresponds, of the current situation with regard to disparities, gaps and potential for development in the regions covered by Objective 1, or in terms of conversion in the areas covered by Objective 2. It should also include a description of the financial resources deployed and the main results of operation undertaken in the previous programming period with regard to the evaluation results available;
- a description of an appropriate strategy to attain the Objectives 1, 2 and 3 and the priorities selected for the sustainable development and conversion of regions and areas, and the related development of human resources and the adaptation and modernisation of policies and systems for education, training and employment. Member States should demonstrate that activities programmed area co-ordinated with other Funds and consistent with the ex-ante evaluation relating to human resources and employment;
- an indication of the planned use and form of the financial contribution from the Funds and, where appropriate, information on the use of other financial instruments, apart from the Structural Funds; the expected requirements for technical assistance and, an indication as regards to additionality;
- an account of arrangements made to consult partners.

For regions covered by Objective 1, the plans should include all relevant measures for economic and social conversion, the development of human resources and, rural development and fisheries structures. Member States have to indicate the particulars relating to each Fund, including the amount of the financial contribution requested and an outline of the operational programmes planned with particular regard to their specific aims and the main types of actions planned.

The programmes are then produced, either in the form of:

- Single programming documents (SPDs): that comprise a single document, approved by the Commission and gathering together the data contained in a Community support framework and an operational programme (integrated

regional programme containing the programme's priorities, a short description of the proposed measures and an indicative financing plan);

- Community support framework (CSFs): These are documents approved by the Commission in agreement with the Member State concerned, containing both the Member State's and the Funds' strategy and priorities for action, their specific objectives, the contribution from the Funds and the other financial resources.

*- Partnership*

This principle implies the closest possible co-operation between the Commission and the appropriate authorities at national, regional or local level in each Member State from the preparatory stage to implementation of the measures. In the programming period 1994-1999 this principle already considered input from national, regional or local partners, at all programming stage. The new Regulations continues this approach by extending partnership to the regional and local authorities, the economic and social partners and other competent bodies and by involving the partners at all stages from the approval of the development plan.

In designating the most representative partnership at each level, the Member State should create a wide and effective association of all the relevant bodies, according to national rules and practice, taking account of the need to promote equality between men and women and sustainable development through the integration of environmental protection and improvement requirements.

Partnership should cover the preparation, financing, monitoring and evaluation of assistance. Member State have to ensure the association of the relevant partners at the different stages of programming, considering the time limit for each stage.

In application of the principle of subsidiarity<sup>60</sup>, the implementation of assistance should be the responsibility of the Member State, at the appropriate territorial level according to the arrangements specific to each Member State.

*- Additionality*

This principle requires Community assistance to be additional to the contributions of the Member State and not to replace them. For each objective the Member State must maintain their public expenditure at least at the level it was at in the preceding period. Between 2000 and 2006, the geographic level at which additionality is checked will be simplified in comparison to the previous period (in the case of Objective 1 the totality of eligible regions, and for Objective 2 and 3 combined the entire country). The Member States have to supply the necessary information to the Commission upon adoption of the programmes, halfway through them and at their end.

The requirement for a national counterpart for the resources provided by the EU is intended to achieve a greater economic impact by increasing the amounts to be invested in a particular region. The Commission and the Member State determine the level of public or equivalent structural expenditure that the Member State is to maintain in the sum of its regions covered by Objective 1. For Objectives 2 and 3 taken together, the Commission and the member State concerned determine the level of expenditure on the active labour-market policy and, other actions designed to make it possible to achieve the goals of those two objectives.

Additionality is verified at three points during the programming period:

- an ex-ante verification, to provide a frame of reference for the whole programming period;
- a mid-term verification no later than three years after approval of the CSF or the SPD, and as a general rule no later than 31 December 2003. Having done

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<sup>60</sup> The principle of subsidiarity implies that public authorities do not take action when this can be done adequately and effectively by citizens (Committee of the Regions, 1995). Article 3b of the Treaty of Maastricht contains a definition of the principle of subsidiarity. The clause in full states that, 'The Community shall act within the limits of the powers conferred upon it by this Treaty and of the objectives assigned to it therein'. 'In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community' (Federal Trust Conference, background paper, 22 May 1996).

this, the Commission and the Member State may agree to revise the level of structural expenditure to be attained if the economic situation has resulted in developments in public revenue or employment in the Member State concerned significantly different from those expected at the time of the ex-ante verification;

- a verification by 31 December 2005.

The Member State has the responsibility of providing the necessary information, first when the plans are submitted, and when the mid-term and the one before 31 December 2005 are made.

*- Management, monitoring and evaluation*

This principle was introduced as such by the Agenda 2000 reforms instead of the former principle of concentration of Community aids into the six former priority areas (period 1994-1999). Under the new Structural Funds Regulations, the Member State for each programme appoints a managing authority. The tasks of these bodies cover the implementation, correct management and effectiveness of the programme (the collection of statistical and financial data, the preparation and transmission to the Commission of annual reports, the organisation of the mid-term evaluation, etc).

Monitoring Committees have also been established. These Committees are chaired by a representative of the managing authority to ensure the efficiency and quality of the implementation measures. The Committees are the responsibility of the Member States.

Evaluation is carried out at three levels, as previously done, but the 2000-2006 period specifically identifies who is to take responsibility for each. Thus, the ex-ante evaluation is the responsibility of the competent authorities in the Member States; the mid-term evaluation must be carried out by the authority managing the programme in collaboration with the Commission, and; lastly, the ex-post evaluation is the responsibility of the European Commission, in collaboration with the Member State and the managing authority. The evaluation reports must be made available to the public.

### Monitoring Committees

Each CSF or SPD and each operational programme have to be supervised by a Monitoring Committee. These committees are set up by the Member State, in agreement with the managing authority after consultation with the partners. The partners are responsible for promoting a balanced participation of women and men. The Monitoring Committee acts under the authority and within the legal jurisdiction of the Member State.

The Monitoring Committee has to satisfy itself as to the effectiveness and quality of the implementation of assistance. To that end it has to confirm or adjust the programme complement, including the physical and financial indicators to be used to monitor the assistance; approves the criteria for selecting the operations financed under each measure; reviews the progress made towards achieving the specific objectives of assistance; approves the annual and final implementation report before they are sent to the Commission; it may propose to the managing authority any adjustment or review of the assistance likely to make possible the attainment of the objectives.

### 3.1.2 Fund's objectives and tasks

#### Objectives

As a component of the Structural Funds, the ERDF is to finance four types of actions: i) the priority objectives 1 and 2 (Art 1); ii) Community initiatives a and b (Art 20); iii) Innovative actions (Art 22), and; iv) Technical Assistance (Art 23), according to Council Regulation (EC) N. 1260/1999 (CR 1260).

Thus, the ERDF contributes to the attainment of the *six* following objectives:

(i) Priority Objectives:

1) **Objective 1**

2) **Objective 2**

(ii) Community Initiatives:

3) **Interreg**

4) **URBAN**

(iii) Innovative Actions

**5) Innovative Actions**

iv) Technical Assistance

6) **Technical Assistance.** The ERDF may finance the preparatory, monitoring, evaluation and checking measures necessary for implementing the Structural Funds. These include:

- studies, including studies of a general nature, concerning the operation of the Funds,
- measures of technical assistance, the exchange of experience and information aimed at the partners, the final beneficiaries of assistance from the Funds and the general public,
- the installation, operation and interconnection of computerised systems for management, monitoring and evaluation,
- improvements in evaluation methods and exchange of information on practices in this field.

The tasks of the ERDF

The tasks of the ERDF are defined in Arts 1 and 2 of Regulation (EC) N. 1783/1999 (Reg EC 1783) of the European Parliament of 12 July 1999. According to this, the ERDF contributes towards the financing of assistance to promote economic and social cohesion by correcting the main regional imbalances and participating in the development and conversion of regions. To that end, the ERDF should also contribute to promoting sustainable development and the creation of sustainable jobs.

As part of its tasks, the ERDF should contribute towards the financing of:

- Productive investment to create and safeguard sustainable jobs,
- Investment in infrastructure:
  - In regions covered by Objective 1, to help to increase the economic potential, development, structural adjustment and creation or maintenance of sustainable jobs, including investment in infrastructure contributing to the establishment and development of trans-European networks in the areas of transport, telecommunications, and energy infrastructure;

- In regions and areas covered by Objective 1 and 2, and the Community Initiatives (as defined before) concerned to the diversification of economic sites and industrial areas suffering from decline, the renewal of depressed urban areas and the revitalisation of and improved access to rural areas, and areas dependent on fisheries; instrument in infrastructure where modernisation or regeneration is a pre-requisite for the creation or development of job-creating economic activities, including infrastructure links on which the development of such activities depends.
- The development of endogenous potential by measures which encourage and support local development and employment initiatives and the activities of small and medium-sized enterprises. In particular:
  - assistance towards services for enterprises, in particular in the field of management, markets studies and research and services common to several enterprises,
  - financing the transfer of technology between enterprises and research establishments and financing the implementation of innovation in enterprises,
  - improvement of access by enterprises to finance and loans, by creating and developing appropriated financing instruments,
  - direct aid to investment as non repayable direct assistance, as repayable assistance, as an interest-rate subsidy, a guarantee, an equity holding, a venture-capital holding or another form of finance,
  - the provision of infrastructure on a scale appropriate to local and employment development,
  - aid for structures providing neighbourhood services to create new jobs.
- Technical assistance measures at the pre-investment stage, for the making of plans (programming), the preparation of innovative actions and technical assistance, the preparation of major projects (as defined in Art 25, CR 1260),

global grants<sup>61</sup>, and at the initiative of the Commission for technical assistance.

In regions designated under Objective 1, the ERDF may contribute towards the financing of investment in education and health that is beneficial to the regions' structural adjustment.

In application of the preceding tasks, the financial contribution of the ERDF shall support, among other things, the following:

- the productive environment, in particular to increase competitiveness and sustainable investment by firms, especially the small and medium-sized enterprises, and to make regions more attractive, particularly by improving the standard of their infrastructure;
- research and technological development with a view to promoting the introduction of new technologies and innovation and the strengthening of research and technological development capacities contributing to regional development;
- the development of the information society;
- the development of tourism and cultural investment, including the protection of cultural and natural heritage, provided that they are creating sustainable jobs;
- the protection and improvement of the environment, in particular taking account of the principles of precaution and preventative action in support of economic development, the clean and efficient utilisation of energy and the development of renewable energy sources;
- equality between women and men in the field of employment, principally through the establishment of firms and through infrastructure or services enabling the reconciliation of family and working life;
- transnational, cross-border and inter-regional co-operation on sustainable regional and local development.

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<sup>61</sup> Global grant: assistance which may be entrusted to one or more approved intermediaries (see complete

## Community Initiatives

As stated in Art 3 of (Reg EC 1783), the ERDF shall contribute to the implementation of the Community initiative for cross-border, transnational and inter-regional co-operation intended to encourage the harmonious, balanced and sustainable development of the whole of the Community's territory (INTERREG), as well as to the implementation of the Community initiative for economic and social regeneration of cities and urban neighbourhoods in crisis with a view to promoting sustainable urban development (URBAN).

## Innovative measures

The ERDF may also contribute to financing:

- studies initiated by the Commission to identify and analyse regional development problems and solutions, particularly with a view to an harmonious, balanced and sustainable development of the whole of the Community's territory, including the European Spatial Development Perspective;
- pilot projects to identify or test new regional and local development solutions with a view to their inclusion in assistance after demonstration of their feasibility;
- exchanges of experience relating to innovation with the aim of turning to account and transferring experience gained in the regional or local development field.

### 3.1.3 Allocation of funds to the regions

With respect to the allocation of fund to the eligible region for the 2000-2006 period, article 7 of Regulation EC 1260 states that 'Using transparent procedures, the Commission shall make indicative breakdowns by Member State of the commitment appropriations for the programming based on the geographical coverage and ...taking

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definition at the beginning of chapter)

full account, for Objectives 1 and 2, of one or more objective criteria) similar to those covered by Regulation EEC N. 2052/1988) namely:

- eligible population,
- regional prosperity,
- national prosperity and,
- the relative severity of the structural problems, especially the level of unemployment.

In practice, however, as Wislade (1999) notes, the Commission proposed very different methods for allocating funding under each objective. The same author describes the methods used for the allocation of resources for Objectives 1 and 2, summarised below:

#### Financial allocation for Objective 1

The principle under the financial allocation for Objective 1 is that the level of assistance should be related to the size of the regional development disparity in relation to the Community average, whilst taking account of national prosperity and the level of unemployment. The methodology used for determining the amounts entailed four steps:

- the difference in GDP per head of the Objective 1 eligible regions and the Community average is measured. In poorest region this gap is greater while for richer regions this is reduced. As a result, resources concentrate on poorest regions;
- The amount of resources per head of eligible population per annum is calculated as a percentage of this adjusted 'GDP per head gap'. The percentage applicable (3, 4 or 5 per cent) varies according to levels of national prosperity expressed in terms of GDP per head as a proportion of the Community average;
- An additional allocation is made in all Objective 1 regions where the rate of unemployment exceeds the Objective 1 regions average. According to Wislade (2000), this is £100 per annum for each unemployed person over and above the average unemployment rate for Objective 1 regions;
- Separate, but similar provisions are made for the Objective 1 phase-out regions, the key difference being that resources levels declined from 2001 to reach Objective 2 levels by 2004.

Apart from the adjustment factor in favour of the poorest regions, these provisions followed the methodology originally proposed by the Commission. The exception is a

number of minor adjustments for 'particular situations' to accommodate competing demands from Member States.

#### Financial allocation for Objective 2

Objective 2 allocation of resources was made on the basis of the population covered by this Objective, adjusted for levels of unemployment. As a result, countries with higher levels of unemployment received a larger share of Objective 2 funding than the share that would have correspond to them according to their population. On the contrary, lower unemployment rates in other Objective 2 regions meant that these regions received a smaller share than the one that would have correspond to them by looking only at their population. As a result, per capita allocation of resources for Objective 2 regions varies widely between countries.

According to Wishlade (2000), the new Structural Funds Regulation favours poorer regions at the expense of poorer countries. This is particularly true when looking at the allocation of funds for these two objectives. Furthermore, this orientation is reinforced through the adjustments made under the consideration of the unemployed number of persons in regions eligible for Objectives 1 and 2.

This is even more significant considering the amount of resources that these two objectives attract. The total allocation for Objectives 1 and 2 regions account for 81.2 per cent (69.7% for Objective 1 and 11.5% for Objective 2) of the total appropriation for the Structural Funds, including transitional assistance, the Community Initiatives and Innovative actions, that in total sum up to EURO 195 billion. The two objectives combined cover 43.8 per cent of the Community population in the period 2000-2005, falling to 41.3 per cent in 2006.

Table 6.4: Allocation of the Structural Funds 2000-2006. Breakdown by EU Member State and Objective (Million Euro)

Country	Objective 1	Transitional Support for former Objective 1 areas	Objective 2	Transitional Support for former Objective 2 and 5b areas	Objective 3	Fisheries Instruments	Total
Belgium	0	625	368	65	737	34	1,829
Denmark	0	0	156	27	365	197	745
Germany	19,229	729	2,984	526	4,581	107	28,156
Greece	20,961	0	0	0	0	0	20,961
Spain	37,744	352	2,553	98	2,140	200	43,087
France	3,254	551	5,437	613	4,540	225	14,620
Ireland	1,315	1,773	0	0	0	0	3,088
Italy	21,935	187	2,145	377	3,744	96	28,484
Luxembourg	0	0	34	6	38	0	78
The Netherlands	0	123	676	119	1,686	31	2,635
Austria	261	0	578	102	528	4	1,473
Portugal	16,124	2,905	0	0	0	0	19,029
Finland	913	0	459	30	403	31	1,836
Sweden	722	0	354	52	720	60	1,908
United Kingdom	5,085	1,166	3,989	706	4,568	121	15,635
TOTAL	127,543		19,733		24,050	1,106	183,564
Total of SF budget	69.7%		11.5%		12.3%	0.8%	
Reserve for transitional support	4.3%		1.4%				

Source: EUR-OP News, 1/2000 Regional Policy, June 2000 (web).

Table 6.5: Financial Allocation of the Community Initiatives, 2000-2006 (Million Euro)

Country	INTERREG	EQUAL	LEADER	URBAN	Total
Belgium	104	70	15	20	209
Denmark	31	28	16	5	80
Germany	737	484	247	140	1,608
Greece	568	98	172	24	862
Spain	900	485	467	106	1,958
France	397	301	252	96	1,046
Ireland	84	32	45	5	166
Italy	426	371	267	108	1,172
Luxembourg	7	4	2	0	13
The Netherlands	349	196	78	28	651
Austria	183	96	71	8	358
Portugal	394	107	152	18	671
Finland	129	68	52	5	254
Sweden	154	81	38	5	278
United Kingdom	362	376	106	117	961
Networks*	50	50	40	15	155
TOTAL	4,875	2,847	2,020	700	10,442

Source: Inforegio News, No 69/99;; Rapid Press Release, IP/99/744 (Web)

\* Networks: establishment of observatories which will promote exchanges of experience and good practice.

