Toward a Modern State in Chile: Institutions, Governance, and Market Regulation *

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Abstract

Chile, as most Latin American countries, inherited the language, religion, and the institutions from 16th century Spanish conquerors. Most institutions have not changed since. This paper examines the institutional and economic structure of the State in Chile. It concludes that in several dimensions the current structure is incompatible with an adequate functioning of market economies, as those intended by the economic reforms implemented during the last three decades of the last century. The country needs to implement reforms in the administration of the State, the working of the Judiciary system, and the incentives and operation of regulatory agencies. Their combined negative effects imply that the benefits of reforms, privatization and market liberalization are partially dissipated in the form of inefficiency and rent seeking behaviour. In turn, this suggest that it is unlikely that the Chilean economy will reach the high growth rates necessary to overcome under development.

Our main conclusion is that, in order to implement a framework in which the State acts mainly as regulator and competition supporter, it is necessary to undertake profound changes in the structure of incentives in which it currently operates. Five elements are at the center of this far-reaching evolution away from centralism, stagnation, and inefficiency: (1) the divestiture of state-owned enterprises, (2) the upgrade and update of regulatory agencies and the institutional framework in which they operate, (3) the improve of competition policy institutions, (4) the improvement of consumer rights protection, and (5) a substantial improvement in the working of the Judiciary system.

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1. Introduction

Over the last decades, Chile has introduced major structural changes in infrastructure and human capital accumulation that have given the private sector priority in goods and services provision. Partly motivated by the severe crisis of the early 1980s and partly by the phenomenal success of the economies of the South East of Asia, Chile is in the path, albeit hesitantly, towards the development of a market economy.

The first step in that direction has been taken already. After sustained efforts, the country has reached macroeconomic stability levels that would have been unthinkable just twenty years ago, when inflation, unemployment and high fiscal and current account deficits constituted the economic ailments of Chile. Nevertheless, this turn of the economic situation has not been the result of only the stabilization process. In addition, there have been substantial changes in the incentives system for the economic agents that were the result of privatizing state-owned companies, liberalizing markets, opening up the economy to international trade and reducing subsidies to private companies.

To a great extent, Chile's institutional structure is still incompatible with an efficient operation of the very same markets the reforms were meant to create. The absence of deep reforms in the State's management, in the administration of the Judiciary and in the working of regulatory agencies does not guarantee that the Chilean economy may reach the high growth rates needed to pull the country out of its still developing condition. Second generation reforms for the Latin American countries have been very much talked about in order to complement the first liberalizing reforms that Chile implemented two decades ago. However, we understand there has not been a clear systematization of what those second generation reforms are, what they mean in terms of complementing first generation reforms and, most importantly, what economic aims such reforms pursue.

This paper discusses and systematizes the kind of reforms that should be introduced and the aims that should be pursued. We understand the ruling principle of these reforms to be the fact that a sustained economic growth demands a healthy microeconomy; that is to say, the incentives and regulatory structure for the involved agents should be implemented to reach the maximum potentialities in the productive and allocative efficiencies that the free operation of the markets imply. It is of particular interest in this context that the government generates the most appropriate mechanisms to stimulate competition and, were this is not possible, to design regulatory mechanisms to emulate its results.

To ensure progress in the direction of a State that regulates and defends competition, Chile should perfect its regulatory framework and modernize the regulatory entities in those industries with monopolistic characteristics; it should make progress in the defense of consumer rights and of the individuals; it should strengthen the entities in charge of assuring market competition and it should update the Judiciary by granting it the capacity to settle the disputes that are typical of a market economy. This

means that the role of the State as the provider of goods and services should be reconsidered as well as the way in which its actions may affect the implementation of the incentives and punishments system the economic agents operate in.

The purpose of this paper is not to introduce a modernization plan. On the contrary, the discussion is focused on the main aspects of economic and institutional modernization of the State with respect to the needed redesign of institutions designed to regulate, to control and to facilitate a fair market performance and competition as well as to ensure the implementation of governance mechanisms to make the changes viable. This analysis may be limited and should be complemented with reforms needed for the country's economic growth, which are not considered in this work: these reforms would include upgrading employment supply (investment in human capital) and its association with institutional health and education, the expansion of the country's infrastructure, environmental and natural resources protection, and others. Further, macroeconomic growth aspects have not been included, such as the improvement of the saving-investment process.

The organization of this paper is as follows. In the next section, the motivation for the analysys is elaborated. Section three is about the need to change the role of the State in a market economy like in Chile. Sections four and five deal with the two crucial aspects of second generation reforms that constitute the core of this paper, the modernization of the regulatory regime and support of competition, and the reform of the Judiciary and defense of citizens and consumers. The conclusion will comprise section six.

2. The Role of the Chilean Government in a Globalized World

The market liberalization reforms in Chile, most of them introduced over the last quarter century generated a sustained growth for about 15 years. However, the slowdown signs over the first years of the 21st century are easily perceived. It has become evident that the benefits that occurred after the first generation reforms may come to a standstill if effective measures to solve the bottleneck problems of growth and, therefore, of the country's economic progress, are not undertaken.[1] In this paper, three basic principles, which are clearly contentious, serve as the framework for the analysis that follows. These principles are:

- The Chilean economy in future will be developed on the basis of a market system as a mechanism of resources allocation. Therefore, the institutional structure that the country should have has to

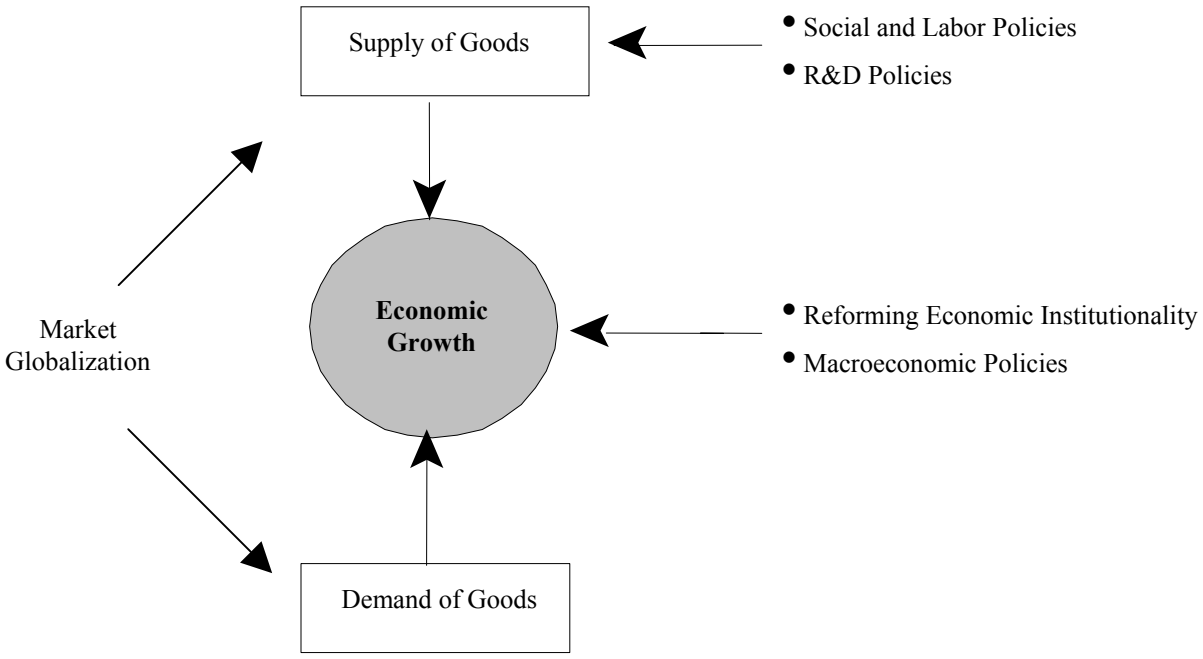
[1] This paper is concerned especially with the institutional bottlenecks that hinder prolonged economic growth, while those aspects that might eventually have an incidence in other dimensions of the economic development process are not dealt with. This is, no doubt, a subjective choice based on the widely accepted notion that economic growth constitutes a necessary though not sufficient pre-condition for economic development.

find the way for this mechanism to be as efficient as possible and for the adverse effects of its failures to be averted or reduced.

