1. Country and Sector Background

Sound fundamentals and a strategy for integration in the world economy through elimination of trade barriers have been effective in underpinning growth at a steady pace in Chile and shielding the country from regional crises. Between 1990 and 2003 Chile’s annual per capita growth averaged 4.1 percent. This is significantly above the level for the region and compares well with high performing economies in East Asia and the Pacific. In the same period, extreme poverty was reduced to 4.7 percent of the population and the overall poverty level was halved to 18.8 percent.

The challenge for Chile is to sustain economic growth and social development and remain competitive in the context of an open economy. Much will depend on the ability of the economy to diversify and reduce its dependence on low value-added exports as factor accumulation and natural resources are unlikely to remain sources of growth in the future. The Chilean economy has already made progress toward this goal. In recent years, cellulose, fruit, salmon and wine have emerged as important new export items. Nevertheless, dependence on natural resource exports such as copper is still high. In 2003, mining accounted for 7 percent of GDP and 41 percent of export earnings.

For these reasons, the Government of Chile (GoC) seeks – as a matter of high priority – to create the conditions for Chile’s transition into a knowledge-based economy. This responds to an international trend where the ability to produce, adapt, diffuse and commercialize knowledge is becoming an increasingly important determinant of economic growth and quality of life improvements. The knowledge economy offers opportunities to the degree that Chile is able to build the skills and knowledge necessary to succeed in a highly competitive global environment. Hence, improving and expanding access to tertiary education (TE) is at the core of implementing the Government’s strategy for growth and social mobility.

2. Objectives

The project’s development objective is to increase the effectiveness of public funding for tertiary education by enhancing coherence, responsiveness, equity and quality in the system, through stronger accountability for performance.

3. Rationale for Bank Involvement

The World Bank has had a decade long cooperation with Chile in education. The proposed project lies in continuation of previous Bank operations in Chile and capitalizes on the many lessons, which the Bank has accrued over time. In consequence of this long and fruitful engagement in Chile, the Bank has
established a valuable network and has made contacts with all major stakeholders in TE. This involvement gives the Bank a unique opportunity to be at the forefront of developments in Chilean TE.

The Higher Education Improvement Project (MECESUP – P055481) has shown the value of the Bank as a catalyst and broker for key sector reform. In particular, the establishment of a competitive funding mechanism for quality improvement at the program level based on transparent selection criteria has been an important innovation in Chilean TE. Having successfully supported the management for results in selected sub-projects, the Bank is in a key position to assist in the adoption of a new financing mechanism that moves performance-based funding to the institutional level.

The proposed operation would complement the Bank’s efforts in the Science for the Knowledge Economy Project (P077282) to assist Chile in strengthening its national innovation system. Universities are the main executors of research and producers of advanced human capital. Hence, Bank involvement in both tertiary education and the funding of research would facilitate coordinated efforts to increase the stock of doctoral graduates, strengthen Chile’s science base and enhance public-private research linkages.

More broadly, the Bank benefits from its extensive international experience in tertiary education. Assisting in advising the GoC, the Bank is therefore able to draw on a vast reservoir of experience and extensive contacts with research organizations.

Finally, Chile provides the opportunity to pilot up-stream instruments in education. As a case of good practice, experience shows that components developed in Chile can inspire other countries to take similar steps to improve their TE system. Due to its active portfolio and contacts in the region, Bank involvement would facilitate the dissemination of lessons learned from such innovations to other countries in the region.

4. Description
The proposed operation is an Adaptable Program Loan (APL) with two phases. A long-term, ongoing partnership is critical to implementing the GoC’s strategy for the tertiary education sector. Notably, the Government’s strategy to increase accountability for institutional results by tying a proportion of public subsidies to performance requires a long-term perspective. The success of this strategy is dependent upon developing institutional capacity for results-based management as well as the design of an appropriate framework for monitoring and rewarding performance. Experience from similar reforms in the OECD countries shows that the policy and institutional framework necessary to implement performance-based funding requires time, adjustment and resources. Therefore, a first step would be to strengthen institutional capacity for results-based management and implement a new funding model in selected institutions (Phase 1 of the APL). This would allow the funding model to be validated and adjusted and subsequently scaled up to cover all public universities (Phases 2 of the APL).