The total appropriation for the Structural Funds and the Cohesion Fund stands at EURO 213 billion, broken down by year as follow:

Table 6.6: Structural Funds resources by Fund, 2000-2006. EURO Billion

Year	2000	2001	2002	2003	2004	2005	2006	Total
Structural Funds	29,430	28,840	28,250	27,670	27,080	27,080	26,660	195,010
Cohesion Fund	2,615	2,615	2,615	2,615	2,515	2,515	2,515	18,005
Total Structural Measures	32,045	31,455	30,865	30,285	29,595	29,595	29,170	213,015

Source: EU, 1999. Structural Policy Reform (web)

For the EURO 195 billion appropriation for the Structural Funds (including transitional assistance, the Community Initiatives and innovative actions) the breakdown for the 3 objectives and Community Initiatives is as follow:

Table 6.7: Structural Funds resources y Objective, 2000-2006. EURO Billion

Objective/ Community Initiative	EURO Billion	%
Objective 1	135.90	69.70
Objective 2	22.50	11.50
Objective 3	24.05	12.30
FIFG outside Objective 3	1.10	0.50
Community Initiatives	10.40	5.35
Innovative action and Technical Assistance	1.30	0.65

Source: EU, 1999. Structural Policy Reform (web)

### 3.1.4 How the ERDF works at the pre-investment stage

#### Summary of main stages

All activities under the ERDF are governed by the Structural Funds Regulations and implementation principles (Concentration, Programming, Additionality and Management, monitoring and evaluation). Resources are allocated on the basis of programming periods (the present period runs from 2001 to 2006). Financial assistance is in the form of non-refundable grants channelled in three ways: Objective Programmes (94%), Community Initiatives Programmes (5.35%) and, Innovative Measures (0.65%). Programmes are managed by designated authorities in the Member States while Innovative Measures are managed by the Commission.

## Objective Programmes

The term “programme” corresponds to a Single Programming Document (SPD) and an Operational Programme (OP). These are prepared by the national and regional authorities and approved by the Commission. An OP can be prepared only in the context of a Community Support Framework (CSF). The two programming systems work as follow:

- CSFs and Ops usually concern a country or a group of regions in a country, eligible under Objective 1. CSFs describe the social and economic background of the countries or regions targeted by the Structural Funds, present the development priorities and the objectives to be attained, and set out the arrangements for financial management, monitoring and supervision. OPs, on the other hand, provide details of the various priorities in a CSF at the level of a specific region or development priority (transport, support for businesses, etc).
- SPDs contain the same information as both the CSF and an OP. They are usually related to operations to which the Structural Funds are contributing less than EURO 1 billion in Objective 1 regions, to operations in Objective 2 regions, and to national operations under Objective 3 and in the fisheries sector.

Together with these two documents (the SPD and CSF), the 2000-2006 period also includes a further document, the Programme Complement, which gives details of the programme at the level of the measures and projects financed. It is drawn up by the programme managers (or managing authority) who also choose the projects. To them actors from the economic and social areas have to apply for funding from the Structural Funds.

Implementation of measures and projects is overseen by the Monitoring Committees. The Committees are composed of representatives of regions, the Member State, the bodies involved and the Commission. The Committees also assess the implementation of the programmes and propose adjustments to the assistance.

## Community Initiative Programmes

These programmes are prepared by the Member States on the basis of Guidelines drawn up by the Commission. Each country appoints an authority responsible for implementing each initiative.

## Innovative Measures

These measures are an exception to the principle of programming and are design to allow the Commission, on its own initiative, to finance pilot projects or innovative strategies for co-operation and exchange of experience between those involved in local and regional development. The Commission organises the calls for proposals and selects the projects.

## The making of the programmes of investment

As it is the Member States primary responsibility to define their priorities for development, the part-financing of programmes by the EU requires that account has to be taken of Community priorities. According to this, Article 10(3) of Council Regulation (EC) 1260/99 the Commission has to publish “broad, indicative guidelines on relevant and agreed Community policies in relation to the objectives... to help the competent national and regional authorities to draw up development plans and to carry out any revision of the assistance”. With respect to the Community initiatives, article 21 establishes that the Commission has to “lay down guidelines describing, for each initiative, the aims, scope and the appropriate method of implementation”. Both guidelines are published in the ‘Official Journal of the European Communities’.

In respect of **Objectives 1, 2 and 3**, Member States have to submit a plan to the Commission. The plan is to be drawn up by the competent authorities designated by the Member State at national, regional and other level.

For **Objective 1**, Community Support Framework (CSF) have to be employed for all regions covered by Objective 1. When Community allocation is less than a certain amount (EUR 1000 million) the requirement is of a draft Single Programming Document (SPD). For **Objectives 2 and 3**, SPDs are employed. Member States may chose to draw up a CSF instead.

Plans have to be submitted to the Commission after consultation with the partners. These plans should be submitted no later than four months after the list of eligible regions have been drawn up.

The Commission has to appraise these plans to determine whether they are consistent with the aims stated in Regulation (EC) 1260/99, and other relevant Community policies. The Commission also have to appraise each Objective 3 plan proposed to see if it is consistent with the measures envisaged with the national plan under the European employment strategy.

The Commission has to take decision on the contribution from the Funds no later than five months after receiving the relevant plan or plans provided they contain all the features listed in article 16 of the referred regulation. That is, the contents of the programming for Objectives 1, 2 and 3.

The Commission has also to appraise the proposed operational programmes submitted by the Member States in order to determine whether they are consistent with the aims of the corresponding CSF and other Community policies. The earlier submission of the operational programmes by the Member States help the Commission to examine the CSF and. So, when adopting its decision on a CSF, the Commission also approves the operational programmes submitted.

The Commission takes a decision on a SPD in agreement with the Member State concerned. The European Investment Bank (EIB) may be involved in the preparation of the SPD. The decision taken by the Commission on a SPD and on the contribution of the Funds not later than five months after receiving the plan.

The Member States have to send the 'programme complement' to the Commission in a single document for information within three months of the Commission decision approving an operational programme of SPD.

The Commission decisions on a CSF or SPD is published in the Official Journal of the European Communities. At the request of the European Parliament, the Commission have to submit to it, for information, these decisions and the CSF and SPD it has approved.

## 4 Convergence in the European Union

The key priorities for the European Union regional policies for the 2000-2006 programming period, i.e. sustainable economic development, competitiveness and innovation, employment and human resources, and equality of opportunity between men and women continue to attract the Union's preoccupation due to the big problems still encountered across Europe.

### - Economic Development

The European Commission (1999) argues that evaluations contained in the periodic reports on the situation of regions in the EU have seen evidence on convergence of lagging regions in Europe. The evidence presented in the 'The Sixth Periodic Report on the social and economic situation and development of regions in the EU', that analyses data for the 1986-1996 period, had confirmed this results, the GDP, or output per head of poorer regions is converging towards the EU average. This period saw the following changes:

- In the 25 poorest regions GDP per head rose from 52% to 59% of EU average,
- GDP per head in the four Cohesion countries (Spain, Portugal, Ireland and Greece) went up from 65% of the EU average to 76.5% in this period of eleven years.

These results have been driven by closer European economic integration, where the Structural Funds have played an important role. One of the reason that explains this performance is the increase in trade between European countries, as an example, export and imports between the Cohesion countries and other EU Members States have doubled in real terms over a decade (European Commission, 1999d).

This study shows that despite these achievements trend towards convergence, significant differences still remain. In fact, although most regions are experiencing at least some convergence, their performance varies considerably. The most favoured lagging regions, particular capital regions, are catching up more rapidly than their rural hinterland.

In terms of GDP, the divergence between the richest and the most disadvantaged regions remain very significant. In terms of overall wealth, the 25 poorest regions of the EU present a per capita GDP equivalent to 60% of the Community average. For the case of the most prosperous regions, this ratio is of 160%.

#### - Sustainability

Action carried out through the Structural Funds has to comply with the environmental requirements of all involved levels and authorities to where funds are directed. The link between economic development of regions and the measures for environmental protection is recognised as a key consideration in the EU regional policy. It is clear, however (Guersent, 2001), that the programmes of the Structural Funds are not environmental policies, “what they are first and foremost is development policies” (p. 165). With respect to the action of the funds during the 2000-2006 period, five elements are considered:

- an assessment of the environmental situation in the recipient region,
- an evaluation of the environmental impact of the programme,
- the involvement of the relevant environmental authorities in the preparation and implementation of the programme,
- conformity with Community law on the environment,
- respect for the polluter pays principle.

#### - Competitiveness and Innovation

The Commission states that Competitiveness has two dimensions: productivity and employment. The EU is performing reasonably well on productivity but badly on employment. Income and output growth of just over 2% over the last decade came mainly from increased productivity, which grew by almost 2% a year, while employment rose by less than 0.5% a year. Lagging regions face the double challenge of catching up with the present, as well as adapting to the future (European Commission, 1999).

Citing the Commission Sixth Report (European Commission, 1999), Guersent (2001), points out that the disparities between regions in the fields of innovation and research,

as well as in the in the fields of technological development (being twice as significant as the gap in the GDP per capita) present on of the main challenges that regional policy is facing during the current programming period. Just as an example, “jobs involving high technology skills in the 25% most advanced regions account for 14.6% of total employment in Europe, against barely 4% in the least developed regions on the Union” (Guersent, 2001 p. 166).

On the other hand, the Commission (1999) argues that an unfavourable sectoral structure, together with a lack of innovative capacity seems to be the most important factors underlying lagging competitiveness. Other factors are:

- Technology. Although differences have narrowed in recent years, technological divergence (measured by indicators such as the request for patents and research expenditure) has been noted to exceed by far the divergence recorded for the per capita GDP.
- Small and Medium Enterprises (SMEs). SMEs play an important role in employment creation and the development of lagging regions. SMEs are specially important in Southern member States of the EU, in addition, these enterprises tend to concentrate in lagging regions within these countries.
- Foreign Direct Investment (FDI). The Commission suggests that FDI contributes to regional development by increasing capital stock and by introducing new products and techniques. In relation to GDP, Ireland, Portugal and Spain have benefited from above average inflows of investment from countries both, within and outside the EU.
- Transport infrastructure. Despite the progress in recent years, significant problems still remain between the EU average and the Cohesion countries. Significant progress have been made in reducing disparities in telecommunications infrastructure.
- Investment in energy infrastructure. This is necessary to reduce disparities among regions due to its close link with economic growth and development.
- Educational levels of the work force. Disparities in human capital have been reduced in EU regions, though significant differences still remain in the relative number of young people without vocational training beyond compulsory schooling.

- Institutional factors. These include the endowment of social capital in the form of the business culture and shared social norms of behaviour which facilitate co-operation and enterprise, which is of particular importance for regional development.
- The efficiency of public administration. Two elements can be highlighted as having a significant impact on recent years in the sphere of public administration: a) changes in the principles governing public sector management, a key feature being emphasis on performance evaluation. Lessons learn from the past can be fed into decision-making to improve policy in the future, and; b) the shift toward decentralisation and partnership, enabling different levels of government as well as the private sector to participate in the policy process and bring their own expertise and experience. According to the Commission (1999), the delivery system introduce for the administration of the Structural Funds has made an important contribution to the institutional endowment of lagging regions. A work by Smith (1998) centred on the Structural Funds at the sub-national level demonstrates how, after the 1988 structural reform, new actors have gained relevance as a result of the administration of these funds.

- Employment and equality of opportunity between men and women

The Commission has recognised that, although output in converging, the situation regarding unemployment is less positive. Unemployment in the EU still stood at just under 10% in late 1998. The 25 regions with the lowest rates of unemployment are at about the same level in 1998 as ten years ago and their rates have remained steady at around 4%. By contrast, rates in the most affected regions have climbed from 20% to 24% (European Commission, 1999). According to Guersent (2001), the Commission is thinking of ways to more effectively translate GDP growth into job creation, at least in the most affected regions.

A particular concern is the importance of long-term unemployment. Figures from the 1997 Sixth Periodic Report show that 49% of the unemployed have been out of work for a year or more, and 30% for at least two years. Another problem is the exclusion from the labour market of social groups such as women and young people. The Commission (1999) argues that these forms of unemployment are particularly

problematic since they seem to be resistant to general improvement in the economy. In the 25 regions with the highest unemployment rates, long term unemployment accounts for 60% of total unemployment, against 30% in the 25 regions with the lowest unemployment. In regions with the highest unemployment rate, only 30% of women of working age actually have a job and youth unemployment rates reach 47%.

Former works encountered significant differences in terms of regional wealth among the regions of Europe. Using data up to 1992 on comparative economic performance, Dunford (1998) demonstrates that there is a strong tendency towards greater social and territorial inequality in the European Union<sup>62</sup>. He argues that in most Member States strong regions have achieved faster rates of growth than weaker regions. Lower rates of growth of certain regions have occurred especially on GDP and employment. Some of the factors that would explain these problems, according to Dunford, is that the widespread restructuring in the EU has occurred without a reintegration of the displaced workforce in the world of work. Institutional factors are also critical determinants of success, as the experience of a number of strong regions suggests.

## 5 Summary and Conclusions

The European Union is a continental scale institution with a wide variety of functions and responsibilities. EU is composed of consolidated institutions that undertake multiple tasks, in particular on economic, social and regional matters related to all Member States.

Regional policy is a central preoccupation within the EU and in all the Member States and regions of the Community. The main instrument to cope with EU regional policy are the Structural Funds. Along their existence the Structural Funds have undergone five structural transformations, each of them trying to cope with the changeable condition of regional problems and with the accession of new members and new regional realities. The most important institution in the administration of the existing regional funds is the European Commission.

Agenda 2000, the fifth structural transformation for the period 2000-2006, is an action programme to strengthen the Community policies to adapt them to a larger Union, for assessing countries' application for accession, and to provide the EU with a more comprehensive financial framework. Overall, the Agenda 2000 package aims to contribute to the objective of economic and social cohesion in the EU by greater concentration of the financial programme. The decentralised character of the new programme and the inclusion of new regional and local partners, public and private, is an important characteristic of the new period.

The Structural Funds, with its four inter-linked funds, is to play a central role in achieving economic and social cohesion in the Union. Each fund plays a distinctive but co-ordinated role in pursuing this objective.

The main component of the Structural Funds is the European Regional Development Fund (ERDF). The fund main aims are to promote development in regions lagging behind the EU average as well as to contribute to the economic and social conversion of regions with structural difficulties. The ERDF represents two thirds of the structural operation in the period 2000-2006 and it works under the same regulations of the rest of Structural Funds. Four principles rule the operation of the ERDF: Programming, Partnership, Additionality, and Management, monitoring and evaluation.

The ERDF finances a large number of actions through out the two objectives and the Community Initiatives. This actions include infrastructure investment, productive investment, employment, technical assistance, and investment for the development of endogenous potential. Financial allocation differ from objective to the other. The variables employed for the allocation of resources consider the population, economic strength, and employment in the regions.

The way national and regional authorities get access to the ERDF resources is done through three ways: In the first one the corresponding authority, national or regional,

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<sup>62</sup> Similar results were presented by Perrons (1992) using 1988 statistic. She argues that regional inequalities revealed a clear centre-periphery pattern with the richer regions concentrated in the centre and the poorer regions in the periphery, especially in the south and west.

submit to the Commission an Objective Programme elaborated under procedures previously established by the Commission. The second path, the Community Initiative Programmes, also requires the preparation of a programme, this time by the Member State, again on the basis of guidelines from the Commission. The third way correspond to the so called Innovative Measures. These are design by the Commission itself under its own initiative. The measures are proposed by the Commission which also keeps the responsibility for selecting the projects from those presented by the national authorities.

It is interesting to see the many transformations that the Structural Funds have experienced over the years (against non in the Chilean FNDR). This can be understood as a response to the changeable condition of the Union and can be thought as a desirable behaviour for coping with new scenarios on regional problems.

The emphasis on poorer regions rather on poorer countries it is also an interesting feature of the new programme. This concept have to do with a long discussion in regional development theory, and in practical terms with the focusing of resources.

The allocation of resources is done, basically, in two stages, with the Commission having the main responsibility. The first by selecting the regions for assistance, and the second when defining the variables for determining the amount of resources that will be allocated to each region or area within a region. Both decisions are taken at a centralised level. The member countries are given the responsibility for selecting the kind of action to carry out with the aid from the Commission. This indicates an top down direction in the planning process.

The long planning period (seven years) it is also something that can be discussed in the light of other experiences with shorter planning periods. Probably one of the main reasons for doing it this way is the level of stability of the economy and the political circumstances of the European region.

The heavy work at the pre-investment stage (much is set up at the programming period, before any physical action starts) would facilitate the carrying out of subsequent stages in the process of investment. On the other hand, however, this can be thought as restricting regional and local initiatives and own solution to particular problems.

Communication of the action of the Structural Funds is a remarkable feature of the 2000-2006 investment period. This is done at the different stages of the programming period and at the different level of authorities and other bodies that participate in the process, as well as to the community in general.

Whether regions of Europe are converging or not due to the action of the Structural Funds and more generally due to the action of European regional policy is still a matter of discussion since results of several studies have presented contradictory information. The European Commission (1999) argues that evaluations contained in the last report (the 1997 Sixth periodic report) on the situation of regions in the EU shows evidence on the convergence of lagging regions in Europe. However, although the GDP output per head of poorer regions is converging towards the EU average, significant differences still remain. Technological divergence has been noted to exceed by far the divergence recorded for the per capita GDP.