- The economy will increasingly be inserted in a globalized economic system, which implies that Chile will have to develop the ability to benefit from the new system and the capacity to defend themselves from the eventual problems that globalization may bring about.
- World economic growth will take place in an increasingly dynamic context where change will be the most typical element in the interaction between economic agents, industries and countries. Thus, the favored strategies should promote creativity, equal opportunities, entrepreneurial capacity, and the ability to adapt to them.

Following such principles, the purpose of this section should be to generate discussion of a rather broad set of problems concerning the functioning of the economy and the institutional conditions of the State, which implies a thorough analysis that certainly goes beyond this work. This is why we have concentrated on the problem areas which we believe are determining for future economic growth. Figure Nº 1 shows the interaction between globalization, markets, and the role of the State.

Figure Nº 1: Globalization, Markets, and the Role of the State



From an economic standpoint, the growth problem is largely determined by the insertion of Chile in the world economy. Such insertion will have major effects on the formation of individual preferences,

to the extent that consumption patterns, the appreciation of creative leisure, working habits and other aspects will change.[2] Additionally, such growth should modify the demand structure of goods and services in relation to the elasticity of the introduction of goods, with "luxury" goods filling an ever larger slot in the baskets of the different social classes. As a consequence of globalization, not much can be done to affect the demand of goods except for the first liberalizing measures: fiscal, monetary, and current and capital account policies consistent with a health macroeconomy.

The demand of goods and services also reflect the effects of globalization. The globalization conditions pose for Chilean producers a major challenge to reach the productivity and efficiency levels of those in international markets. Such challenges are not only technological but, most importantly, related to the idea that globalization will demand ever increasing levels of creativity, negotiating skills and adaptation to changes and working habits in order to offer high quality products and productive processes. This is the reason why the Chilean government is extremely concerned with advancing in the reform of education, health, and social welfare.

Bearing in mind this multifaceted challenge imposed by globalization, three State areas in Chile have been identified that may turn into major bottlenecks to adequately respond to the challenge. These areas of concern are: structure, mangement and administration of the public sector (the State's role) in a market economy; governance structure and mechanisms in the regulatory entities; and, the operation of the Judiciary system, the defense of citizens and consumers.

We estimate that the first area cited above, the structure, management and administration of the public sector, poses a severe threat to economic development. There is significant heterogeneity today in the level of efficiency of the different units of the public sector; while in some of them directives are clear and high performance efficacy has been reached, in others management is highly bureaucratic and administration is disorderly with high inefficiency levels and political interference. Also, the State's entrepreneurial spirit is still debatable especially given the fact that they still control a significant percentage of the GDP, indicating further opportunities for first generation reforms.

With respect to the institutional condition and governance of the regulatory entities, reforms are needed whenever a greater participation of the private sector has been reached in typical state activities such as telecommunications, electricity, and transport. Rapid privatization often preceded the design of the regulatory framework, which may have been thought out hurriedly, with little experience and not much care. In brief, privatization was carried out without the corresponding considerations with respect to market failures inherent to the industries involved, especially when the potentially competitive market activities coexisted with those in monopilistic markets.

[2] There is a wide literature regarding the effects of globalization on other aspects of the citizens' life, such as culture, identity, and so on. See for instance Brunner (1995) and Larraín (2001) for futher discussion.

The weak institutional condition is also strongly present in the organizations in charge of defending and supporting free market competition. The institutions are still very much inclined to punish inappropriate conduct but have spent little time with implementing mechanisms to avoid such conduct. In other words, it is necessary that the institutions established for the defense of free competition modify their role in favor of supporting competition.

Chile shows major defficiencies in the institutional weaknesses associated with settling disputes between parties, typical of all market economies. On the one hand, the Judiciary is one of the most backward in Chile, where procedures are still very similar to those in colonial times. Many members of the judiciary lack an economic background and, worse still, they seem to be far detached from being able to assess their work and, therefore, are not very much concerned with settling disputes promtly and efficiently. A similar case can be observed with respect to the bodies for the defense of consumers and persons; legislation is outdated and permissive with practices that are detrimental to the social acceptance of the free market model that has been implemented.[3]

In summary, Figure Nº 2 shows the need to implement an institutional structure in accordance with a regulator competition-supporter State that acts along with a Judiciary system and institutions for the defense of citizens and consumers. It is of interest to lay stress on the importance of institutional changes and on their effects on economic growth by means of what is called a healthy microeconomy.

3. Modernization of the State: General Aspects

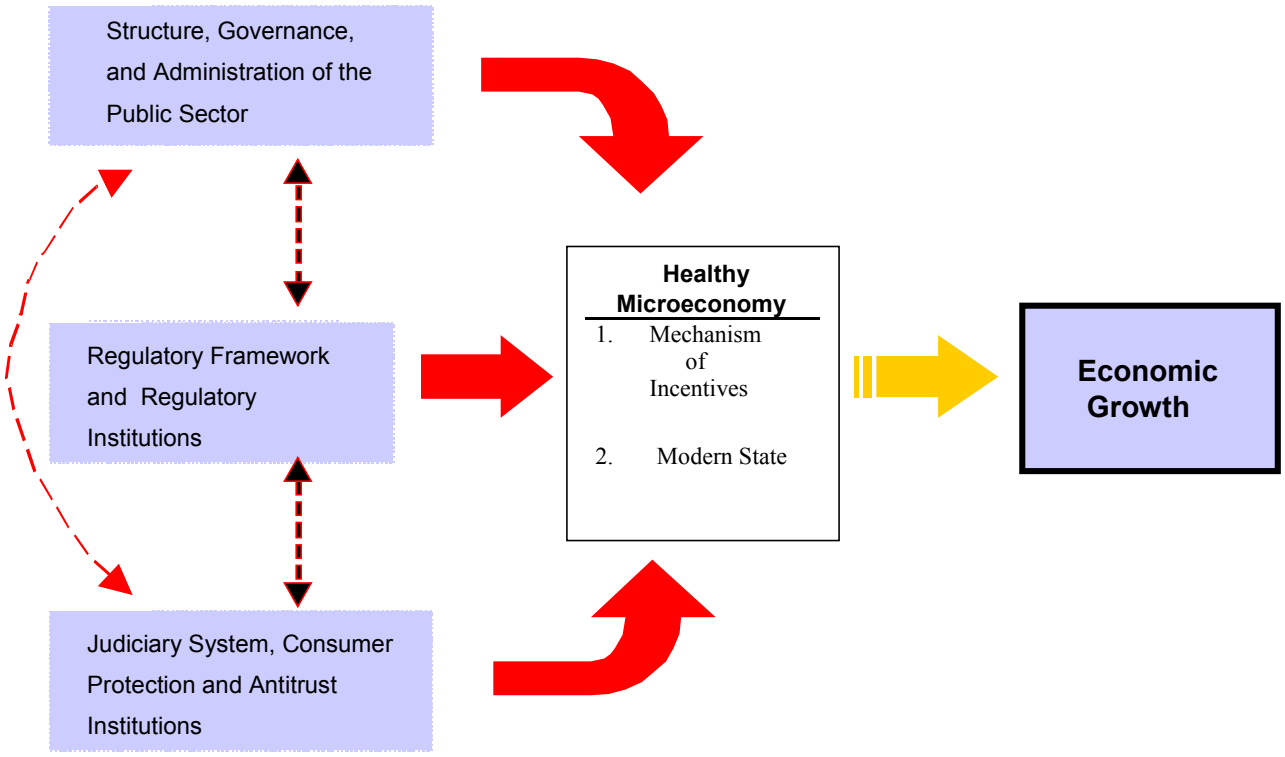
Over the last three decades, substantial structural changes have been made that have given the private sector greater prominence in the provision of goods and services, in developing infrastructure and in human capital accumulation. However, the institutional structure of Chile's economy, especially its state apparatus, to a large extent happen to be incompatible with an efficient operation of the very same markets that the reforms were meant to create.

Most authors agree that the State in Latin America, at least traditionally, reached its nadir in the 1990s (Boeninger, 1999; Burki *et al*., 1999). Historically, the State in Chile has developed a so-called "bureaucratic culture", characterized by institutional features that indicate, on the one hand, severe administrative, structural and organizational problems and, on the other, the undeniable need to implement profound changes.[4]

[3] Since written the first draft of this paper, the Chilean government has implemented several reforms that attempt to solve the problems mentioned in this work. Some of them are: the introduction of payment incentives schemes in public officers, the reform to electricity, consumer, and antitrust acts (all of them enacted during 2003 and 2004), and several other iniciatives still under legislative discussion.