The first phase of the APL would have two components:

**Component one:** Strengthening of the institutional framework for tertiary education through (i) improvement of sector oversight and regulation; (ii) strengthening of policies and strategies for tertiary education; (iii) consolidation of national system for quality assurance; (iv) establishment of a national observatory for tertiary education; and (v) project management.

**Component two:** Sub-projects to enhance coherence, efficiency, equity and quality through: (i) innovative sub-projects for tertiary programs and (ii) sub-projects to stimulate institutional effectiveness in critical areas, implemented through SWAp-like performance agreements.

5. Financing

<table>
<thead>
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<th>Source</th>
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</tr>
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<tr>
<td>BORROWER</td>
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<tr>
<td>INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT</td>
<td>25.0</td>
</tr>
<tr>
<td>--------------------------------------------------------</td>
<td>------</td>
</tr>
<tr>
<td>Total</td>
<td>92.0</td>
</tr>
</tbody>
</table>
6. Implementation
The APL will span 6½ years (2005 – 2012) with implementation in two phases.

Phase 1 (2005 – 2008) would (i) enhance government capacity for sector planning and oversight; (ii) strengthen policies and strategies for tertiary education; (iii) consolidate the national system for quality assurance; (iv) improve the national information system for tertiary education; (v) provide funding for innovative sub-projects; and (vi) pilot institutional performance agreements with additional money in a small number of universities gauged to have adequate fiduciary and information management systems.

Triggers: The second phase will be initiated under four conditions: (i) statistical compendium containing updated data on TE published by MINEDUC; (ii) at least 2000 students enrolled in supported preparatory programs; (iii) increase in the share of students from income quintile 1 and 2 in public universities from 18 percent in 2000 to 21 percent in 2007; and (iv) the first two-year cycle of performance agreements completed in at least 4 public universities.

Phase 2 (2008 – 2011) would (i) roll out performance-based funding to all public universities by tying increases in AFD subsidies to performance agreements; (ii) maintain support of quality improvements; and (iii) use the innovation fund to implement recommendations from the sector studies, e.g. actions to improve participation of low income and indigenous students in tertiary education.

7. Sustainability

Financial sustainability. Chile is a country with a sustained record of growth and sound fiscal management. Since the early 1990s much of the growth in public expenditure has been assigned to improvements of education. However, this has not translated into a high level of public support for tertiary education due to its considerable reliance on demand side financing. Currently, public funding for tertiary education comprises 0.6 percent of GDP and traditional universities receive only about 20 percent of their revenue from direct public subsidies. Thus, the prospects for being able to maintain levels of funding – including potentially increased recurrent costs – are considered high.

Institutional sustainability. It is critical that a revised regulatory framework be established with common consent and the end of the second phase, to codify and institutionalize the changes that would be introduced to the funding system. This would ensure sustainability from an institutional perspective needed to preserve a closer link between funding and performance in Chilean tertiary education.

8. Lessons Learned from Past Operations in the Country/Sector
The Bank has a long history of support to the education sector in Chile from which many lessons have been learned. Notably, the proposed project builds on lessons learned in the MECESUP project. This project has been thoroughly evaluated through an independent external impact study. Furthermore, the OECD 2004 educational review of Chile, which includes a section on tertiary education, provides a solid foundation for the proposed project. Finally, a background study was prepared for the project. This study overviews approaches to results-based funding and compiles lessons learned from implementation in a number of OECD countries. Lessons learned reflected in the project’s design include:

- Dual support for capacity building at the level of the Ministry and the establishment of an innovation fund for tertiary programs proved an effective combination in the MECESUP project. The Ministry enhanced its capacity to formulate policy and the MECESUP competitive fund enabled it to stimulate implementation. This project would do the same by continuing to strengthen the Ministry and maintaining funding that can drive strategy implementation and provide an incentive for institutions to respond to sector priorities.
- Evidence from the OECD countries shows that results-based funding places high demand on the capacity of supervisory authorities to engage in an evidence-based dialogue with institutions. Without a strong counterpart, information asymmetries may lead to under-performance. This lesson is
incorporated in the project’s design through capacity building in MINEDUC, including the establishment of a high-level ministerial committee for tertiary education and support for a national observatory for tertiary education.

