

**REGULATION AND DEREGULATION IN CHILE:
SEPTEMBER 1973-1983***

Daniel Wisecarver**

During the first ten years of the military government a lengthy and wide-ranging series of economic measures were put into place, designed, in nearly all cases, to change the Chilean economy's former character —regulated, intervened and statized— into one favoring free private enterprise with the State playing a subsidiary role. In this way the different sectors of economic activity should be able to develop on the basis of free-market principles. This document is intended to be a descriptive gathering of some of the most important reforms implemented during the period, including also two areas where the reforms introduced were not successful, either because

* Most of this document was prepared in December 1982 for a conference on the Chilean Economic Experience, a conference that was patronized and later canceled by the University of California at Davis California. The paper was revised and completed in October 1983 and a final version prepared in December 1985. In the present version no attempt has been made to modify the content in the light of policies implemented since December 1983; for that reason, it is intended to be a description of the regulatory situation in Chile only up to the latter date.

** Ph. D. in Economics, University of Chicago. Professor of Economics, Catholic University of Chile. I would like to express my sincere thanks to Alvaro Bardón, Martín Costabal, Nicolás Irarrázaval, Miguel Kast, Felipe Lamarca, Bruno Philippi and Carlos Silva, among others, for their valuable assistance and support in the preparation of this paper. In addition, each of these share direct responsibility for its contents, as each of them participated actively in the implementation of at least some of the policies described here. I only hope that my description does justice to their efforts and contribution. I dedicate this paper to the memory of Miguel Kast Rist.

they were incomplete or inconsistent, or because they were badly designed. The general issues dealt with here include: (i) public-sector firms and policies aimed at controlling them, the privatization of some of them, and the continuing importance they still have in the Chilean economy; (ii) policies for controlling and liberalizing prices, including policies in specific sectors such as agriculture, transport and public-service rates, (iii) the transcendental reforms implemented in the labor market, especially pension reform, the Labor Plan and the wage floor, the latter constituting one the failures of regulatory policy; (iv) the series of reforms and modifications introduced into the banking/financial sector, and the enormous cost to the economy and for economic policy caused by the lack of decision and corresponding regulatory failure in this sector.

I. Introduction

According to Stigler (1981), the area of research known as “economic regulation” can be defined as anything included in the whole set of public sector-private sector relations, and includes:

Any public intervention in resource markets (land use, institutions for raising capital and labor);

All activities involved in raising funds for government (with the possible exception of the printing and issuance of money), and all disbursements that do not take the form of purchases in open markets, and

All public-sector intervention in the production, sale or purchase of goods and services”.

Applying this definition to the Chilean context requires one to equate the study of regulation with the study of the entire economy, because virtually nothing has managed to escape the influence and repercussions of the management of controls by the state. Accordingly, the study of deregulation policy in Chile, not only has to examine the story of where and how a significant part of the controls exercised by the State were eliminated or altered, but must also describe how the implementation of these changes was to make it possible, at least temporarily, to place state action within the limits set by the principle of subsidiarity and non-discrimination.

Until before 1970, Chile provided orthodox academic economists with numerous examples of how not to run an economy. From the final years of the 1930s, Chile enthusiastically turned towards a policy of tariff protection and import substitution, even long before ECLAC could take

credit for similar advances in economic policy.¹ All imaginable tools were used to strangle trade: high and variable tariffs (with exceptions for capital and other inputs), quotas, import prohibition, prior deposits, exchange controls, multiple exchange rates, etc. The growing state intervention in the economy, either through regulations and/or the management of numerous public-sector firms, led to a rising fiscal deficit, financed by the Central Bank. The resulting monetary expansion caused inflationary pressures which were met with new price controls, the setting of upper limits for interest rates (implying negative real rates), the establishment of wage floors and many other quantitative restrictions. In addition, during the 1960s, the government initiated an agrarian reform —supposedly general, but in fact politically discriminatory. In brief, although there were sporadic (and ultimately useless) attempts to rationalize the economy, the structure of prices and production (and even property rights) did not reflect the true interaction between the underlying resource base and demand from Chilean consumers.

With the election of the *Unidad Popular* (UP) government in 1970, Chile suddenly became the focus of worldwide attention on the political and ideological plain. However, apart from large-scale nationalization of banks and private-sector industry, the Allende government did not alter the previously existing basis of interventionist policies; indeed, it was unnecessary to do so, as the legal structure inherited from previous governments was sufficient to take economic control of the country (even the confiscation of private-sector companies was legal, according to an interpretation attached to an obscure law established in 1932). Rather, under the UP the control and regulation of almost every aspect of economic activity was taken to its logical extreme, given the ruling legislation, to the point where the economy virtually was paralyzed.

When in September 1973 the military coup deposed Allende and installed the present government, Chile became and continues to be the favorite of the Western press as the world's most recent villain: a symbol of human rights violations. A little bit later, when the government began to apply orthodox neoclassical measures, many of the world's academic economists were provided with a convenient coincidence of targets for criticism. With the political situation as a constant backdrop, Chile served as a perfect excuse to attack the free market economy in general and Chicago economists in particular. Harberger (1982) has argued that much of what economists believe and say about Chile is based on a colossal misinforma-

¹ A century ago, Chilean commercial policy was already deliberately aimed at industrial development protected by tariffs. See Cortés, Butelmann and Videla (1981).

tion; for example, the economy did not have a monetary shock of the classical variety applied to it in the initial years of the new government. In some cases, misinformation seems to be reinforced by a large dose of malicious intention. How else can one interpret the fact that scientific economists, who are otherwise serious and cautious,² and with all of them admitting they are unaware of the details of the Chilean economy, nevertheless unanimously used it as the basis for attacking monetarism and Milton Friedman, although none of them had had anything to do with recent economic policies in Chile.