[4] The State in Latin America derives its centralist conception, according to some historians, from a combination of (1) acceptance of vertical authority promoted by a conservative Catholic Church; (2) profound inequalities in social relations; (3)

Figure Nº 2: The Working of a Modern Economic Institutionality



The State apparatus in Chile is characterized by bureaucratic excesses and rigid procedures; this results in an exasperating slow pace to respond to social needs. It is rightly perceived that management is oriented to conforming to routine procedures and that solutions are based only on expanding the use of inputs ("more of the same"), while obtaining results is not regarded as relevant. In this context, public action is typically explained in terms of bureaucratic dynamics, of following a career, and of short-term political imperatives, not in terms of the interest in solving the population's problems.

There may be genuine interest in improving the population's living standards, but it is not unusual to have efforts wasted because too many of the institutions involved are in charge of the same issues without coordination, because there is no consistency or clearly defined public policy objectives and, more sadly still, because the implementation of public plans does not respond to the most elementary

high concentration of wealth; (4) low educational levels and (5) marginalizing indigenous groups from national politics (Domínguez, 1994).

constraints of the reality around (such as the so-called "white elephants"). In the worst of cases, the State does not seek the common good and it acts in the name of interest groups, political parties or social classes, developing state policies oriented to getting adherence and followers.

The causes of the State's inefficiency are, then, many, inclusive of historical, cultural, economic and legal factors. In our approach, we have concentrated on the economic and institutional determinants, although the conclusions that can be derived from a legal or political analysis are no less important.

From an economic standpoint, the origin of the State's inefficiency and inefficacy is to be found in the absence of proper incentives and regulation mechanisms in public organizations as well as in private cases. Chile is not alone here since the whole of Latin America is known for the absence or generalized weakness of the public administration evaluation mechanisms to assess private or organizational achievements and to punish indolence, inefficiency and lack of endeavor to attain the assigned objectives. The absence of accountability or personal responsibility is the result. Furthermore, the State in Chile has traditionally paid little attention to public opinion; thus, tax payers do not stand the chance of getting informed concerning the destiny given to their taxes or, let alone, to find the way to best use them, or recall public officers who are inept or corrupt.

To some extent, the reason for the lack of accountability and recall lies in the restriction of resources that prevent the development of proper mechanisms. Nevertheless, it must be acknowledged that, rather than the limited funds, the institutional restrictions imposed on the State are far more important.

On the one hand, inefficiency in the implementation of public resources is due to the labor overprotection enjoyed by public officers. Very often, officers enjoy labor tenure, their income is related to fixed salary schemes and negotiated collectively, and they get promoted on the basis of seniority. This situation is not linked to the kind of efforts generally needed to obtain rewards; thus, workers become discouraged to make efforts which are not appreciated while the opportunism of those who do their least seems to be welcomed. On the other hand, there is no "public managers" in public organizations, as there is in private enterprises, commissioned by owners and responsible before them, to obtain given social benefits from the assigned resources.[5]

Updating the structure of the public sector is a manifold area that involves privatization, restructuring organizations and functions, decentralizing, updating information systems and training personnel, among other needs. A thorough analysis of this situation is not the pretense in this section; rather, focusing attention on a possible reordering of the State with a view to developing market economy,

[5] As mentioned, some incentive mechanisms and a newer, formal, open, and transparent process of hiring public managers/officers were implemented during 2003. Although this reform this not solve the problem, it is a enormeous step in the right direction. See details of this reform in Valdés-Prieto (2003).

with increasing private participation levels in the provision of goods and services and with a greater consumer participation in policy making is the purpose.

In his classic study of goods and services provision, Oates (1972) mentions the three basic objectives of the State: stabilization, resources allocation and distribution of wealth. In this paper, we concentrate on the last two as they constitute the most important objectives in Chile in the present time. Nevertheless, we have disaggregated resources allocation into three categories: the provision of ordinary goods and services, the provision of public goods and services, and the generation of norms and regulations (what we may refer to as governance), with the aim of deeply examining the challenges that stand in the way of the State modernization and transformation in Chile. The three aspects related to resources allocation along with redistribution mechanisms and equal access make up the first part of our analysis.

In summary, the functions of the State have been classified into three different levels: decision making (deciding how much and for whom to produce), management (how to produce), and the incentives mechanism plan and performance assessment (which the production rules are).[6] Figure Nº 3 shows the double entry matrix with both analyses, which will serve as guidance. In each box, we give our considerations, which are the consequence of the analysis that follows next.

Figure Nº 3: Scope of the State and Private Participation

	Decision Making Process	Management	Incentive Mechanisms
Provision of normal goods and services	Private	Private	Private
Provision of public goods and services	State	Private	Both
Design of Regulatory Framework	State	State	Both
Income Distribution and Opportunities	Both	State	Both

After the military coup d' etat in 1973, Chile conducted the important process of privatizing many of the state-owned enterprises. Nonetheless, the State is still present in economic areas linked to mining, the energy sector and basic services, among others. Even admitting that State ownership in itself is not

[6] Is pertinent to mention that Chile has the lowest level of corruption indicators in Latin America and one of the lowest in the world (ranks 18-20 out of 145 countries in 2003). If this were not the case, another crucial topic in the reform of the State should be the controlling of corruption.

necessarily inappropriate, historical experience suggests that privatizing and granting concessions seem to allow a better management of the resources, less extended corruption and greater efficiency without causing serious market distortions.

It must be pointed out that there is general awareness in Chile that the State offers no advantages in the decision making process related to production and investment levels and in providing goods and services where no externalities or particular production conditions are be found (e.g., economies of scale). The idea that the State should coordinate or plan market development, that it should administer better than the private sector or that it should offer more efficient incentives mechanisms for resources allocation has been abandoned. On the contrary, it is the public sector that increasingly seeks to incorporate incentives systems that partly replicate the private sector mechanisms. This is why the first row in figure Nº 1 shows that it is possible and advisable to grant the provision of ordinary goods and services to the private sector and allow the latter to decide on what, how and for whom to produce, and also allow it to find the most convenient incentives and control mechanisms within the legal framework of the different societies concerned.

Regarding the provision of public goods and services, there is no consensus over the need or convenience of divesting public companies in these markets. Many authors maintain that state ownership is justified in terms of market imperfections such as natural monopolies and public goods. In such cases, it is said, privatization would lead to a goods and services provision level below optimum and, by and large, would lead the private sector to enjoy monopolistic benefits. However, there is no empirical evidence to support the assertion that when the State operates monopolistically, the proper production level is assured. On the contrary, there is substantial proof that many public companies are highly inefficient and that the monopolistic benefits are appropriated by the executive officers or the employees in the form of high salaries and fringe benefits (Galal *et al.*, 1989).

The privatization experience in Chile in public utilities shows that private ownership may reduce prices and provide incentives to invest. However, this experience also shows that the privatization of utilities demand a carefully designed regulatory framework free of ambiguities, with legal and regulatory entities willing to enforce the terms and conditions of privatization or concession contracts. Moreover, during the 1990s Chile started to develop markets where the private sector operates and, in many cases, finance companies that provide goods and services, such as highways, ports and airports franchising. The Chilean state continues to be responsible for determining the provision levels, which is made possible through private companies with the assistance of subsidies or franchising mechanisms.

A widespread justification for the maintenance of some state-owned companies is that they play a strategic political role, such as by media (newspapers and television) and military or war related companies. Their social role must be admitted, but the evaluation of the extent to which they are strategic

for social development and of the extent to which they may prove useful to perpetuate spheres of power in the hands of privileged classes or power groups must be conducted carefully. For instance, the arguments in favor of state monopolies based on military strategic reasons, those which formerly explained the development of war industries, have lost ground with economic liberalization and globalization. Currently, the destiny of taxes for national defense is being debated because, on the one hand, the perception is that the need for defense has diminished in Latin America; on the other hand, such use of taxes greatly reflect the military negotiating power rather than Chile's need of defense.