The Commission has also recognised severe problems regarding unemployment. Long term unemployment and the exclusion from the labour market of social groups such as women and young people will continue to be a matter of great concern for regional policy. The way how to translate GDP growth into job creation, at least in the most affected regions is a challenge that requires immediate action.

## Chapter 7

# Main Similarities and Differences between the FNDR and the ERDF

## Introduction

Chapter 5 above identified some key elements of the Regional Development Fund of Chile (FNDR) that were not working properly for a correct use of the funds in terms of its performance and overall objective of regional development. Following, chapter 6 presented a detailed account of the similar regional fund, the European Regional Development Fund (ERDF), emphasising those aspects previously noticed in the FNDR as not working appropriately.

This chapter presents and discusses the main similarities and differences in those aspects between the Regional Development Fund of Chile (FNDR) and the European Regional Development Fund (ERDF). The chapter is organised in six sections, each of them focusing on those particular aspects of the two funds. The analysis begins with a presentation of the main features of the two funds; Second, the presentation and discussion of the 'concept of regional development' behind the two funds; the Third part focuses in the specific objectives of the funds and the way these impact regional development; Fourth, a presentation and comparison on the main elements of the method of allocation of funds; Fifth, the identification of the type of actions and sectors/areas of investment and their relevance for regional social and economic development; the Sixth section explores on the possibility of finding other actions that due to the existence of the fund may contribute to regional development. Finally, a summary of the main findings of this comparison as well as some conclusions are presented.

In order to facilitate the reading and understanding of the main elements that characterised both funds as well as the comparison between them, the presentation is done in a two-column table that permits a clear visualisation of these features. This presentation is followed by a general description and a discussion on the main similarities and differences amongst these particular elements of both funds.

## 1 Main features of the FNDR and the ERDF

The Regional Development Fund of Chile (FNDR) and the European Regional Development Fund (ERDF) of the European Union were both set up more than 25 years ago, by the mid 1970s. The two funds were designed to support the development of regions and, apart from the principal aim of both funds on regional development, and the obvious differences in terms of the territories they cover and the amount of resources involved, they present several other differences and similarities that are worth exploring.

The FNDR is the most important regional fund of Chile. The fund is used on an annual basis and it is mainly directed to the investment in basic social infrastructure of projects designed at the regional level. The fund is allocated from the central level to the thirteen regions of Chile. The central level also has the responsibility of authorising the kind of projects proposed by the regions as well as the aggregated accounting of the funds investment. The sectors/areas of investment and the particular projects are designed and prioritised at the regional level, although they have to fall within the category of eligible sectors and type of investment authorised by the FNDR Programme.

The ERDF, on the other hand, is a multi-national, multi-annual programme of investment for the development of lagging regions within the European Union. The fund does not benefit all regions in the Community. The main body responsible for the administration of the fund is the European Commission, which among other tasks is responsible for preparing the method of distribution of funds to the different regions and objectives covered by the ERDF. Once funds have been allocated, it is the responsibility of each national, regional and local government and partners the corresponding investment of the resources.

The main type of activity financed by both funds is infrastructure investment, but a number of other activities are also financed with more or less significance depending on the funds different approach to regional development and the problems regions in each case face.

Table 7.1 below summarises the main features of both funds such as the number of years the fund has been in operation, the amount of resources involved, and people benefited. The comparison ends up with a discussion on one of the most remarkable differences of both funds which is the fact that while the FNDR has not experienced any major reform during over twenty five years of existence (apart from that when the FNDR started to be co-financed by the IDB), the ERDF has undergone five structural reforms in all its years of operation. Finally, an example of a third regional fund, the Interterritorial Compensation Fund of Spain (FCI), is presented to illustrate the reasons that may contribute for a fund to adapt to new scenarios.

Table 7.1: Main features of the FNDR and the ERDF funds

FNDR (Chile)	ERDF (European Union)	Main Features
<ul style="list-style-type: none"> <li>• Primary objective of the fund: Regional Development</li> <li>• Set up of the fund: 1974</li> <li>• Average amount of resources per year (2000-2003) = EURO Million 125.0 <sup>(a)</sup></li> <li>• People covered: 40% of Chile's population <sup>(b)</sup> = 6,084,523</li> <li>• Per capita annual investment = 20.54 EUROS</li> <li>• Main type of investment: Infrastructure projects in the areas of Education, Health, Urban Roads, Rural Roads, Water Supply, Sewer Systems, and Rural Domestic Electricity</li> <li>• Dynamic/adaptability of the fund: Few changes in the last 15 years</li> </ul>	<ul style="list-style-type: none"> <li>• Primary objective of the fund: Regional Development</li> <li>• Set up of the fund: 1975</li> <li>• Average amount of resources per year (2000-2006) = EURO Million 30,430.7 <sup>(c)</sup></li> <li>• People covered: 35-40% of EU population (40%) <sup>(d)</sup> = 146,000,000</li> <li>• Per capita annual investment (40% of pop) = 208.43 EUROS</li> <li>• Main type of investment: Objective 1 'Lagging regions- of average GDP below 75%' = A 69.7% of the total Structural Funds resources fall into this objective</li> <li>• Dynamic/adaptability of the fund: Five structural reforms in the last 21 years</li> </ul>	

<sup>(a)</sup> Total amount of FNDR resources for the period 2000-2003 = 500 US\$ Million

<sup>(b)</sup> Out of 15,211,308 estimated for the year 2000

<sup>(c)</sup> For the whole of the Structural Funds plus the Cohesion Fund (EURO Million 213,015)

<sup>(d)</sup> Out of the 365,000,000 estimated for the year 2000

### Main Similarities and Differences

As seen in Table 7.1 above, the funds present significant differences in terms of the amount of resources, territory and population they cover. However, both funds are very similar in terms of the main aims, their objectives and the type of actions and sectors/areas of investment (as it will be seen in the section that follows).

The most remarkable difference, however, appears when looking at the capability of the funds to adapt to new realities and new challenges. The FNDR, for example, was set up in 1974, in the year 1985 the fund became important due to a loan from the Inter

American Development Bank (IDB) that significantly increased its amount of resources. Since then the fund has been used to finance infrastructure projects in basically the same sectors of investment (Education, Health, Urban Roads, Rural Roads, Water Supply, Sewer Systems, and Rural Domestic Electricity). In this period of sixteen years, three IDB loans have co-financed the FNDR, a fourth one has just started to operate in the year 2000 for five more years, and again no important transformation have been introduced to the fund.

The aim of the fund, 'regional development', is supposed to remain the same, but nothing has been done to redefine the specific objectives, or the method of allocation of fund, or the type of actions and sectors of investment, etc. The FNDR has been basically doing the same thing for sixteen years, and in the same way.

The problem with this is that it is widely felt among politicians, regional authorities, scholars, and public officials in Chile that changes are urgently needed if the fund is to play a more important role in Chile's regional development. The main justification for these changes can be grouped in three categories. First, the traditional sectors that have attracted much of the FNDR resources (Education, Health, etc.) will continue to do so if the corresponding economic sectors (ministries) do not take full responsibility of their duties in infrastructure supply for these areas. Therefore, if the FNDR continues financing exclusively these sectors, little will be achieved with respect to regional development.

Second, the impact on regional development of not only the type of projects the fund finances (infrastructure in these seven sectors), but also in the way this is done (a myriad of small isolated projects spread out over the territory) will be little or inexistent at all.

Third, Chile's economic and social development of the last fifteen years, and especially over the last ten years, poses new challenges and demands new ideas from the regions to succeed in an increasingly changeable economic environment. The FNDR as a decentralised investment fund, with resources that have been increasing over the time, may play an important role at this respect if its action is reoriented to more development-oriented initiatives.

The ERDF, on the other hand, has experienced five structural reforms since 1979, each of them widening the range of operation of the fund, focusing its actions and adapting to new realities. Each new programme has taken advantage of a new beginning and has introduced changes. The first reform saw the introduction of the seven Community Schemes; the second reform aimed to correct the principal regional imbalances concentrating on regions whose development was lagging behind and in declining industrial areas; the third structural reform introduced the four principles of additionality, partnership, co-ordination, and programming; the fourth reform broadened the range of resources and set up the Cohesion Fund; and the fifth structural reform has been drawn up under the prospect of enlargement and greater concentration of assistance.

Another example at this respect is what happened to the [Regional Development Fund of Spain] *Fondo de Compensación Interterritorial* (FCI). Before being assimilated to the ERDF<sup>63</sup> the FCI had also faced the problem of rigidity. Since its creation, in 1978 (article 158 of the 1978 Constitution, and Law 8/1980, article 16), the FCI did not experience any change until 1989, when a reform was initiated. The main causes of this reform were: a) Law 8/1980 had initially considered a reform after 5 years of operation of the fund, which actually began in 1984; the problems associated to the system of allocation of funds and the bias in favour of the most developed regions of the Basque Country and Catalonia; and c) the need to co-ordinate with the ERDF (Ruiz-Huerta J, 1992; Melguizo A, 1992). The resulting 'structural reform' (Castells, 1992b) subdivided the FCI into two areas: a) An interterritorial compensation fund, aimed to territorial equilibrium that provides resources for nine (out of nineteen) Autonomous Communities, and b) Compensatory or sufficiency financing fund that allocates resources to all the Autonomous Communities of Spain.

In the case of Chile neither internal nor external conditions have been able to force the FNDR to adjust to new realities. The most important political event of the country in recent years, the transit from an authoritarian regime to a democratic government in 1990, was not sufficient to change the basic structure of the FNDR, despite the critique

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<sup>63</sup> At present, the FCI is distributed to the regions of Spain according to the same procedures defined for the ERDF, and the fund itself constitutes the national counterpart for addressing the objectives of the Structural Funds.

the fund's objectives and its administration had gain at the end of the 1980s. The last contract with the IDB for the fourth successive FNDR loan, in 2000, although reported as a 'second generation' type of programme by the IDB (IDB, Perfil II CH-0161: <http://www.iadb.org/search97cgi/s97is.dll>) the new programme did not introduced any structural changes on what has been doing since 1985 (see description of this new FNDR Programme in Annexe III).

## 2 The concept of the FNDR and ERDF

The 'concept of the FNDR', or the overall aims of the fund, are found in three official documents: a) the Chilean Constitution, Article 104; b) the Law of Regional Governments –LOCGAR Article 73; and, c) *the Reglamento Operativo* 1995 (the IDB Regulation). An interpretation of these general objectives also appears in an evaluation study of the FNDR carried out by the Ministry of Finance (DIPRES, 1998).

The 'concept of the ERDF', on the other hand is also found in three official documents: a) The Treaty of the European Union, Article 160; and b) The Regulation (EC) 1783/1999 and the Regulation (EC) 1260/1999. However, since the ERDF is a component part of the Structural Funds, which at a time are part of the more general framework of the European Union Regional Policy, there are a number of other basic principles that have to be considered when defining the overall aims of the ERDF. With regard to the EU Regional Policy, for the period 2000-2006, these basic principles are: 1) financial solidarity and greater cost-effectiveness; 2) a clear division of responsibilities between the Commission and the Member States; 3) the promotion of four basic Community priorities: sustainable economic development, competitiveness and innovation, employment and human resources, and equality of opportunity between men and women.

In the case of the Structural Funds Regulations, the guiding principles for the management of all three interrelated funds (i.e. the ERDF, the ESF and the EAGGF) are: 1) greater concentration; 2) fewer objectives -3 instead of 5 as in the previous

period; 3) simplification and decentralisation; 4) improved efficiency; and, 5) more effective controls.

Within this general setting, the ERDF is regulated by its own general objectives, which were first established in Article 160 of the Treaty and then specified in more detail in the Council Regulation (EC) 1783 of 1999, and (EC) 1260 of the same year. These objectives are the ones considered for the comparison with those of the FNDR of Chile.

Thus, the ‘concept of the FNDR and the ERDF, or the overall aims of both funds can be summarised as follows:

Table 7.2: The concept/overall aims of the FNDR and the ERDF

F N D R (Chile)	E R D F (European Union)	
<p>Article 104 of “Constitución Política de Chile” provides that the FNDR is intended to:</p> <ol style="list-style-type: none"> <li>1) Ensure an harmonic and balanced territorial development,</li> </ol> <p>Article 73 of LOCGAR states that the FNDR is intended for:</p> <ol style="list-style-type: none"> <li>2) Territorial compensation,</li> <li>3) The Overcoming of poverty,</li> </ol> <p>Regulation (IDB) –“Reglamento Operativo 1995”, states that the FNDR intents to:</p> <ol style="list-style-type: none"> <li>4) Increase social welfare of low-income groups,</li> <li>5) Support and Consolidate the process of regionalisation.</li> </ol>	<p>Article 160 of the Treaty provides that the ERDF is intended to:</p> <ol style="list-style-type: none"> <li>1) Help redress the main regional imbalances in the Community,</li> </ol> <p>Regulation (EC) 1783/1999 (numeral 4) establishes that the ERDF contributes to:</p> <ol style="list-style-type: none"> <li>2) Promote regional development, harmonious, balanced and sustainable development of economic activity,</li> <li>3) Promote competitiveness, employment, equality between women and men and,</li> <li>4) Protection and improvement of the environment.</li> </ol>	Overall aims

### General description

Five overall aims define the concept of the FNDR as a fund for regional development (Table 7.2). These objectives address three types of question regarding to *Territory* (objectives 1 and 2); *Poverty* (objectives 3 and 4); and *Regional Administration* (objective 5). The objective regarding the fostering of regional governments (Regional Administration objective) was introduced in 1995 with the 1995-1999 loan. The aim of this initiative was to consolidate the process of regionalisation initiated in the country at the end of the 1960s and definitively pushed forward at the beginning of the 1990s.

The ERDF, on the other hand, is defined in terms of four overall aims. These four aims also address basically three types of questions. First, *Territory* (objectives 1 and 2); second, *Economy*, (objective 3); and third, *Environment* (objective 4).

#### Main Similarities and Differences

The FNDR and the ERDF coincide in just one of the three main aspects that define the overall concept of both funds. In each case territorial development (*Territory*) is the main preoccupation of the funds, in the Chilean case aiming at territorial compensation and development and in the European case in order to overcome the regional imbalances in the Community (the majority of the resources are destined to this objective in both cases).

Within the FNDR, low-income groups (*Poverty*) and the consolidation of the Regional Government institution in its administrative aspects (*Regional Administration*) complete the central preoccupation of the action of the fund. In the case of the ERDF, the other two aspects are economic development (*Economy*) that considers the economic performance of regions, employment and equality between women and men, and the protection of the environment (*Environment*) that has to be considered in all actions pursued by the fund.

Thus, the emphasis in the ERDF is placed in economic development, against the preoccupation in increasing the social welfare of low-income groups of the FNDR. This different emphasis determines the kind of specific objectives (discussed in the following section) that each fund will pursue.

A recent report on Chile's future development by the Inter-American Development Bank (IDB, 2001), discusses on the country's medium-term challenges. The report identifies four major challenges, of which two of them, 'reconciling economic growth with equity concerns' and, 'modernising the State and deepening democracy', have to do with the existence of the FNDR fund. As the FNDR is a direct consequence of the IDB policy in Chile, these challenges have to be taken into account when analysing the final objective of the fund.

In fact, under these two strategic lines of actions the objectives of *overcoming poverty* (objectives 3 and 4) and *consolidating the process of regionalisation* in Chile (objective 5) will continue to be central for the action of the FNDR. These central preoccupations in the FNDR will, however, overshadow those for economic development, also stated as main objectives in the FNDR.

If the FNDR is to concentrate on lesser objectives in the coming period its action may be expected to be more focused and to have a greater impact than in previous periods. By focusing on the consolidation of the process of regionalisation of the country, that for the FNDR has meant improving the efficiency of Regional Governments, the overall results can be expected to be even greater. More concentration of FNDR assistance and with more qualified personnel and expedite administrative procedures will end up in a more efficient use of the resources.

The experience of the last two or three years in the administration of the FNDR has showed a shift in the discourse of regional authorities. While before the stress was placed on the actual results of the investment, that is the number of school or kilometres of roads constructed by the FNDR, now the emphasis is put on the number of people that is being employed due to the action of the fund, both during its operation and as a consequence of the increase in infrastructure and the number of places of permanent jobs it generates.

### 3 Specific objectives of the funds

#### 3.1 Specific objectives

Beyond the overall concepts of harmonious and balanced territorial development, the overcoming of poverty, and the fostering of the process of regionalisation pursued by the FNDR, and those of regional development, employment, and equal opportunities of the ERDF, each fund is directed to more specific objectives designed to attain these more general aims. The specific objectives of both funds are summarised below in Table 7.3.