The sole purpose of the preceding discussion is to point out that when Chile is the topic, independently of what aspect is being dealt with, it is very hard to avoid becoming involved in an emotional dispute. Even more so, when the issue of regulation and deregulation economics is intimately linked to normative economics. In this paper I hope to have avoided the largest emotional polemics; but as regards the traditional dichotomy between positive and normative economics, I do not intend, nor have I tried to achieve a purely positive analysis. The deregulatory policies that have been implemented in Chile since 1973 were aimed at dismantling the astonishing set of laws, resolutions and regulations that had been accumulated over more than 40 years, and which gave rise to the aberrations of the UP government. The result of the previous widespread intervention was an economy that was totally distorted, where economic freedom was effectively eliminated and it was irrelevant to assume individual responsibility for actions carried out. If microeconomic theory has at least some relevance, then the new policies introduced since the end of 1973 and up to mid-1982, to limit this regulatory infrastructure and its distortions and install free markets in their place, must have improved resource allocation and increased national income, national wealth and aggregate welfare.

In addition, the distributive aspects of deregulatory policies have been hugely important. Within the historical context of state intervention, groups that were well enough organized and sufficiently important to have access to the government (democratic or otherwise) have always been able to obtain protection and special favors at the expense of the rest of the economy, allowing them to accumulate more resources than they would have obtained otherwise. The deregulation of the Chilean economy, as well as suppressing distortions and inefficiencies, has also largely eliminated the

² To mention one source of examples, see the interviews in the magazine *Cosas* given by J. Tobin (March 15th 1982), P. Samuelson (July 15th 1982), L. Klein (August 26th 1982) and W. Leontief (November 18th 1982).

prospects of special favors to redistribute wealth to pressure groups. This second effect has always been the basic motive for the opposition of certain sectors to the current government's economic policy. In 1975, Jorge Cauas clarified the phenomenon in the clearest and most simple terms, and this has not changed: "It has been a tradition in our country that small economic or political groups invoke the name of the poor to criticize economic measures that affect their particular interests". (Reprinted in Méndez, 1978, p. 202).

The following sections of this paper attempt to describe the most important regulation and deregulation policies implemented out in Chile since 1973. As far as possible, the description is developed in terms of the consequences for resource allocation, the elimination of special discriminatory privileges and freedom of economic action, for the many successful policies and for some mistakes (in my opinion there are two of these and they are described in more detail below). Section 2 provides a general description of the still huge importance of public-sector firms in Chile. Section 3 covers the evolution of general price controls, a detailed explanation of the almost total deregulation of the agricultural and transport sectors and a summary of public-service charges. Section 4 considers some of the most important features of the labor market reforms, while in Section 5 there is a brief summary of the difficult process of liberalization of the financial sector and an examination of the consequences of the absence of a clear regulatory policy.

II. Public-Sector Firms

In 1970 in Chile, the traditional economic questions of what, how and for whom to produce, were conditioned or decreed by the State. In fact, as well as "what? how? and for whom?", the State had added "by whom?". It is impossible to study any aspect of the Chilean economy and not find that at least one public-sector firm has been, and often still is, an important participant.

The State came to assume an entrepreneurial role for various reasons. In some cases it was only accidental, such as the state railway company (*Ferrocarriles del Estado*, and the ETC, which were originally private-sector firms; but when faced with the prospect of bankruptcy and the consequent disappearance of an important public service, the State chose to assume ownership and responsibility. In other instances, such as the Metropolitan Water Company (EMOS) and the Postal and Telegram Service, entities which had once been general public services, these were legally

converted into companies. Some firms were created by specific laws, for specific purposes, such as *Lan Chile* and ENAP. Others such as CODELCO and CTC became public firms when they were expropriated from their foreign owners.

Apart from these specific examples, the concept of the entrepreneurial state was a primordial element in the development strategy pursued from 1939 onwards, the year in which the development corporation CORFO was created. The purpose of CORFO was to promote productive activities by providing credits for private-sector investment, carrying out research and providing project evaluations, sometimes investing directly in certain projects and running their basic firms, originally only in those sectors considered of vital importance for the economy. Thus, in 1944, firms such as ENDESA and CAP were created. However in the course of time, CORFO extended its range of action, ownership and administration to other businesses that were less vital. The most commonly used route for extending state domination was to capitalize overdue loans. For example, by 1970 CORFO had taken over 22 fishing companies, due to breach of contract; it also held partial control of 46 firms, it was the main owner of 31 and the majority shareholder (together with other state companies) of 11 more. In all, by 1970 the State had virtual control of 90 firms, with activities covering the most varied productive areas of the country; public-sector companies accounted for at least 21.1 percent of all fixed capital investment, 4.8 percent of national employment and 22.5 percent of the final demand for goods and services in the economy.³

From 1970 to 1973, CORFO also acted as the state depository for companies that were bought, intervened, requisitioned and/or nationalized. Up to 1973 the state had directly confiscated 259 firms and had used CORFO and its subsidiaries to acquire shares in another 185 corporations, as well as 19 banks. Thus, the total number of firms in which the Treasury had a direct interest had jumped to 620. These firms as a group reported net losses of more than US\$ 500 million in 1973, while the firms included in the “area of social ownership” alone employed 162,545 people,⁴ approximately 5.6 percent of total employment.