Similarly, the need to maintain an state bank in Chile has been its role in regional development, especially in the areas lagging behind progress where private capital markets cannot support productive activities. The less developed sectors, such as rural and small business, certainly demand the substantial support of the rest of society to integrate them more equitably in the process of economic growth. This suggests assistance that should be well targeted, particularly access to loans and to technical aid, and not necessarily directed to expanding state enterprises in the areas.

As a consequence, it should be pointed out that although the State may divest public goods and services provision, the responsibility for the decision on which goods and services are provided and who will provide them cannot be referred to the private sector. Given the presence of market failures, centralized coordination of the provision levels is required in order to obtain a social optimum from the allocation of resources.

A third objective of the State is to provide operation rules for the economic agents and also to provide the mechanisms to adapt, update and upgrade such rules. Such governance as a State function has been recently changed in many economies in Latin America as a result of the openness processes and market liberalization implemented over the last 25 years. However, because it has been the pioneer in introducing liberalization policies and because of the dogmatism with which such policies were conducted, Chile is still lagging behind institutional reforms compared with other countries whose divestiture processes took place later.

Certainly, we are dealing with an area where decision making is a public responsibility exclusively. The private sector may participate with regulation improvement proposals, as is the case in Chile, but the mechanisms used for such proposals must be transparent and efficient, without the margin for the regulating agent to be captured by the regulated enterprises. Similarly, the administration of the bodies that dictate the regulations and panel procedures must belong to the State, given the need to protect the collective good above individual or group interests, an issue to be dealt with later in this paper.

A less developed area that may play a very important role in the future is a more direct consumer participation in the results and incentives control of public decisions. The centralist characteristic of the state administration has traditionally led to little consumer participation in the decisions of the state-

owned enterprises and bodies. As has been already remarked, this situation means the neglect on the part of state officers when having to comply with their social function as well as the disappointment of users concerning the capacity of the State to resolve problems. It has recently been proposed that public hearings be organized to discuss and fix public tariffs or service conditions, with the participation of consumers together with the enterprises and regulation representatives. It would certainly improve accountability of the regulating agents and also improve consumer welfare. The right to recall must be exercised responsibly; it has been seldom resorted to, with bureaucratic complications, so that a major reconsideration of it must be made to turn it efficient.

Regarding income and opportunities distribution, Chile's unequal income distribution is perhaps one of the major challenges confronting this country in the 21st century. Initially, the interest of public policies would be to guarantee universal access to the benefits a market economy offers and to the duties it demands. Nevertheless, it must be admitted that there are substantial distortions and constraints that actually prevent equal access that, to a large extent, explain the active policy participation of the State.

There are two kind of policies to reduce inequality and guarantee equal opportunities. On the one hand, since the works by Tiebout (1956) and Oates (1972), there has been a strong school of thought that suggests that the allocation of resources is economically efficient in providing local goods and services when it has been divested and the decision made at local level. On the other hand, there still are a wide scope for policies aim to reduce poverty and unequal opportunities at the central level.

Whichever the decentralization level chosen, decision making will, then, be a mixed function. The State should centrally retain those redistribution proposals that because of externalities or of economies of scale are of national scope, or those in which there is no capacity to pay at all (assistance).

4. Toward a Modern Regulatory Institutional Framing and Defense of Competition

Mention has already been made of the private sector participation in sectors with natural monopoly characteristics in Chile during the final quarter of the last century, especially in gas, energy, water and telecommunications. With adequate regulation, it should bring about increased internal efficiency in those companies (productive efficiency) and should also offer benefits to consumers, as the literature in the field has underlined.[7] Nevertheless, as some authors have shown, the term "adequate regulation" happens to be a chimera in many such sectors; severe efficiency problems in the allocation of resources have arisen when control was tightened over the market regulated monopoly that was expected to perform

[7] A very good summary of such experiences can be found in Newbery (1999).

more competitively.[8] The question we now mean to address is: how far can we go with an institutional development proposal capable of guaranteeing a balanced development of the advantages of productive and internal efficiency of the private sector in the public utility services area, together with the adequate competition support and consumer defense in those sectors?

4.1 Competition Regulator and Supporter Institutional Structure

Following the rich empirical evidence available, it has become clear that all those market segments with monopolistic characteristics and operated by private enterprises must be regulated. Then, it is assumed that the disadvantages of regulation, measured in terms of direct and indirect costs, are fewer than the advantages with respect to the social benefits they bring about. In this sense, and from a practical standpoint, we rule out as irrelevant the existence of challenging markets in basic services.

Market regulation though is not problem-free. The theoretical and empirical literature on monopoly regulation of public services remarks that the information asymmetries between the regulated firms and the regulators mean a serious constraint to reach allocation efficiency in these markets. The information asymmetries originate in the greater and closer knowledge of the technologies used and of the market conditions enjoyed by the monopolists. As a result of such information asymmetries, "informational rent" is derived and strategic behavior is encouraged by the economic agents.

In sectors with natural monopoly characteristics, the problem is exacerbated to the degree public utility services are vertically related to potentially competitive markets; such is the case of the fixed telephone network and mobile telephone, long distance calling and data transmission, electricity distribution with (potentially) competitive generation and marketing segments, the poliducts to transport natural gas and corresponding extraction and marketing. These vertical relations between monopolistic markets and competitive markets allow the market power of these firms on regulated markets to be used to obtain abnormal benefits in potentially competitive markets.

In principle, the way to reduce informational rent consists of establishing and implementing regulatory frameworks that provide clear solid rules from a technical point of view. Additionally, it is necessary for the regulatory agents to have trained staff to demand compliance with the rules and, in case problems arise, to count on a panel of legal experts capable of settling the matter between the individual parties and, or between the involved party and the State an open expeditious way. A further point is that the regulatory frameworks be capable of modifying and adapting to the economic changes that inevitably occur. The problem that arises is how to ensure that the changes in regulation are not anti-efficiency, and that they do not generate rent for the monopolist or not allow the political capture of the regulator.

[8] See for instance Basañes, Saavedra and Soto (2001) and Bitrán, Estache, Guasch and Serra (1999), who are critical of the poor regulatory framework for basic services in Chile.

4.2 Bottlenecks in the Regulatory Institutional Structure

In practice, particularly in many developing countries, there are many constraints that prevent regulators from inhibiting rent seeking in those sectors where private firms operate in monopolistic conditions. This is mainly due to three reasons: our regulatory entities are technically weak to implement the existing regulations; the regulatory framework is in many cases incomplete or is the source of great ambiguities; regulation is particularly complex occasionally, from the technical point of view.

a) Weak Technical Capacities in Regulatory Entities

As is the case all over Latin America, the first constraint for regulatory entities in Chile is the limited technical capacity offered by the regulatory agents. This technical weakness is due to three main reasons: no independence from political power, no independent budgeting and low salaries.

With respect to the *no independence from political power*, basic services regulation authorities in Chile are officers who enjoy the total confidence of the President of the Republic, who can decide whether they can stay in office, without following clear procedures to support the decision. Lobbying is, then, made possible, and the regulatory bodies may be inhibited concerning the implementation of required technical measures that are politically costly.

As far as the *lack of independent budgeting* is concerned, in Chile, the national fiscal budget is the source of funds of the regulatory entities and, therefore, they operate within the institutional framework of the public sector. As discussed in the previous section, the incentives plan for the public sector shows severe constraints that do not allow it to function efficiently (rigidity, bureaucracy). In only a few countries, like Argentina and Brazil, the regulatory entities are financed with specifically created taxes or with the proceeds generated by private exploitation rights in regulated markets. However, such possibility has not been proposed seriously for implementation in Chile.

Finally, the *salary scheme of public officers* is not consistent with the maintenance and training of the staff's technical capacity. The empirical evidence of this problem is clear: the remunerations in the public sector are below those in the regulated industry, which favors regulatory capture; secondly, there are very few incentives that foster specialized training among the staff and the development of a career within the regulatory entities. Both conditions deter the best young professionals from exploring jobs with the regulatory agency; consequently, they are then generally captured (hired) by the private sector.

b) Incompleteness and Ambiguities of the Regulatory Framework

The second serious regulation problem in Chile is that the regulatory framework is, in some very important circumstances, highly incomplete and or ambiguous. The institutional or contractual structure ruling relations between the regulator and the firm does not predict all the possible contingencies of

operating the sector, or imparts political guidelines which are inconsistent. The existence of ambiguities in any kind of regulation is usually the result of both the complexity of the phenomenon dealt with and the incapacity to predict and anticipate potential conflicts derived from regulating in a poor information context. The presence of ambiguities or the absence of definitions in regulating generally causes opportunistic conduct on the part of both the regulated enterprise and the State institutions.