Table 7.3: Specific objectives of the FNDR and ERDF

FNDR (Chile) <sup>a</sup>	ERDF (European Union)	
<p><i>Objective 1</i></p> <ul style="list-style-type: none"> <li>Supporting the process of regionalisation and territorial compensation,</li> </ul> <p><i>Objective 2</i></p> <ul style="list-style-type: none"> <li>Improving the living conditions of low-income groups,</li> </ul> <p><i>Objective 3</i></p> <ul style="list-style-type: none"> <li>Fostering the institutional development of Regional Governments.</li> </ul>	<p>i) Priority Objectives</p> <p><i>Objective 1</i></p> <ul style="list-style-type: none"> <li>Obj 1. Promoting the development and structural adjustment of regions whose development is lagging behind,</li> </ul> <p><i>Objective 2</i></p> <ul style="list-style-type: none"> <li>Obj 2. Supporting the economic and social conversion of areas facing structural difficulties (in the industrial and service sectors, declining rural, urban and those dependent on fisheries areas),</li> </ul> <p>ii) Community Initiatives</p> <p><i>Objective 3</i></p> <ul style="list-style-type: none"> <li>Cross-border, transnational and interregional co-operation intended to encourage the harmonious, balanced and sustainable development of the whole of the Community area ('Interreg'),</li> </ul> <p><i>Objective 4</i></p> <ul style="list-style-type: none"> <li>Economic and social regeneration of cities and of urban neighbourhoods in crisis with a view to promoting a sustainable urban development ('URBAN'),</li> </ul> <p>iii) Innovative Action</p> <p><i>Objective 5</i></p> <ul style="list-style-type: none"> <li>Finance innovative actions at Community level (studies, pilot projects and exchange of experiences). These shall contribute to the preparation of innovative methods and practices designed to improve the quality of assistance under The Structural Funds Objectives 1, 2 and 3,</li> </ul> <p>iv) Technical Assistance</p> <p><i>Objective 6</i></p> <ul style="list-style-type: none"> <li>The ERDF may finance the preparatory, monitoring, evaluation and checking measures necessary for implementing the Structural Funds. These include: <ul style="list-style-type: none"> <li>a) studies,</li> <li>b) measures of technical assistance, the exchange of experience and information aimed at the partners, the final beneficiaries and the general public,</li> <li>c) the installation, operation and interconnection of computerised systems for management, monitoring and evaluation,</li> <li>d) improvements in evaluation methods and exchange of information on practices in this field,</li> </ul> </li> </ul>	<p>Specific Objectives</p>

<sup>(a)</sup> These three objectives correspond to those identified by DIPRES (1998)

### General Description

In the case of the FNDR fund, there are three specific objectives. Although understood as the 'specific' objectives of the FNDR, they are of a very general nature. In fact, these three objectives are not defined as such by any of the three official documents that set

up and define the FNDR, apart from Objective 3, that it is explicitly defined in the IDB Regulation (*Reglamento Operativo*, 1995). Each one of these objectives addresses each one of the three overall aims that define the concept of the fund (discussed in previous section). For the ERDF, on the other hand, there are six specific objectives grouped in four areas of action: Priority objectives (objectives 1 and 2); Community Initiatives (objectives 3 and 4); Innovative Actions (objective 5); and, Technical Assistance (objective 6), that comprises four even more detailed actions.

#### Main similarities and differences

Two big differences appear at first sight of the specific objectives of the two funds. The first is the difference in terms of the number of objectives in each of them, many more in the case of the ERDF. This characteristic leads to the second and more important one that is the degree of focusing that can be accomplished in each case due to the number and specificity of the objectives. A larger number of objectives in the case of the ERDF fund means less concentration but higher focusing of its action due to the specificity in which they have been drawn (at least some of them). The problem with the objectives of the FNDR, at this respect, is that although they are fewer in number, they have been stated in such general terms that they, in most cases, are not able to achieve a greater concentration and focusing. Thus, these objectives are not only difficult to pursue, but also very difficult to evaluate in order to find out to what extent they are addressing the problems they intended to solve.

In this sense, the three very general and vague objectives of the FNDR are only comparable to the first 'Priority Objective' of the ERDF (objective 1: to promote the development and structural adjustment of regions whose development is lagging behind). This objective is also of a very general nature and almost any kind of action may fall within it. The rest of the objectives of the ERDF point out to more specific aspects of the economic and social development of the regions of the EU.

A third important aspect that differentiates the specific objectives of the two funds is the scope of each fund. Although very general and vague, the three specific objectives of the FNDR have been mainly used to address the social component of the development of regions in Chile. The ERDF, on the contrary, covers very different aspects of the development of EU regions, including: economic and social aspects, the industrial and

service sectors, interregional co-operation, the financing of innovative action, exchange of experiences and technical assistance to improve the quality of the assistance from the fund.

### 3.2 Evaluation of objectives

In order to measure the effectiveness of the funds assistance and the achievements of the objectives stated in each case, both cases contemplate periodic evaluations of the action of the funds. In the case of the ERDF, article 40 of Regulation EC 1260/1999 establishes that Community structural assistance have to be subject of ex-ante, mid-term and ex-post evaluation designed to appraise its impact with respect to the objectives set out for the different funds and to analyse its effects on specific structural problems.

In the case of the FNDR, LOGGAR does not mention anything about an evaluation of the action of the FNDR. The *Reglamento Operativo* 1995-1999 do requires an annual report with regard to the operation of the projects constructed with FNDR-IDB funds. The report is based on a sample of projects for different sectors and regions. The aim of this evaluation is to identify those beneficiary institutions (Health, Education sector, etc) that do not comply with the requirements (compromise to maintain the facilities) established by the Bank at the moment of approving a project.

Nevertheless, SUBDERE has carried out periodic evaluations (at the end of each programming period) for the whole of the action of the FNDR fund, the last one being that of 1997 for the FNDR Programme of 1990-1994.

The 11<sup>th</sup> Annual Report from the Commission evaluated the 1999 performance of the action of the Structural Funds. This correspond to the most recent evaluation of the funds, which has been carried out since 1989. The 1995 evaluation (7<sup>th</sup> Annual Report) introduced the modality of concentrating on a special theme. In the 11<sup>th</sup> report the theme is “measures to promote equal opportunities for men and women”. The main aspect covered in this evaluation can be grouped into two categories. The first category deals with aspects related to administrative facts and the co-ordination of the Structural Funds with other funds and includes: a) the budget implementation, b) the co-ordination with other financial instruments, c) the compatibility with other Community policies, and d) the communication with other institutions involved in the process. The second category

has to do with the actual impact of the funds in the regions of Europe. This includes: e) the implementation of the programme in the member states, including a country by country survey, and f) and evaluation and analysis of the impact of the funds by objective and themes (sectors) such as transport, job creation, etc. A description of the main aspects, and their description, considered for the evaluation of the Structural Funds is presented below in numeral 6. Further Actions for Regional Development.

For the FNDR, the last evaluation was carried out in 1997 and corresponds to the FNDR Programme of 1990-1994<sup>64</sup>. The main aspects covered in this evaluation were: a) allocation of resources (by sector and territories), b) the focusing of the investment (main social groups benefited and areas most privileged), c) the functioning of the works financed by FNDR funds (in terms of the quality of their infrastructure, state of conservation) and to what extent this facilities have benefited the expected population, d) the opinion of the authorities and public servants involved in the process on the technical and administrative procedures of the FNDR, and e) the relationship that exist among the different stages of the process, from the first draft of a project to the final execution of works.

The results of the evaluations are summarised below in table 7.4. Although the themes of the evaluations do not have an equivalent for each fund, the two column presentation is used to allow for a rapid understanding of the main results. Four aspects were considered to present the way evaluation is carried out as well as the main results of these evaluations: co-ordination with other financial instruments, information and communication of the activities related to the management of the funds, results of specific actions by objective, and budget implementation.

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<sup>64</sup> This study was presented and critically analysed when defining the FNDR in chapter 4.

Table 7.4: Evaluation of the FNDR and ERDF funds

FNDR (Chile)	ERDF (European Union)	
<ul style="list-style-type: none"> <li>• Co-ordination with other regional funds is considered in LOCGAR. Co-financing (FNDR and sectoral funds) has been applied in the FNDR since 1995.</li> <li>• Because all public investment is carried out in one computer-based system in Chile, double financing is difficult to occur.</li> <li>• As sectoral investment (not regionalised) is still the main source of public funding in the regions, co-ordination at all levels remains a difficult task.</li> </ul>	<ul style="list-style-type: none"> <li>• Cohesion Fund. Has provided assistance to phases of projects where other Structural Funds have not contributed. No cases of double financing have been detected by the evaluators.</li> <li>• The European Investment Bank (EIB). 61% of loans went to disadvantage regions. Loans for Objectives 1 regions accounted for 45% of that total. EIB has contributed directly to Priority Objective 1 (see table 7.3 above).</li> <li>• The European Investment Fund (EIF). These funds do not necessarily focus on lagging regions. Loan volume guaranteed for small firms is one of the funds main destinations.</li> </ul>	Co-ordination with other financial instruments
<ul style="list-style-type: none"> <li>• Only the most directly involved parties are informed or invited to hear on the implementation of projects and programmes.</li> <li>• An internal document containing the fund's regulations circulates.</li> <li>• The webpage of SUBDERE does not yet include a site on the FNDR fund.</li> <li>• FNDR regulation has not yet considered (therefore not funds are available for this) to give publicity to the existence/action of the FNDR.</li> </ul>	<ul style="list-style-type: none"> <li>• Seminars and other events with interested parties and the public to inform on the implementation of programmes.</li> <li>• Publishing of the funds regulations and of the evaluations.</li> <li>• Implementation of website pages on the regional policy (regularly updated).</li> <li>• Regulation EC 1260/1999 includes an article (art 46) that specifies that member states have to ensure that publicity is given to development plans. Informing the final beneficiaries, the general public, etc.</li> </ul>	Interinstitutional dialogue, information and communication
<p>Objective 2 (Improving the living condition of low-income groups). Period 1990-1994.</p> <ul style="list-style-type: none"> <li>• Because the FNDR is allocated to territories (regions and then comunas), the 1997 study found out that less populated comunas, and therefore with less poor population, attracted more funds than those with larger poor population. The same was recorded by the 1985-1989 evaluation of the FNDR<sup>65</sup>. Objective 2 is therefore not being fully achieved.</li> </ul>	<p>Objective 1 (Promoting the development and structural adjustment of regions lagging behind). Year 1999.</p> <ul style="list-style-type: none"> <li>• Hainaut (Wallonia, BELGIUM). Investment in tourist infrastructure, cleaning up industrial and urban wasteland, promotion of the use of new information and communication technology in secondary education and job-seekers, teacher training. These measures and others in Research and Technology Development have fostered the potential of the regional economy (11<sup>th</sup> Report, p 49).</li> </ul>	Actions by Objective
<ul style="list-style-type: none"> <li>• Commitment in 2000 = 100%</li> <li>• Payments in 2000 = 97% (a)</li> </ul>	<ul style="list-style-type: none"> <li>• Commitment in 1999 = 95%</li> <li>• Payments in 1999 = 89%<sup>66</sup></li> </ul>	Budget Implementation

(a) For *budget implementation* is better to look at the payments rather to the commitments indicator because the system used for committing the money may be different in each case. Payment is the actual disbursement of money and should be equivalent in both cases. Due to

<sup>65</sup> Greene y otros. Evaluation of the 1985-1989 FNDR Programme. Cited in SUBDERE, 1997 p 58.

<sup>66</sup> In May 2001, the Council and the European Parliament approved plans to distribute over the five years from 2002 to 2006 Structural Funds appropriations not committed in 2000 nor carried over to 2001. The funding in question is worth EUR 6,152 million (Inforegio News 86. Date: Wed, 30 May 2001).

a lack of other indicators to measure the efficiency in the use of the funds, the FNDR administration has specialised in expending most of the money available per year. Besides, regions are rewarded or punished depending of the level of expenditure they achieve at the end of each year.

Despite the relative success on the financial and co-ordination aspects achieved by both funds, the impact of the FNDR and the ERDF on the overall objective of regional development can be, however, questioned when looking at the social and economic indicators that show the regions progress or decline.

Although the Commission's evaluations of the Structural Funds show optimistic results about convergence in the European Union (growth of per head GDP from 52% to 59% in the 25 poorest regions, or the increase of GDP per head in the Cohesion Countries from 65% of the EU average to 76.5% in eleven years, or the success of particular programmes in some countries) other studies have encountered significant differences in terms of wealth among the regions of Europe. The centre-periphery patterns in regional equalities, with the richest regions being those of the centre and the poorest of the periphery, revealed by Perrons (1992), and the tendency towards greater social inequality because stronger regions achieve faster rates of growth than weaker regions (Dunford, 1998).

With respect to the FNDR, it is even harder to tell to what extent the fund assistance has had any impact on the regions development. What seems to be clear is the impact of the FNDR in the infrastructure endowment of specially the peripheral less populated regions of the country that, because of the method of allocation of resources, have greatly benefited with the existence of the FNDR.

Whether the growth or decline of a region's development can be associated to the action of a particular policy or the application of a particular programme is something that is not easy to establish. At this respect is better to look at the evidence and impact of a particular measure at the local level. It is here where the effects of an action can be better observed and assessed in order to determine its success, at least in the short run.

#### 4 Method of allocation of funds

The method of allocation of FNDR funds in Chile was a matter of a detailed analysis in a recent study by Universidad Austral (1999)<sup>67</sup>. This study focused its attention in the variables utilised in the distribution of funds to regions. The main findings of the study pointed to the quality and pertinence of the variables utilised, to the excessive weight of the territorial dimension, and to contradictions among some of the variables. The discussion in the present work focuses, instead, on the set up and the main concepts behind the distribution and use of the FNDR (and of the ERDF). This approach has, thus, more to do with the rationale under the allocation of funds and its relationship to regional development than with the specific variables utilised in the distribution.

Table 7.5: Main elements of the method of allocation of the FNDR and the ERDF

F N D R (Chile)	E R D F (European Union)	Allocation of Funds
<p>General Criteria</p> <ul style="list-style-type: none"> <li>• Funds are allocated by territorial units (regions). Once in the regions, funds are allocated by smaller territorial units and by sectors.</li> <li>• Funds are allocated in an annual basis</li> <li>• All 13 regions of the country receive funds</li> <li>• Funds allocation is done in a ‘project-by-project approach’</li> </ul> <p>Variables used in the Allocation of Funds:</p> <ul style="list-style-type: none"> <li>• Regional socio-economic prosperity (that includes 11 variables)</li> <li>• Territorial characteristics (includes 6 variables)</li> </ul> <p>Carry out of Projects</p> <ul style="list-style-type: none"> <li>• Regional Programme of FNDR investment (or the list of individual projects) are approved at the central level</li> <li>• Individual projects are first drawn up then apply for FNDR funds from the Regional Government</li> <li>• Unused funds are used on the following financial year (less than 3% of the funds are not used as an annual average from 1995 to 1999)</li> </ul>	<p>General Criteria</p> <ul style="list-style-type: none"> <li>• Funds are allocated by objective and then by region</li> <li>• Funds are allocated in a seven-year period</li> <li>• Not all regions (out of the 211 NUTS-2 level regions in the EU) receive funds</li> <li>• Funds allocation is done in a ‘programme-based approach’</li> </ul> <p>Variables used in the Allocation of Funds:</p> <ul style="list-style-type: none"> <li>• Eligible population</li> <li>• Regional prosperity</li> <li>• National prosperity</li> <li>• Severity of structural problems (specially unemployment)</li> </ul> <p>Carry out of Projects</p> <ul style="list-style-type: none"> <li>• Programmes of investment (SPD and CSF) are approved by the Commission at the central level</li> <li>• Investment Programmes are drawn after funds have been allocated to the objectives and regions</li> <li>• Unused funds are redistributed over the rest of the period among all eligible regions (10,6% of unused funds in the year 2000 and 2001 combined)</li> </ul>	

<sup>67</sup> This correspond to another of the studies analysed in detail in Chapter 4.

Table 7.5 above presents the main elements and criteria utilised for the distribution and actual use of the FNDR and ERDF funds. These elements have been grouped in three categories: general criteria, variables used in the allocation of funds, and main elements in the actual carry out of projects.

#### Main Similarities and Differences

The most obvious aspect in the methods of distribution of resources of both funds is the big difference in the rationale behind the two approaches. The FNDR is distributed in a territorial ground to all regions of Chile (and within regions to almost all municipalities). The distribution is done in an annual basis and resources are used under a project-by-project approach. Once allocated to regions the FNDR is redistributed to smaller territorial units (the *comunas*). The way this redistribution is done is of great importance to the overall aim of regional development, as it will be argued below.

The ERDF, on the other hand, is allocated only to certain regions in the EU, its funds are allocated first by objectives and then by region. Use of funds is done under a programme-based approach for a period of seven year.

In the case of the FNDR, the specific projects that will receive FNDR funds are first drawn up and then, once assessed and positively evaluated, they can apply for resources. Allocation of FNDR resources to the regions occurs once these projects have been put together to make what is called 'the regional programme of investment'. In the ERDF case, funds are first allocated to the different objectives and regions selected and then the countries and regions benefited prepare and submit the programmes of investment for the whole seven-year period (as in the 2000-2006 period).

The fact that funds are allocated in these two different ways means that regional development is understood and carried out also in two different manners. In the case of the FNDR funds are split among numerous municipalities and sectors, the large number of small individual projects are not linked to each other, have little impact on regional development and the whole system end up being an offer of resources to satisfy sectoral and local governments interests.

## 5 The type of actions and sectors/areas of investment

Table 7.6 below presents the type of actions and sectors of investment of the FNDR and the ERDF as to the year 1999 and 2000 respectively (the end of the third FNDR Programme and the beginning of the 2000-2006 programming period for the ERDF).

In the case of the FNDR both, the type of actions and the areas of investment are grouped in two categories, each corresponding to the main actions and the main sectors of investment and the secondary type of actions and sectors of investment. This is an important differentiation because the FNDR is in fact almost exclusively dedicated to the main actions and sectors of investment presented in this table.