The deregulatory task of the new government consisted of the following steps. Firstly, the 259 firms confiscated had to be returned to their owners; 202 were “normalized” in 1974, and the remaining in the following five years. Secondly, it was necessary to determine in which areas CORFO

³ Méndez (1982); the percentages are underestimates as they only refer to a subset of state firms.

⁴ Sjaastad and Cortés (1981); total employment in the 620 firms was greater still.

would maintain ownership and/or participation, and then draw up a program for selling the shares and the various assets it still had under its control. As it was decided immediately that the government's banking activity should be restricted to the *Banco del Estado*, CORFO sold the majority of its bank shares through auctions of share packets between 1975 and 1976. In 1978, 1979 and 1980, other significant sales were made, so that by 1983 it held shares in just one bank. Finally, for firms that were to remain under CORFO control, a general rationalization plan had to be carried out to enable public-sector firms to operate more efficiently and produce positive returns instead of increasing the overall fiscal deficit.

TABLE N° 1 SHARES OF ASSETS BY CORFO: 1974-1982*

Year	Firms Sold Number	Value**	Packets of Number of packets	Bank shares Value**	Revenue from Miscellaneous asset Sales*
1974	49	3.1	-	-	12.6
1975	28	42.8	9	170.5	10.8
1976	22	83.7	4	6.3	16.8
1977	7	93.6	-	-	30.6
1978	8	68.9	6	40.9	5.0
1979	8	125.0	1	28.9	10.7
1980	6	21.5	1	41.0	7.1
1981	3	97.0	-	-	15.0
1982***	4	7.7	-	-	3.7

* Source: Danús (1981).

** In US\$ million.

*** Preliminary figures.

It was decided that CORFO would retain 18 basic subsidiaries, and accordingly a continuous policy was pursued of divesting other shares and assets. In this way, the public sector as a whole reduced the number of its own firms from 620 in 1973 to 66 in 1981, and of these 28 remain in CORFO hands; these 66 firms, in turn, were two-thirds of the number of firms held by the Treasury in 1970 (see Table 1). Furthermore, the 12 largest CORFO subsidiaries, as a group, managed to reduce their losses and in fact began to produce dividends in 1977.⁵ At the end of 1982, CORFO is

⁵ However, CORFO as a whole continued to generate a deficit in 1979; see Méndez (1981), p.18.

still scheduled to sell shares in another five companies and one bank, as well as a miscellaneous list of other assets of lesser importance.

These results, of course, point to significant progress, but the progress should not be overestimated. Firstly, although the number of firms in State hands has been reduced, it should be noted that three of the most important, CODELCO, CTC and *Chilectra* were private-sector firms in 1970. Furthermore, even in 1981 total employment in the 66 public-sector firms continued to account for more than 3.3 percent of aggregate employment, totally dominating the telecommunications and mining sector (Table 2). In the first half of 1982, 30 of these State firms continued employ more than 92,000 people. In 1980, public-sector firms accounted for approximately 20 percent of domestic product, and the asset value of the 12 largest CORFO subsidiaries was equivalent to 60 percent of the total asset value of all the firms registered on the Stock Market. Finally, although CORFO as a whole generates dividends, three firms, CAP, *Lan Chile* and IANSA, reported a combined loss of US\$ 144 million in 1981.

TABLE N° 2 PUBLIC-SECTOR FIRMS AND EMPLOYMENT BY BRANCH OF ACTIVITY IN 1981*

Sector	Number of Public firms	Personnel	Public employment as a percent of national employment in sector
Telecommunications	6	14,438	95
Mining	8	51,982	88
Energy, gas and water	19	15,934	58
Transport	7	13,968	7
Banks and insurance	4	6,849	6
Other sectors	22	3,335	0,1
Total	66	106,506	3,34

* Source: Danús (1982).

Of course there is nothing inherent in a public-sector firm which makes it more or less inefficient than a private one. Given the same operating rules and appropriate incentives for its managers, there is no cause for concern as regards public-sector companies. However, in practice there has always been one big difference between the two: only private-sector firms are subject to bankruptcy. This was never more evident than in 1981 when CRAV went into liquidation whereas IANSA did not, despite the latter's

losses of US\$ 63 million. Discriminatory treatment between public and private-sector firms also extends to other types of benefits: for example, public-sector firms are exempt from tax on their revenues, on their sales, on stamps and sealed paper and the payment of tariffs.⁶ These privileges were withdrawn from them in 1974-1975 as part of the tax reform, but other forms of preferential assistance were kept on. Even so, until just four or five years ago, the losses generated by public firms continued to be a permanent charge on the national budget. As Cauas (1976) commented when describing the deficit of public-sector firms as a part of the Chilean panorama: "These firms, sometimes classified as pillars of development, have made a notable contribution to the impoverishment of our country". (Quoted in Méndez, 1978, p.201).

From 1981 to the present time, with the exception of most of the programmed sales by CORFO, there has been little progress as regards reducing the size of the productive apparatus of the State. Even the announced sales of public-sector firms have been held up,⁷ due among other factors to effective pressures applied by the unions in these firms. When there is no chance of bankruptcy, jobs become life-time jobs, and administrators can afford the luxury of hiring an excessive number of employees and paying them (and themselves) wages above market rates. More important still for the development and functioning of a market economy, the threat of truly unfair competition is magnified, as illustrated in the following cases. Firstly, one of the official explanations for going back on the decision to sell *Laboratorios Chile*, was that the state ought to maintain a mechanism for controlling medicine prices. However, this same state firm has been accused and is being investigated for practicing *dumping* in medicine prices against its competitors in the private sector. This same allegation of unfair competition has been raised against the ISE. It has been insinuated, but not shown, that *Lan Chile* successfully practiced *dumping* against the now defunct private airline *Aero Andina*. And in a series of cases, the antitrust authorities have ruled against CTC for monopoly practices in competition with new private-sector firms attempting to enter the telecommuni-

⁶ In addition, other types of special privileges against potential competitors from the private sector were conceded to the various public-sector firms, up to and including effective prohibitions on entry. Several of these examples will appear in the coming sections.