- A key lesson learned in reforming Chilean primary and secondary education is the need to link initial teacher education to the new curricula. Despite deep reforms, Chilean pupils continue to perform below expectations in international studies of the IEA, TIMSS and PISA. A government initiative, begun in 1997, to strengthen programs of initial teacher education (FFID) was successful in launching a process of improvement in Chilean faculties of education. However, the program did not adequately address the problems of subject content knowledge for teachers and new teachers’ pedagogical skills. Building on the FFID initiative, the proposed project would therefore include investments in pre-service teacher education under the innovation fund for tertiary education.

- The MECESUP competitive fund made a cultural change in the sector by supporting quality improvement at the program level and providing an incentive for university staff to identify new solutions. Nonetheless, the impact on overall institutional practices and management was less pronounced. The proposed project would add performance agreements targeted at the institutional level. This builds on international experiences showing that institutional performance agreements: (i) encourage dialogue between government and university leaders on national priorities and institutional goals; (ii) combine autonomy with added accountability for results; and (iii) stimulate institutional strategic planning and improvement processes.

- The MECESUP project demonstrates the value of establishing a flexible funding mechanism with transparent procedures as opposed to designating resources to narrowly defined purposes. Each round of the MECESUP competitive fund was designed to respond to specific sector development needs and saw a significant reorientation from investments in teaching facilities to improvement of curricula and learning processes. The proposed innovation fund and performance agreements would offer the same flexibility whilst laying down in detail the transparency of the procedures and the expected end results.
9. Safeguard Policies (including public consultation)

<table>
<thead>
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<th>Safeguard Policies Triggered by the Project</th>
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<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental Assessment (OP/BP/GP 4.01)</td>
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<td>Natural Habitats (OP/BP 4.04)</td>
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<td>Pest Management (OP 4.09)</td>
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<td>Cultural Property (OPN 11.03, being revised as OP 4.11)</td>
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<td>Safety of Dams (OP/BP 4.37)</td>
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<td>[X]</td>
</tr>
<tr>
<td>Projects in Disputed Areas (OP/BP/GP 7.60)</td>
<td>[ ]</td>
<td>[X]</td>
</tr>
<tr>
<td>Projects on International Waterways (OP/BP/GP 7.50)</td>
<td>[ ]</td>
<td>[X]</td>
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</tbody>
</table>

The project would increase the quality of tertiary education in under-represented regions and seek ways to improve access to university education for inadequately prepared secondary graduates and students in non-university tertiary institutions. Specifically, an Indigenous Peoples Development Plan (IPDP) has been prepared to ensure that indigenous and poor students benefit from the project. This IPDP is intended to address issues hindering these students access to TE, as identified through a study and consultation carried out during project preparation. The IPDP contains three main actions: (a) the design of targeting mechanisms to identify and promote indigenous student participation in TE; (b) incentives for universities in selected areas to provide remedial learning opportunities for indigenous students; and (c) studies on ways to strengthen indigenous scholarships for talented individuals.

10. List of Factual Technical Documents


De Ferranti, David et al. (2003). *Closing the Gaps in Education and Technology*, World Bank, Washington, DC


Larrañaga, Osvaldo (2002). *Propuesta de Financiamiento para la Educación Superior en Chile*, Santiago: Universidad de Chile, Departamento de Economía


* By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties’ claims on the disputed areas


11. Contact point

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</tbody>
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