For the ERDF this differentiation was not made because although some of the actions and sectors of investment attract comparatively much less investment than for example infrastructure (as a type of action) or regional development (in the areas of investment), all types of actions and sectors of investment in this fund receive financing and form part, in many cases, of programmed actions by the regions that receive assistance.

*See Table 7.6 next page*

Table 7.6: FNDR and ERDF. Types of Action and Sectors/areas of Investment

F N D R (Chile)	E R D F (European Union)	
<p>Main types of actions</p> <ul style="list-style-type: none"> <li>• Infrastructure</li> <li>• Studies</li> <li>• Programmes</li> </ul> <p>Secondary types of actions</p> <ul style="list-style-type: none"> <li>• Engineering and designs</li> <li>• Acquisition of grounds</li> <li>• Technical assistance</li> <li>• Supervision</li> </ul>	<ul style="list-style-type: none"> <li>• Infrastructure</li> <li>• Studies</li> <li>• Programmes</li> <li>• Technical assistance</li> <li>• Research, Technology, Innovation</li> <li>• Transference of Experiences and Innovation</li> <li>• Direct aid as non repayable assistance</li> <li>• Direct aid as repayable assistance, as an interest-rate subsidy,</li> <li>• Grants (to assist local development initiatives)</li> </ul>	Types of Action
<p>Main sectors/areas of investment IDB Eligible</p> <ul style="list-style-type: none"> <li>• Education</li> <li>• Health</li> <li>• Drinking Water</li> <li>• Sewer systems</li> <li>• Rural Roads</li> <li>• Urban Roads</li> <li>• Domestic Rural Electricity</li> </ul> <p>Secondary sectors/areas of investment <sup>(a)</sup> Non IDB Eligible</p> <ul style="list-style-type: none"> <li>• Domestic rural drinking water</li> <li>• Construction of new roads</li> <li>• Flood deterrents</li> <li>• Rural telephony</li> <li>• Small fishing ports</li>   <li>• Justice</li> <li>• Agriculture</li> <li>• Police and Security</li> <li>• Other sectors (mining, fishing, housing, etc)</li> </ul>	<ul style="list-style-type: none"> <li>• Regional Development</li> <li>• Sustainable jobs</li> <li>• Industrial areas</li> <li>• Urban areas</li> <li>• Rural areas dependent on fishing</li> <li>• Endogenous potential</li> <li>• Small and medium-sized enterprises</li> <li>• Education</li> <li>• Health</li> <li>• Research and technological development</li> <li>• Development of the information society</li> <li>• Tourism and cultural investment</li> <li>• Environment</li> <li>• Clean and efficient utilisation of energy</li> <li>• Development of renewable energy sources</li> <li>• Equality between women and men in the field of employment</li> <li>• Trans-national, cross-border and interregional co-operation</li> <li>• Economic and social regeneration of cities and urban neighbourhoods</li> <li>• Transference of experiences and innovation gained at regional and local level</li> </ul>	Sectors/Areas of Investment

Notes:

<sup>(a)</sup> The first group correspond to sectors included for the first time in the 1995-1999 IDB part of the FNDR Programme, of which no much was done in the period. The second group correspond to the sectors financed by the National Resources part of the FNDR Programme. 17.5% of the FNDR was used to finance National Resources eligible sectors in 1997.

Type of actions

General description

As seen in table 7.6 above, the FNDR is used basically in three types of actions: infrastructure, studies and programmes (multi-annual programmes in the agricultural

and fishing sectors). The other four actions are of less importance and are carried out only as complementary actions for infrastructure investment. The ERDF, on the other hand, finances nine types of actions of diverse nature, and not necessarily related to infrastructure investment, such as: research and technology, transference of experiences and direct aid and grants. All these instruments are directed to help regional development beyond infrastructure supply.

#### Main differences and similarities

Almost all type of actions carried out in the FNDR are also encounter in the ERDF. The main similarity within these actions is the importance given to infrastructure investment. This type of action attracts much of the investment in both cases. With the ERDF presenting a more diversified range of activities than the Chilean fund, the main differences lie therefore on the scope of the ERDF. While in the FNDR almost all activities are focused on infrastructure investment (cement and concrete) in the ERDF actions are of at least three different types: infrastructure investment, research technology and innovation, and direct aid and grants.

These last two concepts of research and technology and direct aids and grants are not considered within the FNDR, although research, technology and innovation have started to be financed in a joint programme with regional universities in Chile. The importance of these types of actions is that they are intended to help regions to generate their own capacity to face development problems in the long term.

#### Sectors/areas of investment

##### General description

Out of the sixteen sectors of investment in the FNDR, seven have attracted most of the investment of the fund during the period 1995-2000. Education, Health, Drinking Water Supply, Sewer Systems, Rural Roads, Urban Roads, and Rural Domestic Electricity concentrated over 82% of the FNDR investment in 1997. The rest of the fund in mainly concentrated in non-IDB eligible sectors.

The ERDF presents nineteen areas of investment that cover a wide range of activities, such as sectoral investment (Education, Health); urban and rural areas (urban neighbourhoods, industrial and fishing areas); research and technology; small and medium size enterprises; environment; transference of experiences, etc.

### Main similarities and differences

When looking at the wide range of sectors/areas of investment covered by the ERDF (which can be explain among other things due to the enormous amount of resources involved and the immense territory, diverse economic structure and cultural background of the regions of the Union) it is interesting to know of the many possibilities available for regional investment. The main difference with the FNDR at this respect is that while the FNDR is primarily a sectoral fund, the ERDF is multi-dimensional fund.

First, the ERDF is territorial because it is focused on regions whose development is lagging behind; second it is problem-oriented because it invests in urban areas in decline and in fishing/rural areas; third, it is also sectoral, since it finances education, health and the tourism sectors; fourth, it is a productive-investment fund because it finances Small and Medium-sized enterprises; Finally, the ERDF also finances activities related to the development potential of specific region within the European Union i.e. Sustainable jobs, Endogenous potential, Research and Technology, Environment, Energy, etc. The investment in infrastructure in the ERDF is just one of the many activities carried out by the fund.

Apart from the quantitative difference in the number of areas and objectives covered by the two funds, there also exist a big contrast in the complexity associated to the kind of investment carried out. In the case of the FNDR, the investment in infrastructure in mainly seven sectors has become quite simple after several years of experience administrating the fund. All the administrative procedures in the formulation and evaluation of projects (the pre-investment stage) and in the execution of them (investment stage) are pre-established and controlled by the national and regional level and already well known to all those involved in the different stages of the process.

The investment in these particular sectors is a direct consequence of the agreements with the IDB Bank for the three loans so far. The reason for the selection of these seven sectors of investment was clear for a country with deficit in all of them by 1985 and on the ground of the political and economical circumstances of that period (the trespassing of the education and health sectors to the local government as well as compensation to regions who failed to benefit from the export-oriented economic strategy implemented during the military government). At the same time, by doing it this way, it was easier

for the central government to control the expenditures carried out at the regional level. The type of sector selected and the type of investment –infrastructure- made sure for the central government that the regional investment would not distort the macro-economical equilibrium that the new economic model needed.

## 6 Further actions for regional development

Due to the FNDR's particular characteristics, such as those analysed in the previous section, especially the vagueness of the fund's objectives and the type of investment (mainly infrastructure) and the sectors of investment (Education, health, Water and Sewer Systems, Roads and Rural Domestic Electricity), as well as the way investment is carried out (the project-by-project approach) the impact of the fund on regional development was argued to be very limited. Apart from the physical outcome of the fund's action: the number of schools and medical facilities constructed, or the amount of kilometres of electric grid installed or roads constructed, etc. (or the number of people actually benefited with each of these projects) it can be said that no other anticipated or unanticipated actions are building or leveraging regional development due to the existence of the FNDR.

The main argument here is that there are a number of other actions, associated to the existence of a development fund that may also play an important role on regional development, beyond the sole benefit of increasing infrastructure capital. These actions refer not only to the final results that can be achieved with a particular fund, but also with the way the entire process is conducted. Two different cases will be provided the ground for comparing analysing these aspects: the first are 'the principles of the Structural Funds', and the second 'the process of decision-making in the allocation of resources in the Scottish Executive'. Both cases will be compared to the Chilean experience with regard to the FNDR.

## 6.1 The principles of the Structural Funds

The principles of the Structural Funds (Programming, Partnership, Additionality and Management, monitoring and evaluation) can be understood as ‘the operational objectives’ of the funds, as they contribute to the achievement of the specific objectives and to the overall aim of the funds. In their role as ‘operational objectives’ they favour a clear and easier management of the funds by providing the necessary guidance to all interested parties. They also ensure wider participation and actually increase the availability of resources by requesting third parties financial participation. Finally, the ‘operational objectives’ also ensure the necessary feedback of the overall management of the funds by permanently monitoring and evaluating the running out and the outcome of the funds.

As it will be argued in this section, these ‘operational objectives’ contribute a great deal to the overall objective of regional development by, amongst other things, leveraging investment and building institutional and social capacity within regions.

What follows is a brief presentation of the four Principles of the Structural Funds<sup>68</sup>. The presentation concentrates on the main features of each principle and discusses to what extent these principles are found in the operation of the FNDR fund of Chile. Since ‘evaluation’ constitutes an important part for the self-improvement of the funds and because this is a very weak component in the case of the regional fund of Chile, the ERDF experience on evaluation (within Management, monitoring and evaluation) will be more extensively presented.

### **Programming**

Programming involves the preparation of multiannual development plans. The plans are undertaken through a partnership-based decision-making process, in several stages, until the measures are taken over by the public or private bodies entrusted with carrying them out. For the 2000-2006 period the programming period covers seven years for all the objectives, with mid-term adjustments. The development plans are based on national and regional priorities and include:

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<sup>68</sup> A more detailed presentation of the Principles of the Structural Funds was done in Chapter 6 above.

- A description of the current situation in the regions (disparities, lags, development potential),
- A description of the most appropriate strategy for achieving the stated objectives, and
- Indication as to the use and form of the contribution from the funds,
- An account of arrangements made to consult partners.

By doing it this way EU Structural Funds are used to pursue a properly thought-out strategy for regional economic development rather than to support an ad-hoc selection of individual projects (Williams, 1996).

Formally, 'Programming' does not exist in the case of the FNDR. Every year regions submit to the Ministry of Finance the list of individual projects they want to carry out in the following year. After the approval of this list, this office authorises the budget corresponding to the FNDR. This presentation is not accompanied by a development plan and the decision on the approval of projects is based almost exclusively upon the technical assessment and eligibility of the projects as established in the loan from the IDB, and the National Ministry of Planning (MIDEPLAN). Only recently, and for specific sectors such as Education and Health, programming is required to accompany the presentation of the individual projects.

## **Partnership**

This principle implies the closest possible co-operation between the Commission and the appropriate authorities at national, regional or local level in each Member State from the preparatory stage to implementation of the measures. Apart from the input from national, regional or local partners, at all programming stages, the 2000-2006 Regulations extended partnership to the regional and local authorities, the economic and social partners and other competent bodies and by involving the partners at all stages from the approval of the development plan.

Nothing formally established exist in this matter in the case of the FNDR. Each region in Chile has developed its own way of preparing the investment programme of each year. In some cases, this includes the participation of local and provincial authorities as well as representatives of the involved sectors (Education, Health, etc). This form of co-operation between the Regional Government and these local and provincial and regional instances has been, however, criticised by these partners because this attempt for partnership do not always constitutes a real space for participation.

### **Additionality**

This principle requires Community assistance to be additional to the contributions of the Member State and not to replace them. For each objective the Member State must maintain their public expenditure at least at the level it was at in the preceding period. Between 2000 and 2006, the geographic level at which additionality is checked has been simplified (in the case of Objective 1 the totality of eligible regions, and for Objective 2 and 3 combined the entire country). The Member States have to supply the necessary information to the Commission upon adoption of the programmes, halfway through them and at their end.

As the FNDR action is based on a sectoral project-by-project approach, the chance of having an unexpected relevant outcome is lower that if fund were used in a more comprehensive manner. Other actions that may be associated to the use of investment funds could stimulate regional development, beyond that of the single benefice of counting with a specific infrastructure project. The assumption behind this argument is that, indeed, a regional fund can provide more for regional development than the mere results if its physical results.

There are two occasions where the principle of additionality is formally applied in the case of the FNDR:

- a) In the projects of Rural Domestic Electricity. Electricity projects consist of the construction of grid or the expansion of existing ones to supply low-income rural communities with electric energy. These projects also consider the installation of electric power generation and distribution of energy for isolated communities. Electricity projects are financed by three parties, to know: the FNDR, the Electricity Companies and the Interested Local Communities. As a result:
- 1) funds for regional development multiply,
  - 2) public and private sector come together after a common interest and objectives,
  - 3) Communities have learnt to organised themselves to face common problems. Experience that have permit them to succeed when developing and implementing other community projects.

No other sector of the FNDR is handled in this way. On the contrary, FNDR fund finances single isolated sectoral projects where no other major value added is generated because of its action. Here, apart from the resources from the Regional Government (the FNDR) the project has to include input from the electrical company that will operate the lines, and the people who will be benefited with the projects (more or less in a 70-20-10 proportion respectively)<sup>69</sup>.

- b) In the “Convenios de Programación” (Programming documents). The Convenios de Programación are programming documents between a Regional Government and one or more ministries for the financing of a project or group of projects that for the magnitude of its investment require the co-financing of more than one party. These type of actions have permitted to accomplish tasks that otherwise would have been impossible to pursue by a single fund or party. These multiparty

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<sup>69</sup> The electrical projects have been one of the greatest successes of the FNDR, bringing down the deficit of rural household electricity supply from around a 50% to less than a 25% in rural areas in ten years, from 1990 to the year 2000.

actions have, at the same time, stimulated co-operation and co-ordination amongst sectors and Regional Governments. Nevertheless, no private co-financing is contemplated in this case yet.

Apart from these two examples of additionality, which are the only formally defined to operate that way, there are a number of other cases where FNDR projects receive co-financing by the beneficiary institution (normally the municipalities). This may occur because not enough funds were allocated to that particular municipality that year, or because an increase in the costs of the works occurred during its execution. This procedure has however not been formally established, and only few cases occur every year.

### **Management, monitoring and evaluation**

Under the 2000-2006 Structural Funds Regulations, the Member State for each programme appoints a managing authority. The tasks of these bodies cover the implementation, correct management and effectiveness of the programme (the collection of statistical and financial data, the preparation and transmission to the Commission of annual reports, the organisation of the mid-term evaluation, etc).

Monitoring Committees have also been established. These Committees, chaired by a representative of the managing authority, ensure the efficiency and quality of the implementation of the structural measures. The Committees are the responsibility of the Member States.

Evaluation is carried out at three levels: the ex-ante evaluation is the responsibility of the competent authorities in the Member States; the mid-term evaluation must be carried out by the authority managing the programme in collaboration with the Commission, and; lastly, the ex-post evaluation is the responsibility of the European Commission, in collaboration with the Member State and the managing authority. The evaluation reports must be made available to the public.

Although some of the tasks described in this principle are carried out by the different public offices that manage the FNDR they do not exist formally as a co-ordinated aim to improved the efficiency of the fund. The ex-post evaluations of the FNDR, carried out at the end of the programming period, especially the most recent one carried out in 1997 for the 1990-1994 programming period, have provided valuable information on some critic aspects of the administration of the fund and of its effectiveness. Evaluations of this nature are pioneers studies in Chile that, according to SUBDERE (1997), still lack of sufficient recognition among the interested parties.

For this kind of studies to develop and further contribute in the improvement of the overall process of investment of the FNDR the first thing to do is to actually include them as an integral part of the process. The attention, in the case of the FNDR, has been largely placed on the financial aspects of the process. Effectiveness of the FNDR has been understood as the percentage of expenditure in relation to annual commitment. This has meant a lack of attention on other aspects such as the physical outputs or the actual impact of the fund on regional development.

#### Evaluation activities in the ERDF

For the programming period 2000-2006, the Commission has prepared three guides to support evaluation activities (European Commission, 1999):

- The ex-ante evaluation of the Structural Funds interventions. The ex-ante evaluation is intended to provide assessments and recommendations on a policy or programme by expert, independently of the planners.
- Indicators for monitoring and evaluation. Under these indications, monitoring will not be purely financial, as it used to be. Existing monitoring, control and evaluation procedures are to be developed and improved.
- Implementation of the performance reserve. Performance is to be assessed on a limited number of monitoring indicators reflecting effectiveness, management and financial implementation.

Table 7.7: Criteria and indicators for the evaluation of the Performance of the ERDF

Criteria	Description	
1 Physical outputs 2 Results	<ul style="list-style-type: none"> <li>• Comparison of actual and planned values for a group of measures (covering at least half of the value of the programme)</li> <li>• Comparison of actual and planned results for employment (temporary/permanent jobs created or maintained) or employability of target groups</li> </ul>	Effectiveness Criteria
3 Quality of monitoring system 4 Quality of financial control 5 Quality of project selection 6 Quality of evaluation system	<ul style="list-style-type: none"> <li>• Percentage share of the programme measure (in terms of value) covered by annual financial and monitoring data compared with target</li> <li>• Percentage of expenditure covered by annual financial and management audits compared with target</li> <li>• Percentage of commitments on projects selected using clearly identified selection criteria or appraised through cost-benefits analysis compared with target</li> <li>• Availability of independent intermediate evaluation of acceptable quality (predetermined quality standards)</li> </ul>	Management Criteria
7 Absorption of Funds 8 Leverage effects	<ul style="list-style-type: none"> <li>• Percentage of expenditure reimbursed or requested receivable in relation to annual commitment (standards: expenditure corresponding to 100% of commitments in first two years)</li> <li>• Percentage of private sector resources actually provided compared with target</li> </ul>	Financial Criteria

Source: European Commission (1999). Annual Evaluation Review.