⁷ CAP and *Laboratorios Chile* were two clear examples in 1982. In fact the Minister of Health has recently mounted a campaign to gain state control over the latter firm, transferring it to the Ministry. This step would open up new possibilities for abuse, since the Ministry of Health, as administrator of the huge public health sector in Chile, is already the most important customer of *Laboratorios Chile*.

cations sector. Finally, *Emporchi* enormously reduced port handling charges in Concepción/Talcahuano alone, at the beginning of 1983. The true reason, given by the administrator of the port himself, was that the small private-sector firm in that area (Lirquén, the only private port in Chile) was about to start a significant project to expand and modernize its facility. Since then the plan has been postponed if not completely abandoned.

In the next section of this paper it will be seen that a central point of the problem of deregulation in virtually all sectors has had to include the treatment of some public-sector firm. In sectors where a long-term solution has still not been found, an integral part of the insuperable obstacle usually involves a public-sector firm as a central protagonist, either openly, or as an indirect and behind-the-scenes force.

III Price-Setting and the Liberalization of Prices: Sectoral Policies

Chile has a long history in methods of manipulating the price mechanism with (i) the microeconomic aim of guiding resources and effort towards certain activities (not to mention their channeling into certain identifiable bank accounts), and (ii) the macroeconomic (political) aim of trying to sweep inflation under the rug of generalized price controls. For example, during the Frei government it was decreed that “products of prime necessity...may not raise their prices in 1966 by more than 13 percent above those ruling at 31st December 1965, nor by more than 35 percent over prices ruling at 31st December 1964. Prime necessity goods are declared to be all articles and services which serve as the basis for determining the consumer price index”.⁸

During the UP, generalized government price controls were used with a slightly different purpose: namely, enabling the massive wage increases financed purely by monetary emission to allow workers in fact to buy more goods and services. In addition, selective price controls were instituted with the aim of expediting bankruptcy and thus justifying the confiscation of selected private-sector firms. At the end of the Allende government, more than 3,000 prices were being explicitly fixed, mainly by *Dirinco*.

It is clear that this process of price controls could either be the outcome of negotiations benefiting certain producers or else arbitrary

⁸ Supreme Decree N° 1379, October 1966, Art. 11. Recorded inflation was 25.8 percent in 1965 and 17.0 percent in 1966.

fixing when interested firms were not allowed to participate, and the post of price-setter had to be one of the lowest wage but best paid jobs in Chile. The list of fixed prices—including items such as chalet-type dog houses and woolen gloves for small children—served as inventories of goods which at one time had been available for sale. But, of course one of the most dramatic and visible effects of price controls and the UP's economic policy was the widespread scarcity of most goods in formal markets, and the appearance of well developed black markets, giving birth to long queues. In fact, it is part of Chilean folklore that, in those days, when people saw a queue they would line up, sometimes for hours on end, without knowing what was to be sold: it was a question of buying whatever it was in the largest amount possible.

The military government took as its first economic priority the restoration of the price mechanism as the most direct route towards the elimination of queues and black markets and to stimulate the revival of production. The first step involved a sharp devaluation and the unification of exchange rates. Simultaneously, it was decided that the vast majority of price controls would be abolished, and on October 15th, 1973, Decree Law 522 was published. This law define three groups of goods and services:

1. Those whose prices would be freely determined by producers and importers. However, the law mentioned that these prices should be based on the exchange rate, wages and other labor costs, input costs, the cost of credit, taxes and a reasonable rate of profit.
2. Goods and services whose prices would still be fixed; Table 3 lists 33 prices thus dignified. *Dirinco* was the agency in charge of setting these prices in line with cost studies.
3. A third group of 18 types of goods whose prices would be informed; i.e. prices were also free, provided they were not rejected by *Dirinco*.

The change was drastic. In just one month of government some 3000 prices were set free for the first time in years. What is more, they were not interfered with to “fight” inflation, as had been made clear in the law relating to price increases caused by variations in cost components. Nevertheless, there was always (and there still is in certain circles) a persistent mistrust of completely free price systems, especially in an economy which has always been characterized more by monopolies created through restrictions and state favors than by the existence of firms guided by competitive market forces. Therefore, as well as the decisive steps taken to realign the price structure, the government gave a clear warning to potential monop-

lists and promised to modify the antitrust laws,⁹ requested moderation in prices on the part of the private sector and began to stress the role of international prices and free trade in limiting abuses in domestic prices. Finally, to smooth out the effect of the price increase for low-income families, the government provided direct and temporary subsidies for tea, coffee, pasta, sugar and edible oils.¹⁰

TABLE 3 FIXED PRICES AND INFORMED PRICES ORIGINAL LISTS FROM DL 522, OCTOBER 1973

Fixed Prices

Bread	Steel
Flour	Cement paper
Ordinary pasta	Sanitary artifacts
Sugar	Matches
Oil	Tires
Tea	Fuels
Milk	Detergents
Television receivers	Air and land passenger transport
Beef	Liquid gas cylinders and their valves
Sirloin	Copper cables, tubes, and sheets
Minced meat	Gas
Entrecote	Electricity
Marrow bone	Telephone charges
Casserole	Water
Bones	Motorized vehicles
Lard	Cigarettes
Products of the type currently made by <i>Chiprodal</i>	