Tangible examples of ambiguities within the regulatory framework of basic services have arisen over the last years in different countries in Latin America. In Chile's energy sector, for example, the absence of definition of the responsibilities when a period of drought occurred made the crisis worse and, first in a long time, led to rationing of consumption, which might have been avoided. In telecommunications, the authority has had to constantly create regulations to prevent local telephone companies from wielding their monopolistic power in other more competitive markets (long distance, mobil telephony, Internet, etc.). The fishing activity overexploitation in Chile has caused long negotiations to impose constraints to make the sector's development sustainable. The opportunistic conduct in some road construction concessions may reduce the government's credibility, which in turn may produced suboptimum investments.[9]

c) Complex Regulation and Regulation by Incentives

A third problem occurring not only in developing countries is the fact that regulation may prove especially complex from a technical point of view; there is no consensus with respect to the best possible regulatory regime. Regulation is often confronted with economic and technical problems for which there are no theoretical or practical solutions (for example, electricity transmission rates). Additionally, technological progress often causes substantial changes in market operation and renders the former regulation obsolete. Even the technological changes may defy the very definition of what constitutes "a market" regulated by an authority. Two examples may be useful: one of them is found in telecommunications, where mobile telephone's boom and cheap prices have made it a closer substitute for land based telephones. In turn, this puts the regulator in a difficult position to decide which market is relevant for the regulation of fixed telephones; in the other instance, more importance will be given in the medium term to investment cost reduction and network operation, which will make electricity distributors request authorization to offer telephone service (and vice-versa). The regulator will have to face network integration and competition conflicts between economic sectors.

[9] As mentioned again, recent legal modifications tends to reduce some ambiguities in these regulatory frameworks. Two examples are the following. In the electricity sector, firms are clear regarding their responsabilities in providing energy during droght (reform implemented in 1999), they know their transmission tariffs and that private arbitrators are going to settle any disputes among them (both reform implemented in 2004). The second example is how the government settle lobbying into the fishery sector, where a 10 years operating act was enacted in 2001 in order to make clear the operation of the sector for a decade before enacting a new definitive act for this sector, to be operative in 2011.

Certainly, there are no simple solutions or prevention of these problems. What must be demanded of regulation is the capacity to face complexities with mechanisms capable of supplying an appropriate consensus-based solution within a reasonable period, and, also, if regulation mistakes are found, to provide effective mechanisms to correct them. Unfortunately, very often the regulation mechanisms are not easily modified.

4.3 What To Do with the Regulatory Institutional Structure ?

There is still a lot to be learned although regulatory problems have been widely debated at the moment of establishing the regulatory institutional structure. Most problems are in sectors whose regulatory framework was designed in the 1980's. For example, the regulation of Chile's energy sector, a pioneer in allowing competition for generation at that time, has remarkably lagged behind and has raised severe operational problems, with conflicts and growing litigation in the sector.

However, some reforms introducing competition in other sectors are remarkably positive. For example, telecommunications regulation in Chile, quite precarious initially, has evolved toward establishing better and more effective local telephone regulation regimes. More significantly yet, the government made a great effort to implement a long distance multicarrier system that brought about a major increase of the sector's competition and competitiveness and has reduced rates to the benefit of consumers[10]. Similarly, the opening up of public bids for road construction and the privatization of water companies have incorporated the experience of the previously privatized sectors to correct possible mistakes and to avoid the opportunistic conduct of the regulated enterprises (Basañes, *et al.*, 2001).

In spite of the general good performance of the regulatory experience in Chile, there is still much that remains to be done to update the regulatory institutional conditions. Not only is it necessary to give the regulatory entities technical and financial capacity but also they must receive the minimum required directives to ensure economic and political independence with respect to their environment. It is additionally necessary to allow them to identify and resolve ambiguities, to increase transparency in administrative procedures, to go forward with incentives regulation mechanisms, and to reach economies of scope in regulation, in competition support and in the defense and information to consumers. Although a thorough treatment of the mentioned directives is not the pretense, the last introduced elements will be further dealt with.

[10] Bitrán, et. al (1999).

i. Regulatory Entities Independence

The regulatory organizations must be given independence from political power and from the regulated sectors themselves. This presupposes deep changes when defining the regulatory institutional conditions of the basic services in Chile, whose minimum directives should at least guarantee:

- *Separating the regulatory entities according to the economic activities.* For various reasons, it is advisable not to centralize regulation in a sole entity. First, the regulation of the different sectors (energy, gas, telecommunications, others) is highly heterogeneous from the point of view of the technical, economic and, particularly, the development level of each sector. Secondly, this would make accountability of the corresponding superintendents easier. Thirdly, the regulated enterprises and the political parties would be less motivated to capture a very powerful regulator. Finally, the interruption of regulation activities of sectors that for political reasons or other circumstances are less appealing than other activities would be diminished.[11]
- *Regulatory entities economically and hierarchically independent of ministries.* It is required that political authorities, and their activities concerning the sector's development and competitiveness, be separated from the role of regulator with respect to the regulatory function the latter exercises. This eliminates the political dependence of regulators, avoids the opportunistic conduct of the government with aims other than the long-term development of the sector and reduces the political capture motivation; the regulators' technical capacity and the implementation of more efficient mechanisms is made operative, from the point of view of the incentives and career making chances with these entities.
- *Allowing the President of the Republic the ability to appoint and to remove superintendents, but in both cases using a transparent process.* In fact, the President's decision regarding the appointment of a regulator is not a big deal, but what is important is that the removal of a regulator should be based upon specific and transparent conditions, such as proven negligence, abandon of duties, regulatory capture, corruption, an so on.

ii. Strengthening of the Regulatory Entities

The institutional capacity of the regulating agents must be strengthened so that they can solve ambiguities efficiently within the regulatory framework of the basic services. Not much has been done to identify them and, thus, change norms and regulations. Unfortunately, it is only when opportunistic conduct appears that the mentioned ambiguities also appear. Three minimum necessary though insufficient changes to improve this situation are:

[11] It is important to remark that this separation of regulatory entities that not prevent for create the figure of a supraregulator of utilities, however this position should be think as a person whose aim is beyond any technical regulation, more precisely this person should be in charge of balance power with private holdings operating in more than one utility sector.

- *To provide regulators and comptroller agents with the human and financial resources that could allow them to perform their function on equal conditions as the basic services companies under their supervision.* An interesting aspect to analyze is the possibility for the regulatory agent to be partly financed with taxes on the regulated enterprises themselves, with some clear objective mechanism as, for example, being paid for the job they do. Although this is the way used in very few countries in Latin America, the experience of the regulatory agents in Argentina (ENRE and ENERGAS) has been clearly successful on this regards.
- To go further with the *implementation of dispute settling mechanisms of conflicts occurring outside current legal proceedings* and with the enforcement of the solutions contributed with by private arbitrage may prove convenient in the short run. The electricity act enacted in March 2004 certainly is in this direction, whose example should be imitate at least in the telecommunications and water and sewage sector.
- *To study how to adapt to the regulatory framework, with reference to the significant policies in each individual sector, should, in the medium term, be centered on the ministries, not on the regulatory organisms.* The latter should only provide support to the technical work done by ministries; they should not become involved in fostering the deep changes in the norms ruling the sector they themselves regulate. The regulatory agencies would then become technical bodies only; the political discussions inherent in the transformations in the regulatory structure could, then, be avoided. On the other hand, the strengthening of the regulatory institutions would reduce the existing ambiguities within the regulatory framework and also the underlying opportunistic conduct entailed in them.

iii. Transparency of the Regulatory Process

The regulatory entities procedures must be updated to have transparency in the regulation process. This suggestion points in the direction of helping with the profound changes that imply the regulators' independence. An indirect way to achieve the independence of the regulatory entities is to reform the procedures they are ruled by in order to make them transparent. Some minimum requirements in this direction are:

- *The demand to back up the decisions made by regulators and comptrollers.* For example, it is desirable that the methods the regulator follows to make decisions, particularly tariffs decisions, could be replicated by third parties, especially independent academicians; the regulators should have the obligation to substantiate their assumptions and judgments in written form.
- *The adoption of a comprehensive administrative procedure applicable whenever the regulator makes a decision.* Apart from helping to reach transparency in the decisions, this could foster

public participation in the process because it would allow those who were interested to have the opportunity of having a say in public and of becoming involved in the decision making process.