Two challenges have to face the FNDR with respect to “evaluation”. The first one is to actually carry out more frequent evaluations in one or several of the aspect presented above, i.e. the effectiveness of its action, the efficiency of its management and its financial administration, or other matters that may be of interest for the fund to evaluate. The second one is to become more flexible to incorporate the recommendations proposed as a result of the evaluations. The current every-five-years evaluation has to be complemented with annual studies on more specific aspects that are always arising from the different regional government or from other involved actors in the process.

In conclusion, and as a result of the comparison between the activities carried out by ERDF under the name of “principles of the Structural Funds” or the “operational objectives of the Structural Funds”, the only operational objectives formally in operation in the case of the FNDR fund is that of Additionality and, into a lesser extent, that of Evaluation (of Management, monitoring and evaluation). In the first case two

cases were encountered, the Rural Domestic Electricity projects and the Programming documents, and in the second the evaluation of the FNDR commissioned by SUBDERE every five years.

Table 7.8 below summarises the existence of these actions in both funds. These and other actions can be implemented to make the most of regional funds. Other mechanisms, that will come from the particular experience of different countries, can also be used to contribute to regional development. In the case of the Structural Funds these have used to incorporate the private sector, to build social and institutional capacity, and to learn from the experience.

Table 7.8: Further actions for Regional Development. The Principles/Operational Objectives of the Structural Fund and their counterpart in the Chilean experience.

FNDR (Chile)	ERDF (European Union)	
<ul style="list-style-type: none"> <li>• Additionality: Electricity projects and the programming documents.</li> <li>• Evaluation (every five years). Financial control (more frequent)</li> </ul>	<ul style="list-style-type: none"> <li>• Programming</li> <li>• Partnership</li> <li>• Additionality</li> <li>• Management, monitoring and evaluation</li> </ul>	Operational Objectives

## 6.2 The process of decision-making in the allocation of funds

The way funds are allocated to specific objectives, territorial units, and particular projects is of special importance for the entire process of public investment to function and to attract all the support of interested parties and the public in general. Apart from the theoretical and methodological aspect involved, it is very important also to take care of formal aspects such as the procedures, the participation of interested parties, and the transparency and clarity of the process.

The procedures for financial management set up for the Structural Funds provide a detailed framework to look at. Another example at this respect is the financial framework for the Scottish Executive and the Scottish Parliament.

The Scottish Executive was established in 1999, following the first elections to the Scottish Parliament. The same year the government introduced a Public Finance and Accountability, setting out the financial framework for the Scottish Parliament. This framework was based on the recommendations from the Financial Issues Advisory Group (FIAG) report.

In order to meet the requirements of providing opportunities for the Parliament to comment on expenditures priorities and to influence the Executive's preparation of Budgets, as well as to provide the opportunity for the public to participate in the process, a three-stage framework was proposed.

This three-stage framework summarises the entire process of decision making in its structure and timing. What follows, it is a comparison between this three-stage framework with that utilised in the approval of the regional budget by the Regional Governments in Chile. A two-column, similar to that of previous comparisons, have been utilised in order to facilitate the reading of the main differences and similarities that exists in the two processes.

*See two-column comparison in next page*

## Three-stage Framework of the Process of Investment Decision Making

### SCOTTISH CASE

#### Stage 1: Strategy and Priorities Discussion

*Date: April - August*

The process should begin when the previous year's process is concluded in March or April. In this first part of the stage the discussion should be about future strategy and priorities, based on the forward plans for years two and three. It should include public input through subject committees. Local authorities and public spending bodies should have the opportunity to comment as part of this process.

The Executive should publish and Annual Report by 20 April each year, setting out the final proposals for the year immediately ahead, and the provisional plans for the two following years. The Report should include policy objectives and some assessment of performance against past objectives.

#### Stage 2: Preliminary Draft Budget

*Date: Mid September - End December*

This stage begins in mid-September with the publication, by the Executive, of a Preliminary Draft Budget for the year ahead. It is more detailed than the earlier plans, but still provisional due to, a) The Cabinet in London may take decisions which will affect the total budget, b) some demand-determined programme projections may change or some unforeseen pressures may appear (opportunities for saving), c) Government in London may decide to change tax rates in ways which would influence the Scottish Parliament's decision on its own tax varying power.

### CHILEAN CASE

#### Strategy and Priorities Discussion

*Date: March - May*

Even though general deadlines have to be followed by the Regional Governments in Chile, the process itself differs from one Regional Government to another. The process begins with the Executive and Assembly discussion on strategies and priorities for the following year. According to this, local authorities (Municipalities) and public spending bodies (Education, Health, Public Works, etc) seeking funding for the following year present their investments proposal (projects) to the Executive's technical office. In this stage they also participate in the process of decision making by telling the Regional Government their own priorities.

#### Preliminary Draft budget and discussion of Strategies and Priorities

*Date: End June – End July*

At the end of June the Executive presents a draft proposal to the Regional Assembly. The Assembly has, by law, one month to analyse the proposal and give it back to the Executive suggesting any change they consider it should be made to the final proposal. The size of the budget under consideration is an estimated figure based the last budget amount plus an estimated twenty percent. The exact available amount if given by the Central Government at the end of December each year.

### Stage 3: Final Proposal

*Date: Mid January, Mid February.*

The Executive publishes, by 20 January, a complete set of Budget Proposal. The proposal should include how it has responded to the Parliament's earlier reports and the latest development in London. A debate is held on the proposal. During this stage, committees should be able to seek clarification from officials. They should not however be able to vote on individual budget proposal made by the Executive. No more than 30 days after the proposal have been tabled, the Parliament votes on the Executive's proposal for use of the tax raising or diminution power (if there is any proposals to exercise this power). If the Executive's proposal prevail, the Parliament then vote immediately on whether to accept or reject the Executive's proposal for the expenditure budget (mid February).

### Final Proposal

*Date: Mid August – End December*

By mid July the Executive presents the final budget proposal to the Regional Assembly. As mentioned, the Assembly has one month to approve or reject the Executive's proposal. At this stage what it usually takes place is an agreement on the final proposal in such a way that the members of the Assembly are allowed to make minor changes on the Executive proposal. The experience of the last 4 years exercise is that the Regional Assembly changes the Executive's proposal in about 25% to 30%. It is the Executive duty to try to avoid changes that will pose technical problems on the carry out of the budget.

Once accepted, the proposal is presented to the Executive approval at the National Level, in September each year.

Conclusions on the three-stage framework comparison:

There exist several differences between the process of investment in Chile and in Scotland, however a similar framework underlies both processes. The main differences and similarities are presented below.

- a) For the case of Chile, the process is not formally divided in stages, even though a similar procedure, as the one followed by the Scottish Parliament, is used.
- b) To approve the annual budget the Executive and Regional Assemblies follow the general indications stated in LOCGAR. No specific or more detailed procedures exist in the case of the FNDR.
- c) The main difference with the Scottish Parliament's procedure of budget allocation with that of the Chilean Regional Governments is that after the approval of the regional budget (by the Executive and Assembly in the regions), the final proposal goes to the approval of the Executive at the National Level. From the Executive, the proposal goes to the approval of the National Parliament. At this stage, the National Parliament rather than looking at individual projects or lines of actions, focuses its attention in the amount of resources that the proposal involves.
- d) The time allotted for the first stage is considerably less in Chile than the one that exist for the Scottish Parliament. Beside, no Annual Report is presented by the Executive to initiate the discussion.

In the case of the FNDR, instead of focusing the discussion between the Assembly and the Executive on policies, strategies and priorities, the fact that the members of the Assembly represent particular district within regions and because final decision is usually delayed due to the final adjusting changes that have to be done to approve the budget, discussion tends to concentrate on individual projects.

## 7 Summary and conclusions

This chapter has summarised the five main features that define the existence and functioning of the Regional Development Fund of Chile (FNDR), and that in the previous chapter were identified as the main weaknesses of the fund. Prior to the presentation of the five aspects (the concept of the fund, the specific objectives, the method of allocation, the type of action and sector of investment and the existence of further actions for regional development) this chapter has also includes a general presentation of the fund.

The chapter also presented the way these five features revealed in the case of the European Regional Development Fund of the European Union (ERDF). In order to compare how these elements manifest in each fund a two-column table was introduced that permitted to put the characteristic features of the FNDR in front of their counterpart in the ERDF.

The main results of this comparison are summarised below:

- a) Under the ‘main features of both funds’ the principal difference between the two was the tendency of the FNDR to do the same kind of things and in the same way during almost all its existence, while the ERDF, on the contrary, had experienced five structural transformations that have permitted the fund to adjust to new realities and face new challenges.
- b) The ‘concept/main aim of the funds’ resulted to be quite similar in many ways. Both funds aim to promote regional development and to compensate regions lagging behind. The main differences at this respect lies on the emphasis on particular aspects such as on the territory, on poverty and on regional administration, as in the case of the FNDR; and on the economy, and on the environment in the case of the ERDF.

- c) With regard to the ‘specific objectives’, they differ considerably for both funds. The main differences were:
- The few number of objectives in the FNDR against a larger and more specifically designed number of objectives in the case of the ERDF,
  - The low degree of focusing in the FNDR, mainly due to the poorly design of the objectives. All three objectives are very general and almost all kind of action can fall within them. On the contrary the ERDF tend to be much more specific in terms of its specific objectives, but presenting a much larger number of specific objectives.
- d) In the ‘method of distribution of funds’ the discussion centred on the main factors under the distribution of resources. Here the main differences were:
- FNDR funds are allocated to region while the ERDF are allocated to objectives,
  - FNDR resources are allocated in an annual periodicity and used under a projects-by-projects basis, against the multi-annual programme-base approach of the ERDF,
  - FNDR resources are split into a large number of small isolated projects. ERDF assistance goes to interlinked projects that have to be part of a wider programme of investment,
  - The financial management of the FNDR, because of its unchangeable nature (the fund has been doing the same for the last sixteen years), has become an easy task for the regional governments. Almost all funds (over 97%) are committed and carried over during the expected period of execution. On the other hand, 10% of ERDF resources were not committed/carried over during the first two years of operation in the 2000-2006 period.
- e) The ‘type of actions and sectors of investment’ of both funds present significant differences. The most important of these are:
- The overwhelming importance of infrastructure investment in the case of the FNDR against the wide variety of actions carried out by the ERDF,

- The sectoral orientation of the FNDR in just basically seven sectors (Education, Health, etc.) versus the multi-purpose action and the wide range of activities and instruments included in the ERDF.
- f) In ‘further actions for regional development’ this work focused on the principles of the Structural Funds and explored to what extent these principles (understood as the operational objectives of the Structural Funds) were found in the FNDR case. Only “one and a half”, out of four, of these actions were encountered in the Chilean case. The importance of these guiding principles is that, as it was discussed above in this chapter, they contribute to built social capacity and leverage regional development.

In sum, the FNDR has much to do to clarify its own objectives and procedures in order to become a real actor in Chile’s regional development. To do so the FNDR has to be redefined in several aspects that at present restrict the fund possibilities to leverage social and economic development. The final chapter “Conclusions and Consideration for Further Research” presents and discusses on some preliminary elements that should be considered in order to transform the FNDR in a more active player in regional development in Chile.

## Conclusions and considerations for further research

### Introduction

This thesis has analysed the role and performance of the Regional Development Fund of Chile (FNDR), in particular its relationship with the process of regional development. The research focused upon the process of investment and upon overall results of the fund on regional development.

Two different empirical approaches evaluated the action of the FNDR. The first was concerned with the analysis of particular aspects of the fund labelled as the “key elements” in the running of the FNDR. The second presented and compared the experience of a similar fund for regional development. The fund selected to carry out this comparison was the European Regional Development Fund (ERDF).

The empirical analysis addressed five key elements of the administration and actual performance of the FNDR. This analysis unveiled important features about the relationship between the action of the fund and regional development in Chile and about some operational aspects of the fund. It also set out the role the fund may play in regional development in terms of contemporary growth theory and policy making.

The comparison suggested further elements for the analysis of these five key elements and also introduced other aspects to be considered for the improvement of a regional fund. Because of its tremendous magnitude and scope, the ERDF provides an effective comparative example for the FNDR of Chile.

The most significant findings of each chapter are outlined below. Chapters 2, 3, 4 and 6 are presented separately. Because they complement each other, chapters 5 and 7 (the key elements of the FNDR and the comparative analysis) are presented together.

## 1 Summary of results

### *Concluding comments on chapter 2*

Chapter 2 set up the theoretical background for the analysis of regional funds and development. Three aspects were covered in this section: economic growth and regional theory, the process of decentralisation, and the relationship between economic development and infrastructure investment.

From a theoretical point of view, the relationship between regional funds and regional development relates to the role regional funds may play in development as a source of infrastructure capital. According to the 'new growth theory' -which seeks to explain growth through advances in the level of technology, infrastructure and human capital- regional funds may constitute a potential endogenous force for sustained growth.

The process of decentralisation in Chile, of which the creation of the Regional Governments has been the most important step, is expected to have a great impact on the development of regions. As a complement, regional funds, the main policy instrument at Regional Governments' disposal, have been increasing over the last decade. The overall effects of these funds on regional development in Chile, however, remain unstudied.

So far, infrastructure investment has been the most common mode of investment of the funds studied. As it was argued, infrastructure investment plays an important role in regional economies by providing the basis for the development of most, if not all, economic activities. However, whether it contributes to economic growth in the long run is still a matter of considerable debate. Nevertheless, what is clear, nowadays, is that the potential returns to investment in infrastructure is higher in developing countries than in developed countries.

### *Concluding comments on Chapter 3*

Chapter 3 dealt with the regional development experience of Chile. This section reviewed the historical context under the countries' development as well as the evolution of its administrative organisation. These features were used to explain the

country's present state of development, which together with the use of recent data on economic and social indicators permitted us to introduce the present regional disparities in Chile. The opinions expressed by selected key informers in the interviews carried out for this purpose highlighted the importance of the FNDR on the process of decentralisation. It is normally said that decentralisation has helped the FNDR to increasingly become a regions' fund, however some pointed to the fact that the very existence of a fund such as the FNDR reinforced the need for decentralisation. More than a question of what was first, the importance of this assertion is that without the FNDR the process of decentralisation would have been empty.

Nevertheless, although the action of the FNDR and decentralisation in Chile have certainly played an important role in increasing opportunities for regions, especially in the areas of public administration and the management of investment resources, and to a lesser extent in the election of local and regional authorities, the structural problems caused by the traditional highly centralised administrative system seem to persist.

It was demonstrated that the economic model pursued by Chile in recent years had differential impact on regions. Economic development has clearly been concentrated in Santiago. The incapacity of regions to appropriate their share in the benefit of economic growth, or of the centre to redistribute wealth, is something that needs to be addressed to the light of the process of decentralisation in Chile if the model is to be sustainable in the long run.

Redistribution of power, although considered in the Agenda for Decentralisation of the present government, is said to be something that has not yet been achieved in Chile. Nevertheless, the administrative institutional structure that resulted from the creation of regional governments embodies significant advances compared to past decades. The wide range of objectives and tasks assigned to the Regional Governments embrace a much more comprehensive approach to development compared to previous experiences. It was argued that this new approach incorporated the social, cultural and economic dimensions as three inter-linked objectives for regional development.

The maturity exhibited by the economic model adopted more than two decades ago in the country, the experience gained after two decades of an increasing process of

decentralisation, plus the creation of Regional Governments, provide new foundations to drive national and regional development at the beginning of the new century.

*Concluding comments on Chapter 4*

By reviewing several aspects of the functioning of the FNDR plus a discussion on the results of evaluations carried out on the FNDR by three recent studies, chapter 4 highlighted several problems associated with the fund functioning. The main conclusions of this work were analysed together with the results of a questionnaire applied to key relevant political actors of the transition period in Chile.

The problems identified had to do with the way funds were being allocated, with some technical and operational inconsistencies among the specific objectives and with respect to the relationship between the fund and the overall objective of regional development and its changes over time. With particular emphasis in the transition period from the military regime to the democratic governments.

Among the first group, the most relevant observations related to the redundant use of variables and indicators for the distribution of resources and with the reduction of the flexibility of the fund due the creation of the 'provisions'. Other problems had to do with the lack of well defined procedures for the process of decision-making in the allocation of funds, and the insufficient amount of information passed to other relevant actors and the public in general.

With respect to the second group of observations (those related to impact of the fund on regional development), the most significant aspects were the contradiction among the objectives of the fund *-discussed in greater detail in chapter 5-* and the restrictions imposed by the IDB on the type of actions and sectors of investment carried out by the fund since 1985. The incapacity of the fund to adapt to new realities after more than twenty-five years of operation is being strongly sustained by scholars and public officials in recent years.

Many of these problems were also addressed by the interviewees, who introduced an additional element in the analysis. That is the difference that exists among regions in the management of the fund. There is a chance to do things beyond to what has been the

common practice, for example in the use of regional funds, where some regions have utilised this chance with significant results for their own development.