Informed Prices

Pharmaceutical products	Products of the type made by Indus Lever
Glass sheets for construction	Electronics products
Lubricants	Coarse cloth and canvas
Parts for motorized vehicles	Beer
Bata products	Glass bottles
Products of the type made by <i>Pizarreño</i>	Ball-point pens
Washing machines, refrigerators, etc.	Aluminum crockery and containers
School registrations, fees and services	School uniforms
	Nails and wires
	Soluble coffee

⁹ The modified law was in fact published on December 22nd 1967.

¹⁰ See the speech *Estado de Hacienda Pública* by Admiral L. Gotuzzo, in Méndez (1978), pp. 23-45.

Although there were other procedures for fixing some prices not included in Table 3,¹¹ the processes of price deregulation can be resumed in terms of the legal adjustments to Decree Law 522. Items can be transferred from “fixed” to “informed” or “free”, and vice-versa. Some specific price settings were quaint, due to the name, type of product, name of the distributor and place of sale. For example, in July 1974 the retail sale price was fixed for all Rann detergents, imported by the Ancud Chamber of Commerce Purchase Center; as was the retail price for soya oil from Holland imported by Domingo Coro and Son Ltd. These cases, which have their own intriguing histories, were the exception; the general policy, particularly from 1977 until May 1982 (1981 was a notable exception) has been to allow increasing price freedom.

In December 1980 an important step was taken, when Decree Law 3.529 prohibited prices that had been on the “informed” list returning to the fixed-price category; likewise free prices could not return to the status of informed or fixed. In this way, any future fixing of prices would require a special law, rather than just a resolution from the relevant minister. Currently, the only prices that continue to be legally fixed in Chile are drinking water and drainage, natural and liquid gas (as well as products related to the use of these fuels) in the two southern regions, electricity charges for clients with installed capacity below 2000 kilowatts, the variable part of taxi rates and some inter-urban bus fares on daytime routes on working days, for vehicle models prior to 1971.

However, the recent history of fixing and freeing telephone charges has been a model of disorder, inconsistency and the absence of clear criteria. One should understand firstly that, according to the global prices policy, with the passage of time, a certain number of charges corresponding to auxiliary services in which competition was possible, were removed from the fixed list, leaving to the regulator’s discretion only the charges for standard urban services, long distance telephone-to-telephone rates and other charges for services which “only” the telephone company could provide.¹² Then in September 1982, the new telecommunications law foolishly decreed complete freedom of all telephone charges, unless the Antitrust Commission were to decide that the telephone service constituted a monopoly, in

¹¹ In general, all public institutions that charge for their services or products (not including DL 522) were free to set initial price levels, but all future change - not only increases but changes - had to be approved by the Economics Ministry.

¹² Connection to a new line in the network, change of number or an alteration in the telephone directory, and the suspension and restoration of service.

which case the Economics and Telecommunications Ministries could set rates. The Antitrust Commission immediately determined that telecommunications was a monopoly service, but the two ministers decided not to exercise their right to set rates, preferring the Telephone Company to announce these on the December 1st, 1982. The Antitrust Commission then suggested that the freely announced rates would be rejected until the two ministries had in fact fixed them. As this latter suggestion was not obligatory, a final resolution remained pending as regards how to set charges, while those announced by the companies themselves came into force. Never was the lack of communication, planning and direction in the telecommunications sector, at the level of relevant authorities, more evident.

In sum, the price system in Chile has suffered a huge transformation in the space of ten years, from a system in which almost all prices were fixed, and where almost no price reflected the underlying conditions of supply and demand in the economy, to one of the freest price systems in the world. With the current exception of certain bus and taxi rates, price-setting has been turned into the classic problem of setting rates for public services. Although all prices that have been freed have their own stories, there are two sectors that deserve more detailed attention: agriculture and transport.

Deregulation in the Agriculture Sector

The history of Chilean agriculture is one of the clearest examples of the destructive effects of control through public-sector firms. The most important firm by far was ECA, whose main role was to serve as “regulator” of agricultural prices and supply throughout the country. In practice what ECA achieved, by using its legal monopoly to import wheat and other agricultural products, was to isolate Chilean agriculture from international markets. ECA consequently imported at world prices, but sold at lower prices calculated to apply downward pressure on the domestic inflation rate.

At the same time, ECA assumed effective responsibility for setting prices for the Chilean producer, prices which of course could not be significantly different from those at which ECA sold its imports. Indeed, ECA policies constituted an indirect and burdensome tax on agricultural products, and in order to soften the impact of this tax, the state bank *Banco del Estado* assumed the legal monopoly for importing fertilizers and other inputs, which it then sold to farmers at prices below what the *Banco del Estado* had itself paid.

Finally, so as to complete the circle, *Socora* was effectively given a legal monopoly to export agricultural goods. *Socora* exported products at

prices sufficiently depressed so as to be compatible with ECA selling prices, but at the same time, given the incentive of low import prices provided by the *Banco del Estado*, constant pressure was put on farmers to expand output. In summary, given the actions of these three state entities, together with centralized coordination by *Odepa*, Chilean agriculture was effectively isolated from any influence exerted by genuine market forces, as price and quantity incentives were totally arbitrary and artificial.