- *The open supply of regulatory activity information*. This could be accomplished by publishing Internet pages that, by offering all the information available, would thus do away with third party entry barrier to access information. Likewise, regulators should put all information regarding the regulatory process to academic research, under strict confidentiality conditions, in order to increase knowledge about the working of utility sectors.
- *Implementation of regulatory accounting in basic services.* This systematization of information can help with system transparency, with the memory preservation. By doing so, it can generate stability in the procedures used and in the rules of the game for the regulated enterprises themselves.

The procedural changes suggested should enhance the prospects of making the regulator accountable in the hope that it will help to control administrative acts by binding them to minimum procedural standards. Similarly, and closely related, is the need to create, along with the procedural reform, a system to allow those affected to present claims in case the transparency rules may have been trespassed. This issue is dealt with further in the next section.

iv. Incentives Mechanisms

For regulation to be successful, the means used must be improved. Regulation should be direct; this means a regulation is applied and non compliance with it is punished. Indirect regulation seems to be better: the inclusion of market elements in regulation. The aim is to modify the incentives so that the agents' interest lies in "complying" with the regulation. This approach enjoys certain advantages concerning regulation costs. Both kinds of regulation are necessary, but different legal bodies might change many direct regulations and displace them with other more indirect or with incentives.

As an example, more competition in telecommunications has allowed local telephone companies to enter different market segments, the interest of the new firms being to capture clients with more important demands. Because of the rigid legislation, the incumbent cannot react to greater competition by offering alternative plans as quickly as an efficient operator would be expected to do, given the months it takes to obtain authorization from the regulator to make the offer. In terms of incentives, what may appear as self-evident is to authorize alternative plan offers by the regulator and always maintain the regulated tariffs option, while, ex-post ensuring that these practices are neither discriminatory nor predatory.[12]

[12] In fact, Telefonica obtained the right to offer flexible plans to its subscribers in local telephony from the Antitrust Commission (currently, Competition Court) in 2003. However, such a flexibility requires Telefonica to obtain a permit from the regulator before implementing any alternative plan.

v. Best Use of Economies of Scope in utilities' Regulation

Finally, the governance structure must be redefined in order to make the best use of economies of scope and to enhance the interaction between the regulator role and the competition entities role. The responsibility for the defense of competition belong typically to other public entities: *Fiscalía Nacional Económica* (the Chilean simil to the Department of Justice in USA) and the Antitrust Commissions (currently the Competition Court, an special court in charge to settle disputes on this regard). The responsibility for the defense of consumers it is the responsibility of SERNAC (Consumer National Agency).

However, the problems concerning basic services present high specificity and are complex to resolve. Experience has shown that involving these entities may cause severe problems, in particular regarding co-regulation of utilities. It is extremely important to clearly define the role of each institution, to separate duties and avoid inconsistencies in regulation, and to enhance communication among them in order to facilitate their working.

4.4 Bottlenecks in the Promotion and Defense of Competition [13]

Establishing modern regulatory institutional conditions in a market economy open to a globalized world demands an institutional structure for the defense of competition to complement it in order to reach the aim of supporting competition. Therefore, it is necessary to have commissions and a legal system in charge of watching over competition in markets involving oligopoly (or potentially competitive); especially, the markets related to regulated basic services.

It has proven advantageous to separate functions: fact finding and investigating unfair practices on the one hand; making legal and other decisions, on the other. In the first case in Chile, the work is done through the *Fiscalía Nacional Económica*); the legal work is in charge of the *A*ntitrust Commissions (from now on, indistinctly Competition Court). Within this institutional structure, the antitrust commissions function like the courts of the judicial power system and they should be, in theory, independent of any other public office. The *Fiscalía* was thought of as a public service branch with its own separate budget and staff; in Chile, it is directly dependent on the President of the Republic.

We believe various problems restrict the scope of these entities. They are:

- *The aims of the antitrust commissions are often not clear or are poorly defined.* The objectives the commission members follow to make their evaluation vary immensely, from commissions whose task is to defend competition to those whose responsibility is to defend consumer rights,

[13] Most of these problems were solved upon the creation of the Competition Court, which replaced the Antitrust Commisions. The new law was enacted at the end of 2003 and the first draft of this article was used as a discussion paper for implementing such a reform. See Saavedra (2003) for further details of this legal reform.

market development, or other aims. This is the reason why, even in the same country, similar unfair practices have been judged following different criteria.

- *Insufficient professionalism of the commissions.* The first restrictive factor is to work exclusively according to the sense of responsibility the commission members may have; they obtain no remuneration for the job done, do not have advisors to support their decisions and cannot neglect their private activities to entirely devote themselves to this one. Usually, this implies that the time left available to comply with this duty is very limited and often confined to attending commission meetings only.
- *Commission integration has not been organized to allow the most qualified members to be part of it.* Experts are ever more needed because the economy evolution is accompanied by increasingly complex strategic business activities. The integration of the commissions may affect and be affected by the interpretation of the legislation related to the defense of competition. For example, emphasis on *punishing conduct* contrary to competition, where concrete evidence of such conducts is fundamental, should demand the presence of a legally trained professional. On the other hand, the stress on *defending competition* should be associated with the need of specialists in market organization (economics).
- *In many cases, the commissions are not independent of political power, especially the government.* This is a particularly delicate aspect when considering possible conflicts between the Antitrust Commissions and State organizations such as state-owned companies, superintendence offices, regulatory entities, among others.
- *Antitrust Commissions have not been properly defined in terms of the relations with the Judiciary System.* Such Commissions in Chile are part and are not part of the judicial power pyramid. It is not clear how the Supreme Court is going to revise judgements made by the Antitrust Resolution Commission, what adds uncertainty to do business in Chile because the scarce preparation on economic grounds that the member of the Supreme Court have.
- *Antitrust commissions overlap with regulatory entities.* Almost all over the Latin American countries with an institutional framing for the defense of competition, little attention has been paid to the fact that the antitrust commissions have become co-regulators of the system. Many of the decisions made by the administrative authorities have been rejected by the firms affected by such measures, thus paving the way to the kind of opportunistic conduct that ends up partly sidestepping regulation. Administrative decisions delay strategy has been widely used by companies in the energy and telecommunications sectors in Chile during the 1990s and more recently.

- *The Fiscalía Nacional Económica has economic constraints* for hiring the number of appropriate well-paid staff that would be needed; additionally, neither are the funds enough to commission studies or hire specialists in the diverse issues involved. This situation has been partially resolved with the Reform DL 211, in 1998.

In the light of the information contributed, it is relevant to comprehensively revise the institutional framing for the defense of competition, including the aims of the institutions and their structure, their integration and the faculties of both the antitrust commissions and of the regulatory entities. The result of this comprehensive revision will help to determine with greater certainty what aspects of each of the institutional framing elements must be strengthened.

i. Clarifying the Aims of the Legislation for the Defense of Competition

The priority in updating the institutional framing for the defense of competition is to clearly define the aims of the legislation. This is particularly valid in a context in which the option has been not to define the criminal conducts themselves. Along with the strengthening of the traditional role in the regulation of unfair practices, it should be expected that:

- *Commissions and regulators defend competition.* With reference to basic services, deregulation of potentially competitive markets should be supported.
- *Antitrust commissions become organizations of consultancy and permanent discussion for regulatory entities.* Nevertheless, to be able to play this critical role, it is necessary to make the commissions more independent of the Executive Power.

ii. Antitrust Resolution Commission with Full Time Members

To have a more professional Antitrust Resolution Commission by having full time commissioners (judges) is a necessary condition for recruiting professionals trained on industrial organization. Moreover, these members should have this as their main activity. By doing so, uncertainty on judgements and the delay on resolution may be reduced.