With respect to the three studies about the FNDR presented in this chapter, the main conclusions point to the methodological aspects of them. First, the studies were developed in an empirical-type analysis and did not explore further in the theoretical aspects about the significance of a regional fund in regional development. None of the studies used of a comparative analysis to test the FNDR, which would have permitted to learn from possible differences and similarities.

The field study work assessed changes noted by some of the main *Fondo Nacional de Desarrollo Regional* (FNDR) actors during the transition period (from the end of the 1980' up to the beginning of the 1990'). The purpose of this field work was to find out to what extent these key actors had planned or anticipated something different in the use of FNDR funds compared to what has actually occurred in recent years.

In general, the representatives of the regions were more optimistic than those from the central level about the role of the fund under a democratic government. They felt the FNDR could play a significant role to coordinate the different public offices and sectoral budgets at the regional level. They anticipated the significant role the FNDR would play as the main instrument to attain the regional strategies of development. After 12 years this is a reality in all regions.

One of the main outcomes after a decade of operation of the FNDR under democratic governments is one not anticipated by the interviewees. This is the fact that, despite the many restrictions imposed from the central level (and the IDB) in terms of political and administrative constraints, after ten years of progressive regional experience, regional governments have become major actors in regions development, and the FNDR its major policy instrument.

...Comments on chapter 5 are presented together with those on chapter 7 ahead.

#### *Concluding comments on Chapter 6*

The study of the Structural Funds of the European Union, and in particular of the European Regional Development Fund (ERDF), the subject matter of this chapter,

provided substantial material about different approaches to regional development and policy, about new methods of allocation of resources, administrative and budgetary procedures, and other related matters. Conclusions in this chapter refer only to EU regional policy and the Structural Funds operation. A comparison of the main aspects of this fund with those of the FNDR of Chile is carried out in chapter 7.

The most significant aspects of this fund are summarised below:

- Regional policy is a central preoccupation within the EU. The main instrument to cope with EU regional policy are the Structural Funds, of which the ERDF is the main component.
- Four principles rule the operation of the ERDF: Programming, Partnership, Additionality, and Management, monitoring and evaluation.
- It is interesting to know of the many transformations that the Structural Funds have experienced over the years (against none in the Chilean FNDR).
- Funds investment is carried out in multi annual periods (seven years). In contrast, the FNDR use a year by year procedure.
- An important part of the work is done at the pre-investment stage (during the programming period, before any physical action starts). This facilitates the carrying out of subsequent stages in the process of investment.
- Communication of the action of the Structural Funds is a remarkable feature of the 2000-2006 investment period. This is done at all different stages of the programming period and at different level of authorities.

#### *Concluding comments on Chapters 5 and 7*

Chapter 5 presented an in-depth analysis of five elements that were considered to be fundamental for the existence and operation of the FNDR i.e. the concept or overall objective of the FNDR, its specific objectives, its methods of resource allocation, the type of action and sectors of investment carried out, and finally, a discussion on the potentiality of further actions for regional development. Chapter 7 compared these aspects with those of the ERDF.

The main observation about the concept/overall objective of the FNDR has to do with the changes this fund has experienced over time due mainly to three circumstances: the application of different strategies of development in the country, the co-financing of the fund by the IDB, and most recently the establishment of the 'provisions'. Despite these changes the FNDR continues to finance almost the same kind of projects, the same sectors, and in the same way as originally conceived. Comparatively, the ERDF, with almost the same age as that of the FNDR, has experienced five structural reforms incorporating new sectors, and over all, new financial instruments and sectors of investment.

Since the FNDR operates only with three objectives, compared to six of the ERDF, one might anticipate more concentration and focusing in the Chilean case. That is not the case because the vagueness in the definition of objectives, among other things, gives as a result a wide dispersion of actions in terms of the sectors and the territories it covers. For that reason, monitoring and evaluation of the performance of the fund is a very difficult task.

With respect to the method of allocation of funds the main problem detected was the lack of correspondence between the objectives stated and the variables and indicators used for such distribution. For that reason, the resulting allocation of resources has little to do with the actual differences among regions in terms of their social and economic indicators. Thus, despite the enormous differences in population or population living under the level of poverty in the regions of Chile, among others considerations, peripheral, less populated regions receive almost the same absolute amounts of resources that those of Central Chile that present most severe problems.

Other significant methodological difference can be appreciated between the two funds in terms of the overall distribution of resources. FNDR funds are allocated on an annual basis and in a project-by-project scheme. ERDF resources, on the other hand, are allocated at the beginning of a programming period for the whole of the programme (seven years in the present phase) and resources are used in a programme-based approach. In the case of the Chilean FNDR, this strategy seriously limits the possibility of the funds to be used in conjunction with other public or private investment funds or programmes. The year by year approach has made the FNDR to become a sectoral offer

of resources for small, low-impact infrastructure projects for each of the, for example, 52 local administrations in the Biobío Region.

With regard to the type of action, infrastructure investment represents over 90% of the total FNDR investment. The type of infrastructure financed by the FNDR is not intended to stimulate productive investment or competitiveness, but the answer to the objective of 'equal opportunities', in this case by providing access to basic services on education, health, and few other basic needs. This procedure is a direct consequence of the agreement with the IDB for the FNDR-Programmes. Although the IDB represented only 15% in the FNDR-Programme of 1995-1999 (and 40% in the 2000-2005 period), the fund has overwhelmingly being used (over 80% in 1997) to finance IDB eligible sectors.

In the case of the ERDF, infrastructure is also the main type of investment, but a significant number of other actions are also carried out. The diverse nature of the ERDF financial assistance includes research and technology, non-repayable and repayable direct aid and grants to assist local development initiatives, etc. The FNDR is far from implementing such measures, however much could be done in terms of the sectors/areas of investment that could be incorporated (jobs creation, industrial areas, small and medium-sized enterprises, to mention just some).

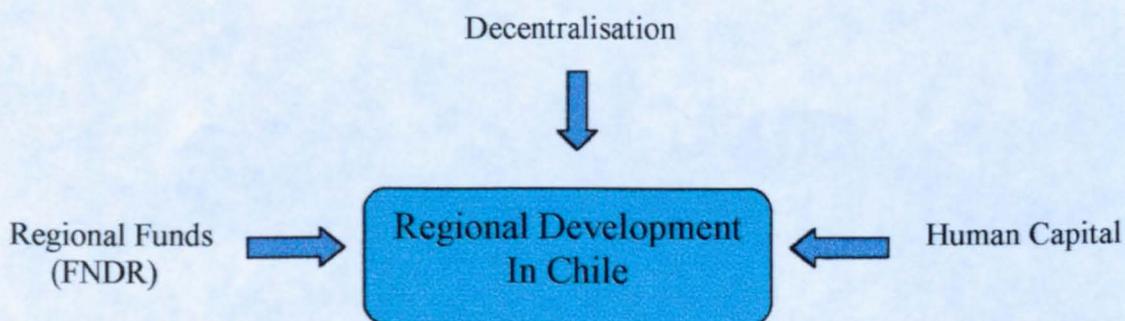
In the opinion of several public officials and scholars (reflected both in the literature and interviews carried out in Chile), this has been the responsibility of the own regional governments that have been unable to go beyond the formal administrative limits to explore new possibilities of development of the existing funds. A remarkable example of a region which has trespassed these limits is that of the Region of O'Higgins (Region VI). In fact, O'Higgins was able, and brave enough, to direct a significant share of its FNDR of one year to finance the construction of a road that connected the region's fruit plantation to a main export port. This project had a significant impact on the development of the whole region as fruit exports was one of the main economic activities of the regions and several other sectors were directed linked to this activities.

With regard to "further actions for regional development", the excessive concentration of the FNDR on infrastructure measures clearly undermines the fund potentialities to

stimulate development. At this respect, the FNDR has much to learn from other experiences. The two-column comparison between the FNDR and the ERDF presented in Chapter 7 evidenced several weaknesses of the Chilean fund in terms of its limited range of activities and possibilities of intervening in regional development. The main weakness is precisely that, the FNDR resources being used mainly in infrastructure projects in a few number of sectors.

However, recognising the many limitations of the FNDR, there is no doubt that the most significant product of the fund has been the build up of a vast human capital in all regions of the country. These groups of skilled people made up of politicians, social leaders and professionals that have grown together with the development of the fund, constitute the fund's main legacy for the development of regions.

#### Main Elements for Regional Development in Chile



In favour:

- Decentralisation: A process that since the 1990s has been carried out with increasingly force in Chile (More autonomy in administration of public investment, Creation of Regional Governments).
- Regional Funds: Particularly de FNDR, but also other regional funds managed in conjunction with the FNDR that have increased as a proportion of all public investments in regions.
- Human Capital: Principally associated to the experience gained in the management of FNDR funds, but also from the closed association between Regional Governments and regional universities.

Against:

- The legacy of a very centralised system that comes from the colonial period, in which Santiago has always concentrated, and continues to do so, the political and economical power.
- The attitude of regions that fear to act independently of the central government (although they could do so) to make full use of what they have at their disposal.

With the endowment of a highly specialised human capital, together with an increasing number of responsibilities, political power and resources to administer, regions can challenge the power of Santiago and start to play a more significant role in the social and economic development of their territories.

## 2 Considerations for further research and concluding remarks

Theoretical aspects and empirical evidence on the role regional economies may play on the overall performance of national economies provide a vast area of study that is worth exploring. Two paths of study suggested here are the ‘economic growth theories’, to explain how growth occurs and how it spreads throughout space, and ‘the relationship between public intervention (policies and investment) and regional economic growth and development’, to see how growth and development actually occurs in space. These two particular issues (among many others) should be further investigated as they provide key element for the understanding of regional development.

With respect to the main subject of this work, and in a practical approach, Table 8.1 below proposes a simple model for the use of regional funds in Chile. The model was constructed bearing in mind the main well/working aspects of the two funds analysed and the main not-to-repeat problems encountered in the analysis of the two funds and the evidence provided by the other experiences reviewed in the operation of regional funds, particularly in the case of the regional development fund of Chile.

It has to be said that it is very important to have a regional fund that function efficiently in Chile. This come from the fact that both, the process of decentralisation the country is undergoing, and the increasing regional governments participation (not only in the provision of social basic infrastructure but also in productive investment and the strengthening of regional administrations) will require effective policy tools, like the FNDR, for regional development in the next years.

The model proposed begins with the identification of a clearly established main purposes and objectives for the fund. Different specific objectives are suggested for each of the fund's main purposes, as well as the allocation criteria to be used in each case and the type of action and sector of investment it could be carried out. Several principles underpin the work of all three main purposes. The main point here is that, whatever the main purpose(s) of a fund, there must exist clearly differentiated objectives associated to them, allocation criteria able to discriminate according to the specific objectives, and suitable actions and sectors of investment to accomplish the ultimate objectives for which the fund has been created.

Table 8.1, below, introduces the “principles” that set up the general rules for the operation of the fund. It then sets the overall purpose or main objectives. In front of every main objective it proposes several specific objectives that intent to clearly identify the fund` scope. Following, for each set of specific objectives it suggests the allocation criteria that have to be consistent with the objectives to attain. And, finally, it identifies the type of action and sectors of investment to be accomplish.

A particular fund can pursue more than one main objective (or overall purpose), such as the ones presented below, or others according to the particular needs of a country and the historical context of its regional development. Nevertheless, different objectives have to be addressed with different type of allocation variables that have to be reviewed from time to time to make sure they still discriminate in favour of the consecution of the objectives.

Table 8.1: Alternatives for regional funds in Chile

Principles	Overall Purpose	Specific objectives	Allocation criteria	Type of action and Sectors of investment
<ul style="list-style-type: none"> <li>* Decentralisation and simplification</li> <li>* Greater concentration of assistance</li> <li>* Protection and improvement of the environment</li> <li>* Management (programming, monitoring, evaluation) and budgetary efficiency</li> <li>* Additionality (public-private financial co-operation)</li> </ul>	1) Tackle Poverty	<ul style="list-style-type: none"> <li>*Provide training</li> <li>*Employment creation</li> <li>*Small and medium-sized enterprises</li> <li>*Social regeneration of urban neighbourhoods</li> <li>*Rural areas</li> <li>*Equal opportunities (access to services)</li> </ul>	<ul style="list-style-type: none"> <li>*Number of poor people (total, urban and rural)</li> <li>*Vital statistics and of health and education</li> <li>*Availability of basic social services</li> </ul>	<ul style="list-style-type: none"> <li>*Type of actions to be defined by programming period (4 or 5 years). For example: Productive investment; Infrastructure investment; studies; Technical assistance; Research, technology and innovation; Programmes, others.</li> </ul>
	2) Regional Economic Development	<ul style="list-style-type: none"> <li>*Increase competitiveness</li> <li>*Strengthening partnership</li> <li>*Sustainable jobs</li> <li>*Support Industrial areas</li> <li>*Assist Rural areas and those depending on fishing</li> </ul>	<ul style="list-style-type: none"> <li>*Economic and social indicators</li> <li>*Territorial indicators (not all regions may be selected for assistance)</li> </ul>	<ul style="list-style-type: none"> <li>*Type of sectors: Any for which MIDEPLAN<sup>(a)</sup> has methodologies for the preparation and evaluation of projects</li> </ul>
	3) Institutional development of Regional Governments	<ul style="list-style-type: none"> <li>*Regional Executive</li> <li>*Other regional offices</li> <li>*Municipal level (Management and co-ordination, procedures and human resources)</li> </ul>	<ul style="list-style-type: none"> <li>*All regions according to their needs</li> </ul>	

<sup>(a)</sup> The Ministry of Planning in charge of the National System of Public Investment in Chile (SNI)

The alternatives proposed above for the regional funds of Chile do not differ greatly from what it is actually being carried on, except for the second main objective *Regional Economic Development*. In fact, although productive investment was included in the operation of FNDR funds since 1998 (see chapter 5) the sector continues to be marginal in the total FNDR.

Thus, the most innovative elements in this proposal are the main purpose of *Regional Economic Development* and the *specific objectives* associated to it. Among all possible alternatives for economic development, such as those existing in the European Regional Development Fund (ERDF), or the regional funds in Spain, the ones presented here are the most pertinent to Chilean reality.

As the amount of investment funds for economic development are increasing in the regional level the discussion on what to do with them will soon occupy a relevant place among politicians and public officials. With regard to FNDR funds, however, as the new programming period has already been set up by the Chilean Government and the

Inter American Development Bank<sup>70</sup> the intervention in productive investment will have to be postponed to the new programming period, after 2005. This proposal specifically points in that direction and tries to stimulate an anticipated debate on the subject. Further studies that take into account the reality of each region will have to be carried out to the light of the regions own strategy of development and the economic model followed by the country.

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<sup>70</sup> Despite the recognised need for intervention in this area, productive investment does not occupied a relevant position in the new programming period 2001-2005 (see Appendix 4) compared to other type of actions such as social infrastructure, that continues to be the main object of the FNDR.