Within this institutional context, freeing the prices of agricultural products did not make sense without curtailing and rationalizing the degree of intervention these institutions exercised. Socora's export monopoly was eliminated, as was (more slowly) the commercialization of agricultural inputs by the *Banco del Estado*. On the other hand, the transformation of ECA required a lengthy, careful and methodical process of reorientation. Firstly ECA's role was fundamentally redefined: instead of being an institution with responsibilities covering the length of the country, with 102 establishments for sale and storage, 2917 workers,¹³ and the legal burden of regulating all possible aspects of Chilean agriculture, ECA's job was limited to ensuring a regular supply of agricultural products in just 50 isolated areas in the extreme North and South of Chile. In order to keep to this role, the majority of ECA's physical assets were auctioned off between 1975 and 1982, and the number of employees was reduced to 404 in 1980, falling to 200 by the end of 1982. ECA cost the Chilean economy US\$ 504.2 million in 1973 and US\$ 166.1 million in 1974, in simple budgetary terms alone. Between 1975 and 1979, this cost fell to an annual average of US\$ 21 million, while for the years 1980-1982 ECA reported a profit (mostly due to asset sales) of approximately US\$ 1.4 million per year.

In the process of reducing ECA's generalized control of agricultural sales and prices, public- and private-sector entities had to be convinced that a freely functioning market could give effective results and in fact would be more desirable. Certainly the most important step in eliciting private-sector participation in the market was a "simple" change in the ECA purchase and sale policy. Until the 1973-74 harvest, the ECA simply set the nominal price of, say, wheat, the same price for buying and selling, usually without significant warning and without giving information about the basis for determining the price. As a result, there was obviously no incentive for private-sector firms —speculators or millers— to store grain, and farmers had to sell all their harvest as quickly as possible in order to avoid the risk of loss on the stored product and inflation tax on their earnings.

¹³ Including workers that were indirectly dependent on ECA, the employment figure is even higher: between 4800 and 5000 people in 1974-75.

For the 1974-1975 harvest a new pricing policy was put into effect: the ECA set a basic daily purchasing price (for wheat sold in Santiago) based on international prices, with daily adjustments in line with the variation in the CPI, plus storage costs and interest. For purchases further to the South (and close to wheat-producing areas) there was a surcharge to cover railroad rates. Finally, the pre-announced ECA selling price was set at a constant percentage above the official purchasing price during this first year. The spread thus created was 3 percent in Santiago, rising to a maximum of 9 percent in production areas. The effects of this new strategy were immediate and dramatic: farmers now were not faced with the urgent need to sell immediately and could give themselves the luxury of storing their production, while millers were led to accumulate wheat for use during the year. As result, ECA purchases fell from virtually 100 percent of the harvest each year to just 5 percent. Correspondingly, ECA budgetary losses (and the concomitant effects on monetary emission) fell from US\$ 116.1 million in 1974 to “just” US\$ 22.3 million in 1975. The same pricing strategy was implemented for the 1975-1976 and 1976-1977 harvests with an annual increase in the spread between the buying and selling price, and each year ECA participation in the wheat purchases declined. On January 7th 1978, wheat was officially eliminated from the list of fixed prices, as the market had shown that ECA participation was not needed to regulate sales and prices.

At the same time as direct ECA participation in agricultural markets was being restricted, other intervention mechanisms were also abolished, with the result that the agency lost the authority to set norms on grain, flour and milling operations, as well as in arranging national contracts for the shipping of agriculture products and maintaining its monopoly of the dissemination of information on agricultural production, consumption and prices.

Meanwhile, agricultural organizations spokesmen have waged a continuous campaign (and an intensifying one in the current recession) against “excessive” market freedom in their sector, the existence of foreign dumping and domestic shortcomings in the marketing of agricultural products¹⁴, and this has recently begun to bear fruit in the sense that certain previously

¹⁴ It is continually argued that the market process is permeated by powerful intermediaries with monopoly power who exploit farmers and consumers. However, agricultural organizations have not brought an explicit complaint before the Antitrust authorities nor have they tried to enter the supposedly lucrative business of marketing of agricultural products, although there are absolutely no entry barriers. It would seem that no one connected to the agricultural sector responds to potential incentives and benefits, (although it should be recalled that it only took a 3 percent spread between the buying and selling price of wheat to reduce ECA harvest purchases from 100 percent to 5 percent).

It is particularly noteworthy and characteristic that farmers have only considered the alternative of seeking State intervention.

known policies have been reintroduced, aimed at providing protection for the sector.

Milk products now have a 25 percent tariff surcharge on imports, to offset “unfair” competition from abroad. CORFO was persuaded to expand *Iansa* operations, guaranteeing prices for the production of sugarbeet and reopening refinery plants that previously had been closed. (Remember that while *Iansa* was losing money in 1981, CRAV went into liquidation). In December 1982, wheat producers managed to obtain government support for taking out a power of purchase aimed at regulating wheat prices. Although the headlines in the Santiago newspapers proclaimed that the private sector (*Copagro*) would carry out this activity, it turned out that this entity enjoyed financial support from the *Banco del Estado*, would use the remaining ECA silos and would have a guarantee that its participation would not mean losses for the private sector body. Apparently the methodical dismantling of ECA infrastructure had been rather slow. It only remains to be seen how much this new attempt to regulate the wheat market will cost the Chilean economy. And, as if to ensure that the cost will not be insignificant, in May 1983 the government also established a floor price for wheat, something that the wheat producers themselves have been clamoring for.