Resources should be made available to find the appropriate professionals who could accept and dedicate themselves to a full time commitment. Special provisions should be considered not to allow the pursuit of other activities, except perhaps for part time academic activities, during the time the commission member remains in the position. Similarly, there should also be explicit provisions not to allow certain activities to be performed after leaving this position.

iii. Redefining the Mechanisms to Appoint Commission's Members

Redefining the appointment mechanisms of members seeks to help the members be independent of political power as well as of the Judiciary system. The demands imposed by modernization and the

development of the Chilean economy toward an institutional framing for the defense of competition require the corresponding resources and personnel. A step forward is the training of professionals with a greater degree of specialization and elimination of the hazards of the present appointment system.

The main obstacle to appoint the most appropriate candidates to occupy public administration positions is perhaps the dependency on vested interest groups. To help improve the situation, profound changes must be introduced in the appointment procedures. Some of them are:

- *Essential changes in the selection of members by ad-hoc committees not directly dependent on the executive power.* The selection of the candidates must be transparent. It is advisable the selection board enjoy the corresponding qualifications and not be linked to other State branches; also, citizens should enjoy the opportunity to have a say in this matter and there should be the possibility to implement an enquiry system.
- *Changes in the commission members selection and appointment procedures*. The aim of the procedure to appoint these members is to select the most qualified individuals to occupy the position, which is not an easy task since "qualification" cannot be testified by third parties[14]. The application process should be simple in formalities, with ex-post information examination; it should be left to the interested parties; substantive requirements should be demanded, like publications on related issues in prestigious academic journals, experience in antitrust cases, and others; transparency in the process should be improved by making the application process equal the public selection rank, and making the candidates qualifications and background publicly available.

iv. Limiting Review of the Commission Decisions

The review of the commission decisions should be limited while, at the same time, the formal protection of the commissions by the judicial power should be maintained. Although the decisions made by the commissions should be subject to control by the Judiciary, such control should be exercised over formal errors the members may have generated, not over the fundamental content in the decisions.

Improved relations with the Judiciary system may help to avoid the main risk concerning the appointed commissions; that is to say, the little concern with the procedures and due process of law other than those followed by commissions (which occurs when the defense of competition is not within the control of the judicial power). Similarly, not being part of the Judiciary prevents the possible inappropriate uses of legal appeals by preventing complex technical matters be dealt with by members not skilled effecting these areas (a situation that takes place when the commissions remain part of the judicial system structure).

[14] We take some aspects of this discussion from Galetovic and Sanhueza (2002).

v. Referral of the Competition Defense Decisions to the Regulatory Entities

The power of the commissions that decide on regulations affecting free competition should be limited. They may become co-regulating agents of the decisions made by the administrative authority.

One way to avoid such possibility is to have the regulatory entities resort to the mentioned commissions for non-binding advice concerning the sector's issues. This is the way the administrative authority may count on a significant opinion on the matter while free competition would not become the guiding principle of the management regulation function. The institutional deficiencies relating to a matter under administrative law (see next section) could be worsened and the above commented situation might quickly turn into a functional equivalent to substitute for the failures of the system.

5. Justice Modernization and the Defense of Consumers and Persons

What is the appropriate role? What is the minimum expected of a modernized Judiciary system more in accordance with a market economy? These are the questions to be addressed in this section. We also discuss the institutional requirements for the defense of persons with respect to the State and the defense of consumers in relation to private enterprises.

One of the fundamental components for market economy operation is an independent, reliable judicial power that can settle increasingly complex technical matters. Unluckily, both the legal proceedings applicable in economic issues and the commission members' capacity to resolve these problems prove quite inadequate in Chile as well as all over Latin America.

The judicial power system acknowledges the conflicting nature of the economic issues, but antitrust commissions and arbitration systems have been created to deal with them. However, a substantial portion of the disputes, sooner or later, is channeled out to the central judiciary (especially to the Courts of Appeal and the Supreme Court), where the economic disputes receive treatment similar to other legal cases. The major constraints found in Chile's judicial power system are the very low procedural efficiency, the judges' poor general economic background, the absence of specific commissions to treat highly technical issues or the absence of courts for contentious- administrative cases. These constraints increase the direct and indirect litigation costs: it is rather difficult to predict the decisions to be made by judges, while a social and individual fair treatment of the cases is not guaranteed.

Some authors go further and point out that a system based on Roman Law, mostly in force all over Latin America, tends to inhibit the technological innovation process and the entrepreneurial spirit that constitutes the essence of the market system, imposing too many restraints on the private sector,

which can only act according to law. By contrast, Common Law is more ample and only punishes what is not permitted, which is stimulating for the introduction of innovations (White, 1997).

5.1 Bottlenecks in the Judiciary

The Chilean judicial power system is not efficient in settling disputes because the different procedural stages take a great deal of time. There is no systematic quantitative analysis available concerning penal procedures, but different studies have shown that even the most expeditious procedures are considerably slow in Chile, even compared with those in other countries of Latin America which, it is said, enjoy lower institutional standards. Figure Nº 4 summarizes the length of civil procedures in some of the Latin American countries selected.

Figure Nº 4: Duration of Ordinary Civil Procedures, (two instances)

Country	Duration
Argentina	More than 2 years
Chile	**2 years and 9 months**
Colombia	2 years and 9 months
Costa Rica	10 months
Paraguay	More than 2 years
Perú	4 years and 6 months
Uruguay	8 months

Source: Martínez (1999)

The data in the figure is consistent with other studies for Chile, where the summary civil procedures last approximately an average of 2 years and 5 months (Cerda, 1993); the duration of contentious-administrative procedures related to alimony, visitation rights and custody reach on average one year and 2 months in the initial instance stage only (Universidad Diego Portales, 1994).

Similarly, in cases brought to the Antitrust Commission for unfair practices in Chile's energy sector, it was estimated that the average duration of the trials in the years between 1989 and 1997 reached 2 years and 8 months, not including the Appeals to the Supreme Court, where treatment and final decision took a similar time (Basañes, *et al.*, 2001).

This poor legal performance in Chile shows the need for modernizing the Judiciary system, both in its procedures and in its structure. To such end, three changes should be introduced:

- To implement or strengthen reforms to civil and penal procedures to make them more expeditious and reliable to the parties involved. These improvements are complementary to the proposal for the creation of special commissions.
- General and professional training of legal officers, and retraining of those who hold office; specific economic training for judges.

- Creation of special commissions to settle highly technical economic matters, and to resolve problems or disputes derived from deeds or omissions committed by the State to the detriment of individuals.

Next we refers to the last two changes mentioned above.

a) Legal Reforms Implementation and Economic Training for Judges

As explained by Vargas (1999), when dealing with penal procedural reforms taking place in Chile, the present procedures applicable virtually all over the countries in the region and in most cases are the ordinary procedures followed for simple criminal offenses. These are the procedures that have been followed since the Inquisition days, according to which the interest of the State in punishing crime is above the rights of the individuals. The system, then, proves inefficient for the defense of the accused and considerably affects the corresponding individual rights. Transparency is not present and judges rarely get directly involved in the cases, which ultimately results in generalized unfairness and legal administration inefficacy. Finally, in this system, the judge investigates and passes sentence, thus giving rise to serious conflicts of interests related to the situation of the judges in the administration of justice.[15]

It will be essential to introduce procedural reforms for civil actions in Chile, and also to go deeper into the penal procedural reforms under way since the end of the 1990s. These reforms need to focus on the implementation of oral, public, more simple and improved procedures; that is to say, procedures entirely different from the procedures for civil cases that are in force in Chile today. Whenever pertinent, before and during the proceedings, the parties involved should be encouraged to accept mediation with the assistance of a judge or of a mediator external to the judicial power system. This would diminish the workload and would reorient the focus of the system from being a punishing agent to making amends for the damage caused.

The main advantages of procedural reforms supported by mediation would be upgraded legal services and the potential for the poorer sectors of the economy to gain access to the services. This would improve procedures and would offer more efficiency, access and transparency while, at the same time, the system could become more productive.

These kinds of reforms require well trained judges and legal professionals familiar with economic issues, something that is not very common. Very few judges have received an appropriate background in economics nor have they been trained to deal with economic issues. These gaps in formal academic training to analyze economic issues raise two major issues:

[15] See Dewatripont and Tirole (1999) for a formal treatment on the separation of tasks between a judge and the parties in conflict.