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# APPENDICES

# Appendix 1

## Acronyms and Abbreviations

CONARA	National Commission for Administrative Reform / Comisión Nacional de la Reforma Administrativa (Chile)
CORBIOBIO	Corporation for the Regionalisation of Biobío Region / Corporación para la Regionalización del Biobío (Chile)
CORCHILE	Corporation for the Regionalisation of Chile / Corporación para la Regionalización de Chile
CR	Community Regulation (EU)
CSF	Community Support Framework (EU)
DGs	Any one of the 26 Directorates Generals of the European Commission (EU)
DIPRES	Budgetary Office / Dirección de Presupuesto (of the Ministry of Finance, Chile)
EAGGF	European Agricultural Guidance and Guarantee Fund (EU)
EC	European Commission (EU)
ECLAC/CEPAL	Economic Commission for Latin America and the Caribbean (UN) / Comisión Económica para América Latina y el Caribe (NU)
ECSC	European Coal and Steel Community
EIB	European Investment Bank
EMU	European Monetary Union
EQUAL	Transnational co-operation to promote new means of combating all forms of discrimination and inequalities in connection with the labour market (EU)
EU	European Union
EURO	The Currency of the European Union (except in United Kingdom, Denmark and Sweden)
ERDF	European Regional Development Fund (EU)
ESF	European Social Fund (EU)
FCI	Interterritorial Compensation Fund / Fondo de Compensación Interterritorial (Spain)
FCM	Municipal Shared Fund / Fondo Común Municipal (Chile)
FDI	Foreign Direct Investment
FIAG	Financial Issues Advisory Group (Scottish Executive/Parliament)
FIFG	Financial Instrument for Fisheries Guidance (EU)
FNDR	Regional Development Fund / Fondo Nacional de Desarrollo Regional (Chile). FNDR = FNDR Programme
FNDR-IDB	Regional Development Fund - IDB part (Chile)
FNDR-NR	Regional Development Fund - National Resources part (Chile) FNDR-IDB+FNDR-NR = FNDR Programme (or FNDR)
GDP	Gross Domestic Product
GNP	Gross National Product

IDB/BID	Inter-American Development Bank / Banco Interamericano de Desarrollo
IDR	Regionally Allocated Investment / Inversión de Decisión Regional (Chile)
ILPES	Latin American and the Caribbean Institute for Economic and Social Planning / Instituto Latinoamericano y del Caribe de Planificación Económica y Social (ECLAC/UN)
INE	National Statistic Institute / Instituto Nacional de Estadísticas (Chile)
INTERREG	Cross-border, transnational and interregional co-operation intended to encourage the harmonious, balanced and sustainable development of the whole of the Community area (EU)
IRAL	Locally Allocated Regional Investment / Inversión Regional de Decisión Local (Chile)
ISAR	Regionally Allocated Sectoral Investment / Inversión Sectorial de Asignación Regional (Chile)
LEADER	Rural development (EU)
LOGGAR	Law on Regional Government / Ley Orgánica Constitucional de Gobierno y Administración Regional (Chile)
MERCOSUR	Southern Common Market / Mercado Común del Sur
MIDEPLAN	Ministry of Planning and Co-operation / Ministerio de Planificación y Cooperación Nacional (Chile)
NAFTA	North America Free Trade Agreement
NUTS	Nomenclature of Territorial Statistical Units. Established by the Statistic Office of the European Communities in co-operation with the national institutes for statistics (EU)
ODEPLAN	National Planning Office / Oficina de Planificación Nacional (at present MIDEPLAN-Chile)
OECD	Organisation for Economic Co-operation and Development
OP	Operational Programme (EU)
PMB	Neighbourhood Rehabilitation and Improvement Programme / Programa de Mejoramiento de Barrios (Chile)
PMU	Urban Rehabilitation and Public Facilities Programme / Programa de Mejoramiento Urbano y Equipamiento Comunal (Chile)
RGs	Regional Government (s) Chile
RM	Metropolitan Region of Santiago / Region Metropolitana de Santiago (Chile)
RO	Reglamento Operativo (FNDR-IDB Regulation)
RS	Projects assessed and recommended for execution (Chile's national system of public investment-SNI)

SEM	Single European Market
SEREMI	Regional Ministerial Office / Secretaría Regional Ministerial (Chile)
SERPLAC	Regional Planning Office / Secretaría Regional de Planificación y Coordinación (of the Ministry of Planning-Chile)
SMEs	Small and Medium Enterprises
SNI	National System of Investment / Sistema Nacional de Inversiones (Chile)
SPD	Single Programming Document (EU)
SUBDERE	Sub-secretary for Regional Development and Public Administration-Home Office / Subsecretaría de Desarrollo Regional y Administrativo (Ministerio del Interior, Chile)
UA	Universidad Austral de Chile
UCR	Regional Unit Control / Unidad de Control Regional (of IDB/SUBDERE-Chile)
UK	United Kingdom of Great Britain and Northern Ireland
UN	United Nations
URBAN	Economic and social regeneration of cities and of urban neighbourhoods in crisis with a view to promoting a sustainable urban development (EU)
US\$	United States Dollar
VAT	Value Added Tax

APPENDIX 2

# CHILE



**Basic Statistic:**

**Official name:** Republic of Chile. **Capital City:** Santiago. **Population:** 15,050,341 (INE, Census 2002). **Area:** 774,759 sq. kms, **Density:** 51/sq.kms. **Urbanization:** 85.8% (2000 UNDP).

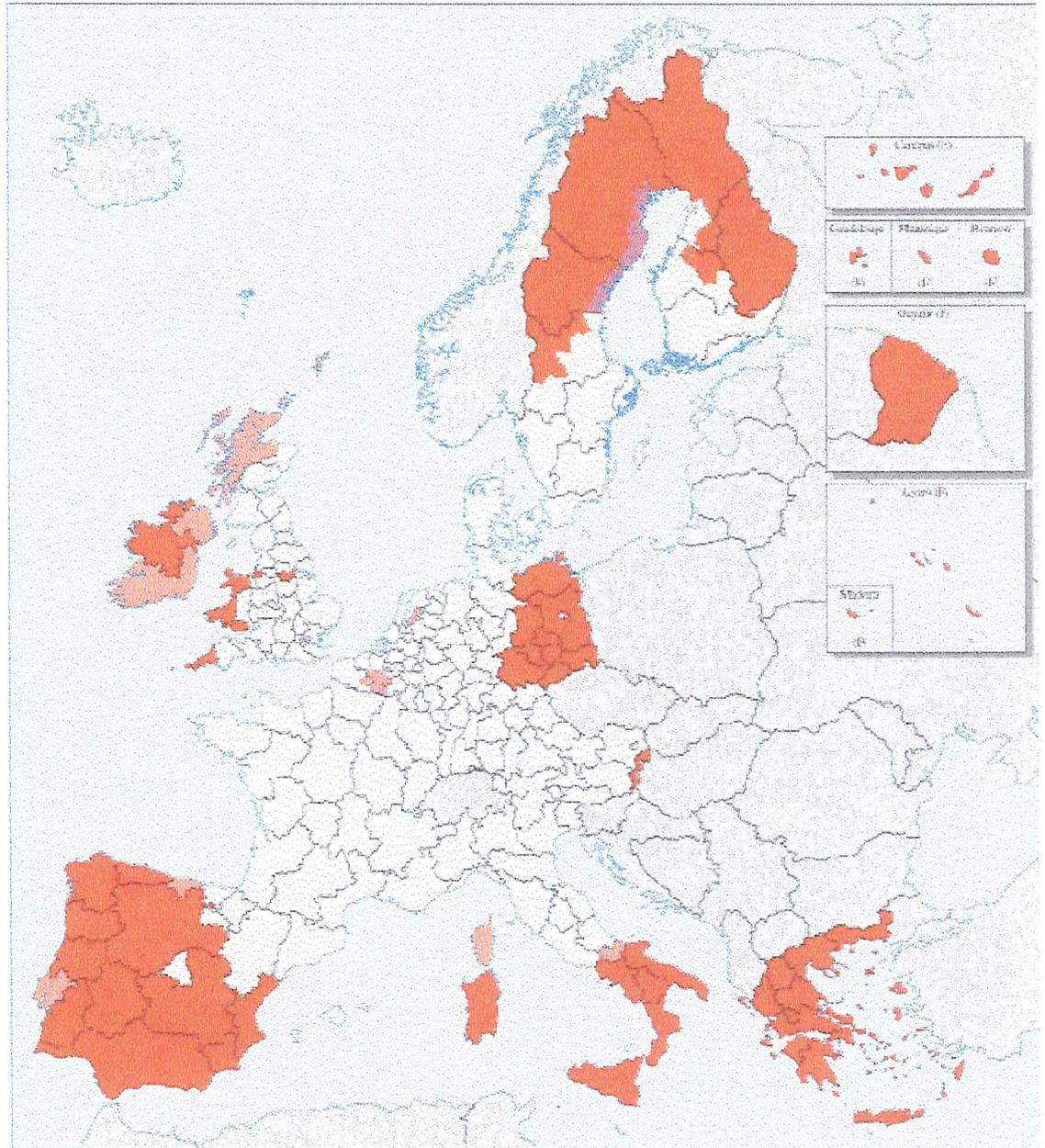
**Language:** Spanish. **Literacy Rate:** 95.8% (2000). **Religion:** Roman Catholic (81%).

**Currency:** 1 Chilean peso (\$) = 100 centavos. **Exchange:** 740 pesos per US dollar (08/2002).

**GDP per capita:** US\$9,420 (ppp, 2001 World Bank). **Poverty:** 2% (% of population below US\$ 1 a day, 2001 World Bank). **Major Exports:** Commodities: copper 41%, other metals and minerals 8.7%, wood products 7.1%, fish and fishmeal 9.8%, fruits 8.4% (1991), Partners: EU 25%, US 15%, Asia 34%, Latin America 20% (1995 est). **Major Imports:** Capital goods 25.2%, spare parts 24.8%, raw materials 15.4%, petroleum 10%, foodstuffs 5.7%, Partners: EU 18%, US 25%, Asia 16%, Latin

# Appendix 3

Map of the regions of the European Union (example of objective regions)



Objective 1 regions



Phasing-out Objective 1



## Appendix 4

### **The New FNDR: Programming period 2001-2005<sup>a</sup>**

(IDB loan CH-0161)

The IDB has co-financed the Regional Development Fund of Chile (FNDR) since 1985 in three consecutive loans. In the year 2001 a new FNDR programming period began which introduced some changes with respect to previous experiences.

As this new FNDR programme was not considered in the analysis of the performance of the fund, neither in the comparison with the selected aspects of the European Regional Development Fund (ERDF), a summary of the main features of this new programming period is presented below.

The general purpose, objectives and areas of investment presented below describe only the IDB part of the FNDR Programme. Nevertheless, as this new IDB loan will also finance investments of the type previously financed with the FNDR National Resources, the IDB terms of reference will apply now to almost any FNDR action in this coming programming period.

#### 1 Main Features of the 2001-2005 FNDR Programme

FNDR 2001-2005										
<p>* Name of Programme: Programme for Improvement of the Efficiency and Management of Regional Investment CH-0161</p> <p>* Appropriation:</p> <table><tr><td>Total:</td><td>500 million US\$, of which,</td></tr><tr><td>IDB:</td><td>300 million US\$</td></tr><tr><td>National Resources:</td><td>200 million US\$</td></tr></table> <p>* The fund is sub-divided into three components:</p> <table><tr><td>Investment (94%)</td></tr><tr><td>Institutional strengthening (5.6%)</td></tr><tr><td>Studies to deepen decentralisation (0.4%)</td></tr></table>	Total:	500 million US\$, of which,	IDB:	300 million US\$	National Resources:	200 million US\$	Investment (94%)	Institutional strengthening (5.6%)	Studies to deepen decentralisation (0.4%)	Main features
Total:	500 million US\$, of which,									
IDB:	300 million US\$									
National Resources:	200 million US\$									
Investment (94%)										
Institutional strengthening (5.6%)										
Studies to deepen decentralisation (0.4%)										

In this new period there will be less resources for investment compared to the previous process because part of the funds will be used for new objectives (Institutional strengthening and Studies for decentralisation).

<sup>a</sup> Summarised from IDB documents: 1) "Program for Improvement of the Efficiency and Management of Regional Investment (CH-0161)" and, 2) "Perfil II. Chile, 12 de Julio de 2000". Retrieved August 2001 from the IDB database on the World Wide Web: <http://www.iadb.org>

The introduction of sub-funds within the FNDR has to be added to the existing provisions of the FNDR. As the total amount of US\$ 500 million is less, in real terms, compared to the same nominal figure of the previous period, this mean less resources and more objectives.

## 2 Main Purpose and Objectives of the Fund

FNDR 2001-2005	
<p>Main objective according to the IDB loan: The general objective of the programme is to support efforts to improve the efficiency and management of regional investment in the framework of an expanded government decentralisation process.</p>	Main Purpose
<ol style="list-style-type: none"> <li>1) Continue channelling investment resources to promote socio-economic development and, especially, improve the living conditions of the lowest-income groups.</li> <li>2) Develop the capacity of regional governments to plan, programme, and allocate investment resources in accordance with the government's social development objectives and regional development priorities.</li> <li>3) Strengthen and rationalise the use of investment financing instruments at the regional government level.</li> <li>4) Improve the efficiency of regional investment, by enhancing the distribution and prioritisation of investments within each region in order to optimise results.</li> <li>5) Improve the quality and targeting of investments, by developing the capacity of municipal governments and technical units within the deconcentrated government system to plan, evaluate, design, and efficiently execute investment projects.</li> <li>6) Support the government in its efforts to deepen its decentralisation policy.</li> </ol>	Specific Objectives

The main objective stated for the current FNDR period addresses mainly the 'Institutional strengthening' component of the fund. In the same way, the specific objectives are mostly oriented to the new tasks of developing the capacity of regional government to carry out their duties and to improve the efficiency and focusing of investment.

Being the objectives defined in these terms, the flexibility of the fund actually increases. From the point of view of the regional governments, as theses objectives refer principally to administrative issues (or to generic intentions in favour of low income groups) they can do whatever they think may be better for the economic and social development of their particular regions.

Poverty targeting: The IDB declares that "As the make-up of the project portfolio under the programme may vary, reflecting demand in the regions, it cannot be ascertained whether more than half of the direct beneficiaries will be poor. For this reason, the programme does not qualify as a poverty-targeted investment" [IDB, 2001(a)].

### 3 Areas of assistance

The three areas of assistance considered in this last programming period, i.e. a) Investment, b) Institutional strengthening; and, c) Studies to deepen decentralisation, refer to the following:

#### a) Investment

According to the IDB requirements, the investments must be consistent with the regional strategic plans and the multi-annual investment plans. The programme will finance all sectors financed by the FNDR, including the following:

- (i) areas that have received financing through prior IDB operations, such as education, health, sanitation, rural roads, urban street paving, rural electrification, rural telephony, flood protection, and infrastructure for fishing coves; and,
- (ii) investments of the type that the FNDR has traditionally financed with its National Resources, such as investments in recreation and sports infrastructure, fire control equipment, and irrigation infrastructure.

Other projects that address emerging issues such as urban renewal, citizen security, and productive development will be supported on an experimental basis during the first two years of the programme. The IDB points out that the results of such projects will then be evaluated in order to determine whether they should be fully incorporated into the FNDR. As these types of intervention are found to be viable, the experience gained and the evaluation methodology used will be shared with the other regions.

A total of US\$ 470 million was allotted to this first component.

#### b) Institutional strengthening

Under this component, financing will be provided for technical assistance, consultancies, and equipment to strengthen the managerial capacity of the regional governments and regional government agencies (de-concentrated ministerial offices, services, municipal administrations, etc.), as well as that of SUBDERE and the Ministry of Planning and Co-operation (MIDEPLAN) at the central government level.

At both levels of government (national and regional), the aim is to achieve greater efficiency in regional investment through better co-ordination of available sources of funding and by financing investments that are consistent with regional development plans and strategies.

A total of US\$ 28 million was allotted to this component.

### c) Studies to deepen decentralisation

Financing will be provided for studies and advisory services to support implementation of the government's decentralisation strategy in the short and medium terms. The studies will focus on the following four areas:

- (i) political decentralisation and citizen participation to enhance local and regional democracy;
- (ii) administrative decentralisation and de-concentration to configure the distribution of responsibilities among the various levels of government;
- (iii) financial decentralisation to consolidate a more autonomous and equitable financing system; and,
- (iv) land-use management to create the necessary conditions for regional and local development with a national perspective that will reduce geographic inequities and address the specific problems faced by both urban areas and remote communities.

The studies will be conducted during the first three years of the program and will include outreach and public information activities (stakeholders in the political and academic spheres and civil society organisations) through forums, seminars and workshops.

A total of US\$ 2 million<sup>b</sup> was allotted to this last component.

The main changes of the new programme are the introduction of new sectors of investment, the financing of sectors traditionally financed with FNDR-National Resources and the emphasis in institutional strengthening.

The IDB assessed negatively the achievement of the objective of Institutional strengthening of the previous period [IDB 2001(a)]. According to the IDB, this is mainly due to the Ministry of Finance's decision on reducing the amounts of resources (that corresponded to the National counterpart of the programme) that had been allocated to this purpose. The new programme aim to ensure that this does not happen again. For this reason, the new actions will not be limited to training, but will also include the development and use of instruments and mechanisms to enhance planning, programming, and prioritisation of the regional investment portfolio.

In pursuing this objective, Institutional Strengthening Units will be established, as well as indicators that will permit to evaluate and monitor the activities carried out under this component. The creation of these units, and a presentation by the regions of an 'institutional strengthening programme' is a pre-condition for the disbursement of the IDB resources.

IDB also argues that in order to deepen the decentralisation process and increase the transfer of resources and autonomy to the regional governments it will be necessary to

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<sup>b</sup> IDB document "Program for Improvement of the Efficiency and Management of Regional Investment (CH-0161)" stated that the figures for each of these items were US\$ 410.4 million, US\$ 9.7 million, and US\$ 2 million respectively. Strangely, these figures do not sum up US\$ 500 million. After consulting with the IDB (Oct. 4, 2001) the figures used in the text, above, are the correct ones.

strengthen the technical and institutional capacity of the regional governments by introducing new managerial instruments, such as strategic planning in the prioritisation of investments, multiyear investment programmes, and programming agreements.

These are all new concepts introduced to this last programming period that were discussed in this work as serious lacks in the management of the fund. The adoption of these instruments and procedures will certainly improve the administrative aspects of the management of the fund. What is still missing is a deeper discussion on the specific objectives, stated by law, for the action of the FNDR.

#### 4 Evaluation and Information

This aspect was also pointed out as a significant lack in the running of previous programmes. In this new FNDR period, the programme states that:

- within 60 days after the end of each semi-annual period of programme execution, the executing agency will submit semi-annual progress reports to the IDB for consideration on the status of programme activities. The report submitted at the end of each year of programme execution will also include the investment plan for the following year, the financial status of the programme, information on the institutional strengthening activities, and the studies and activities for public information carried out during the respective year, as well as those planned for the following year.
- annually, after delivery of the semi-annual progress report at the end of each year of programme execution, SUBDERE will review the information with the IDB to assess the progress of the programme, identify any difficulties that have arisen, and devise the necessary corrective measures;
- as part of the programme evaluation process, two external evaluations will be conducted: a mid-term evaluation and a final evaluation according to a methodology and guidelines to be agreed upon by the executing agency and the IDB. The findings of the first evaluation are to be submitted to the IDB once 50% of the programme resources have been committed or 30 months after the effective date of the loan contract, whichever occurs first. The final evaluation is to be conducted within the six months prior to the date of last disbursement of the financing.

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