Deregulation of the Transport Sector

A Passenger Transport in Streets and Highways

Buses. Some of the regulations existing in 1973 and 1974 were really spectacular. For example children could be transported to and from their respective schools only in yellow colored buses, to such an extent that the owners of such buses sometimes managed to convince the police to ticket parents who carried anyone other than their own children in the family car. (There is a true story of a father who had to appear in court and show the judge his family record book in order to prove that the eleven children that he was carrying in his non-yellow vehicle were his own children!) Also, if any organized group wanted to hire a bus (or take their own) on a weekend trip to the beach, they had first to obtain permission from the Undersecretary of Transport, with at least three days’ notice. In fact, no bus could go anywhere, at any time, for any purpose, without express authorization. One of the crucial decisions reserved for the Undersecretariat for Transport, and one which required careful study and consultation with other ministries, was the color and material of the uniforms the

drivers of such buses would wear the following year. Of course, regulators did not ignore more fundamental things as well. For urban transport, cities were divided into fixed routes that were assigned indefinitely to specific operators; the rights on a route and its use could not be transferred.¹⁵ The authorities fixed the number of buses and their frequency on the route; frequencies were uniform regardless of the day of the week or the hour of day, and they was controlled by the police. To ensure compliance with these obligatory timetables, bus drivers were prohibited from taking rest periods in the bus terminal (giving rise to the phrase “ping-pong routes”). The Ministry of Transport also set quotas for the number of buses that could come into Chile,¹⁶ their model, size, country of origin, etc. Most restrictions and controls were codified in Supreme Decree N° 106, 1969, which also required the Undersecretary for Transport to ensure no unfair competition from a similar transport service could appear, and specifically not with artificially lower costs. Hence, all rates for the service were fixed.

This system remained intact until 1978, and then the process of deregulation began. The first step was to guarantee operators complete freedom in deciding the frequency of their routes. Then, the bus companies themselves obtained permission to freely alter up to 10 percent of their routes each month. Next, the restriction on the number of operators and buses per route was abolished, with the only requirement being a certificate vouching for the vehicle’s adequate mechanical condition. Although these steps were obvious and must even seem simple, each one was a outcome of a lengthy discussion period. The most effective tool the Economics Ministry had at its disposal in deregulating the sector, was the threat of inflationary pressure. As all rates were fixed, they had to be readjusted periodically in line with the general increase in prices. Thus the Economics Ministry made approval of resolutions for raising prices prepared by the Ministry of Transport, conditional on the promulgation by this Ministry of resolutions abolishing one or other of the restrictions mentioned above. (“logrolling” or “blackmail” are two ways of describing this, depending on one’s point of view). Currently the Undersecretary for Transport still has to approve new routes, for reasons of traffic control, as well as special services to embassies, for example, but otherwise urban transport services are completely free of quantitative restrictions.

¹⁵ Good routes, with their correspondingly higher (fixed) tariffs, were naturally allocated to the union leaders and spokesmen.

¹⁶ In other words, brought in under special lower import tariffs granted to approved imports.

The second front of deregulation was freeing collective transport rates. This process was slow and painful, and the first steps were taken only in 1980. Firstly, firms operating new buses (1976 models and later) on new routes (approved of course), were allowed to set their own rates. There also given freedom to set rates on routes which combined with the Santiago Metro; in both cases, special rates were kept for students. Secondly, on July 30th, 1982, rates were freed in the following cases: (a) in selected localities where there was still no urban service (!?); (b) in the whole country on night-time routes as well as on Sundays and holidays; and (c) in the case of 1976 and newer buses, regardless of whether their route was new or not. In the first week of 1983 the cut-off year was set back to 1973 and then later to 1971. The latter step guaranteed that in the absence of explicit legislation to the contrary, all bus fares would be freely determined in the medium to long run.

Up to 1977, rural and interurban bus services were subject to the same series of generalized controls; furthermore there was an additional and more explicit barrier to entry on interurban routes. If a company wanted to provide a service between two or more cities, the application for approval had to pass through an advisory committee made up of the head of the Department of Rail Transport in the Undersecretariat for Transport, a representative of the State Railroad Company and a representative of the National Confederation of Bus-owners in Chile. This system was so efficient in restricting the number of bus routes and bus companies, that potential passengers tried to use their political connections to earn the privilege of paying monopoly prices for tickets that were not available at bus stations. The system also created a new form of "bandit": the pirate taxi. Just as it was illegal to drive an unauthorized bus on any interurban route, it was also illegal, but more difficult to identify, to carry fare-paying passengers in a private car on the same routes.

Deregulation here was quicker and easier. Firstly, in 1977, restrictions on access to routes were eliminated. Secondly, fares became informed, rather than fixed prices on any route served by more than one firm. Finally, all interurban bus fares were free from State control in 1978. The subsequent improvement in the passenger service throughout the country has been notable. To take just one example, prior to deregulation, the route between Santiago and Valparaíso/Viña del Mar was operated by two firms using old and uncomfortable buses, and the service was not very reliable. By the beginning of 1982 there were 12 firms covering the same route: at any time of day one could, for example, take the Metro from the outskirts of Santiago and have to wait under 15 minutes before getting into a new

modern and air-conditioned bus that would reach its destination within two hours. The fare was less in nominal terms than five years ago. Moreover, passengers were not the only beneficiaries: in Santiago the daily rates for entering swimming-pools also fell.