- *The considerable high degree of economic matters litigation in Chile.* Very often, bureaucracy or the absence of decision making power competence of the judges delay procedures which should be shorter. The experts' reports may frequently exhibit little impartiality in this matter; they may even offer no substantive contribution to the resolution of the case.
- *The judges tend to make decisions based exclusively on evidence derived from unlawful activities.* In the economic field, concrete evidence of unfair practices is hard to find; for example, to prove predatory practices is virtually an impossible except when those who perpetrated them are extremely careless. However, it is possible to punish circumstances in which there exists the founded suspicion of the unfair practices. Even though by law the judges may interpret and enforce law following presumptions, the latter demand the judge be highly professionally competent and have wide experience. A judge contrary to taking risks will probably concentrate on tangible evidence to avoid incurring in legal errors.

The first issue, delay in resolving cases, is occasionally solved by the parties involved with the assistance of independent arbitration. This is common practice in Chile and in Argentina to settle disputes in regulated industries. Even though arbitrators have intervened in settling important disputes, especially those in the public utility services, they are not empowered to hold binding arbitration (for both parties), which considerably restraints their effect. Consequently, consideration should be given to the possibility of developing an arbitration system that carries with it the threat of punishment for failure to follow through with the agreements.

However, the most important need is for judges with a knowledge of economic issues and with decision making power based on the analysis of the conditions that allow opportunistic conducts. Chile's judicial power system should include a permanent educational program in economic and legal matters; as mentioned before, profound changes in procedures should also be made. Finally, the creation of special commissions for economic issues and, in particular, for issues where the State is one of the parties involved is becoming ever more necessary. This is dealt with next.

b) Special Commissions

The need to establish special commissions is not related solely to economic matters. There are not many cases in the Latin American judiciary with such characteristics; there are none of the sort in Chile. Consequently, it is possible to think of having economic commissions, contentious-administrative commissions perhaps, like those already functioning in Argentina, France or Spain, or with a more comprehensive scope, to deal with different economic issues, with or without the presence of the State.[16]

[16] There have been proposals already. The government of Chile, through Comisión de Modernización de la Institucionalidad Reguladora del Estado (Committee for the Modernization of the State Regulator Institutional Framework) in 1998 suggested

Having special economic commissions would mean an improved justice administration, quicker procedures and more efficiency, access and transparency in the functioning of the judiciary system as legal decisions related to influential groups could be made independently, helping to prevent corruption within the judiciary itself. In practical terms, these advantages would be the direct consequence of two separate innovations to be introduced in the mentioned special commissions:

- In civil economic cases: the courts have become overburdened with basic services payment or interpretation of contracts between private parties, mainly oral public procedures stripped of formalities would make the system work more quickly. For example, over 60% of civil and penal actions are related to matters not requiring the intervention of a judge; only the bureaucratic procedures, such as in aggressive collection causes (excluding the trial itself), making inheritance effective, reassigning legal budgets, miners' demonstrations, and others, could be required.
- More complex cases: would demand a closer more profound analysis of the corresponding sources and implications. Consequently, specially trained staff should be hired to support the judges in these matters, thus allowing the latter to have a more comprehensive view of the dispute to be settled.

There would be three potential economic quantifiable gains from such changes. First, time saving for the system users, which could be significant in the more complex cases since they generally involve hiring professionals of high alternative cost and the interests at stake are enormous. Secondly, reduction in the number of cases that could be referred to the courts of appeal, a direct consequence of better assessed and better made decisions in the first instance. Finally, the market system credibility, since the state would be subject to legal scrutiny in administrative acts affecting persons, especially in the case of regulation of basic services.

5.2 Consumer Rights and Defense Bodies

We believe it is also possible to introduce the Ombudsman in Chile. Although in Chile this office has recently been opened (2002), it has not been thought out in accordance with a regulator institutional framework; rather, an organization parallel to the state, open to society as a whole and independent of political pressure groups, with the main aim of defending people before political power abuses. We, at least, feel sure it is not an entity meant to defend people from deeds or omissions of the State related to the type of litigation occurring in the regulated public utility services.

the creation of national economic commissions, which would represent only an instance for further appeal in matters related to competition and basic services. Unfortunately, this idea has only been partially included in the draft for the creation of fiscal commissions.

The Servicio Nacional del Consumidor (SERNAC) [Consumer Defense Agency] should be made stronger. This is the office in charge of informing the consumers and, eventually, defending them from abuses by the business sector. A side discussion is the introduction of novel instruments to award people the possibility to defend themselves in cases where the whole population may be affected, like, for example, incorporating class action suit*s*, widely known in the United States, to our judicature. This could make the elimination of barriers possible, for people to have access to a better and more efficient administration of justice.

It is important to mention that the recent modification to the consumers protection act (enacted in July, 2004) incorporates the idea of class actions suits through the figure of consumers *fuzzy* rights. However, in a narrower sense than that used in the United States.

6. Main Conclusions

Chile, with its liberalization reforms of the final quarter of the 21th Century, is heading toward the development of a market economy. Substantial structural transformations were introduced that granted the private sector greater predominance in the provision of goods and services, in infrastructure development and in human capital accumulation. In part of the 1980s and the 1990s, the country enjoyed high sustained growth that, we believe, is the result of the mentioned reforms implementation.

The institutional structure of Chile's economy, the state apparatus most particularly, is incompatible with the efficient functioning of the market that the reforms were meant to open. The absence of profound changes in State administration, in the administration of justice and in the regulatory agencies and competition institutions does not guarantee the Chilean economy can reach the high sustained growth rates needed to lead the country to full economic development.

The root of the efficiency and efficacy problem in the functioning of the State is to be found in the absence of adequate incentives and regulation mechanisms for persons and for public entities. There is generalized weakness in the public administration evaluation mechanisms that should praise individual and corporate achievements, and punish indolence, inefficiency and the little effort to obtain the desired objectives. Instead, little individual accountability responsibility is the result. Furthermore, the State in Chile has traditionally acknowledged little weight to public opinion; tax payers stand poor chances of obtaining information related to the destiny given to their taxes or of having a say in their application, or of recalling inefficient corrupt public officers.

Chile must also respond to the challenge of implementing regulatory frameworks and competition defense bodies to reap the benefits of market liberalization and privatization of state-owned enterprises. In practice, there are numerous constraints that prevent regulators from inhibiting rent seeking in sectors

where private firms operate in monopolistic conditions. There are three reasons to account for this situation: our regulatory entities are technically weak to enforce the existing regulation; the regulatory framework is not complete and may be the source of ambiguities that give rise to opportunism; occasionally, regulation is particularly complex, from a technical point of view.

The regulatory entities must be independent of political power and of the regulated sectors, which presupposes profound changes to the institutional framing of basic services. The regulatory organizations' institutional power must be strengthened to be able to efficiently resolve the ambiguities within the basic services regulatory framework. Not much has been done to identify them and thus modify the norms and regulations. Unfortunately, it is only when opportunistic conducts appear that such ambiguities come to the surface.

The means to achieve regulation must be perfected. Currently, the focus is on direct regulation, in which a regulation is implemented and then punishment applied if it is not compliance. Indirect regulation appears to be better; that is to say, the introduction of market elements in regulation. The purpose is to improve incentives so that the agents themselves develop an interest in compliance.

Governance structure must be redefined to benefit from economies of scope between the role of regulator and that of competition defense. The responsibility for defending consumer rights and competition typically belongs to Antitrust Commissions; educating and informing consumers is virtually non existent given the SERNAC institutional weakness.

Chile's performance in legal matters points to the need for a significant updating of both the procedures and the structure of the judicial power system. To reduce the present weaknesses, the following changes are needed: a) implementing or strengthening reforms to civil and penal procedures to make them more expeditious and reliable to the parties involved (including special commissions for economic cases); b) professional education of the judicial power officers and the retraining of those currently active as civil servants, with particular emphasis on training judges in specific economic matters; c) setting special commissions to resolve highly technical economic issues or settle litigation derived from deeds or omissions by the State to the detriment of persons.

Finally, we should note that the future development of Chile requires attention to corruption, that is so very widespread over most of the Latin American countries. This scourge causes substantial direct costs in the political, economic and social spheres that diminish, if not inhibit, the gains from structural reforms, privatization and market openness to private sector participation. Any reform to the role of the State, in management, structure, regulation and competition bodies or the Judiciary system, will ultimately be unsuccessful in the presence of high corruption rates.

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