To make the description of bus transport deregulation more complete, it needs to be mentioned that the state firm operating in the sector, the *Empresa de Transporte Colectivo* (ETC), produced annual deficits on the order of US\$ 10 to 15 million. At the start of the present government, this public-sector firm owned approximately 35 percent of all Chilean buses, as well as its own set of exclusive routes, its own factory for replacements and more than 5000 employees. ETC was well known for its social routes¹⁷ and for having its vehicles under repair for up to 6 months a year. It was interesting to verify that when these same buses were sold to private-sector operators, they worked the whole year in two daily shifts. The closure of ETC not only represented a general reduction in costs for the government, but also the disappearance of a real threat of unfair competition against the highly competitive private sector.

Taxis. The number of cars that could be employed as taxis was strictly controlled by the Undersecretary for Transport, the Director of Transit and indirectly by the professional taxi drivers' union. Each municipality had assigned a fixed quota of taxis which were identified with special number plates —and, of course, vehicles holding these plates were worth several times the value of the car itself. The monopoly these taxis enjoyed allowed them to provide a bad service (they would agree to take a given client to certain places, only if it was convenient). The only control on these taxi drivers was in setting their fares.

In 1976 the monopoly was broken by simply eliminating quotas. Any car built in 1972 or later could operate as a taxi, subject to the sole requirement of being painted black with a yellow roof. The only future restriction (but not retroactive) requires that cars should not be more than 10 years old. Apparently there are no reliable statistics on the number of taxis before the monopoly was broken, but estimates of the increase in the taxi fleet range up to 100 percent and higher. The sector is now highly competitive and it provides an excellent service. The only threat to entry comes from taxi-driver unions, but until now they have had no success in extinguishing competition.

¹⁷ It often turned out that these routes existed for the exclusive benefit of a variety of government officials, their employees and related social groups.

The attempt to deregulate taxi fares represents one of the reforms that still remain to be carried out in this area. At the end of 1980, when taxi drivers sought new increases, they were given a choice: either keep existing fares (41 pesos for the fixed charge and 1 peso for every 200 meters), or change to a system in which the fixed charge (indicated clearly with a label on the window) would be completely freely determined by the taxi driver, and the variable charge could rise to 1 peso per 100 meters. The market began to function immediately; some chose to stick with the old system, a large number experimented with different values for the fixed charge and others even negotiated openly with potential clients. However, the organized taxi-driver union was against freeing any part of the fare,¹⁸ and they launched a campaign against the new system.

As soon the campaign began to disappear the Transport Undersecretariat, for reasons that are still unclear, decide to force all taxis to adapt to the new system. Apparently it was thought that competition would only be achieved if all participants were identical. A week of intense meetings followed, between the authorities and the union leaders, and the fares system that finally emerged was with new variable fares and taxi drivers being able to choose the fixed charge from among the following values in pesos: 20, 30, 41 (?), 50, 60, 70, 80 and 90. All Santiago taxis chose 41, the pre-existing rate. The net result, after a month of obstacles, was that taxi fares were exactly what the unions had previously asked for.

Collective (or shuttle) Taxis. The final master stroke in the Chilean passenger transport system was the institution of collective or “shuttle” taxis known as “*colectivos*”. These are taxis which operate certain defined routes carrying up to 4 or 5 passengers. From the beginning they have been given complete freedom to set fares and routes, and may cover any route they wish. The only requirement is that they should be black and carry a badge indicating their destination. These shuttle taxis are extremely flexible and create new routes, both urban and inter-urban, whenever a potential demand is detected. They really represent an equilibrium force in the transport market, as they compete with buses and regular taxis. In fact, their existence along with free entry in all aspects of transport, eliminates the need to set prices in this sector.

To summarize, the terrestrial transport service in Chile has been the model of a competitive market working well, achieved largely through the

¹⁸ The reason is obvious: as they now had no control over entry, the only justification for the continued existence of unions was their ability to achieve and deliver increases in fixed fares through highly publicized negotiations with the authority.

application of a consistent deregulation policy. Clients can choose among the whole spectrum of possibilities, from the cheapest and the most uncomfortable of buses, to an expensive but excellent radio taxi service. The only weak point in the system might one day be the Metro, because prices are fixed by the authorities. If it was decided to set these prices artificially low, the Metro would again become a source of unfair competition for buses. Such a subsidy, which would be financed by the State, in turn could initiate a series of problems in a chain reaction. Fortunately, before the current recession, the Metro was covering its operating costs and contributing to the payment of its debt service. But unfortunately, efforts to turn the firm into a corporation with private-sector investors, as a protection against potential future implicit subsidy policies, unfair competition and consequent losses for the central government, have been rejected. This reaction largely reflects a mistrust of the private sector, a consequence of the financial crises that have afflicted the country (see Section V).

Santiago used to be well known for its long and disorderly queues of people waiting for the next bus, or for competition to the death among clients for the few taxis they could find. Passenger queues have now disappeared, there are always buses available, and now it is the taxis that compete fiercely (but openly) for clients. The market works and everyone has gained, except for those privileged few who were used to having unlimited guarantee of monopoly benefits.

B. Railroads

The state railroad company was granted legal status in 1884. Since then, the legislative history of Chilean railroads includes a long series of special tax exemptions, various direct and indirect subsidies, and implicit and explicit schemes of protection against potential competition, either from other railroad operators, or else alternative forms of transport.¹⁹ The operations of the railroad company for a long time have been characterized by a series of inefficiencies, which have raised costs, added to the existence of a large number of free passes for groups that had acquired the “right” to travel at reduced fares (if not free). Up to 1970, the company had 27,185 employees, 26,404 in 1973²⁰; and in 1986 it was generating yearly losses of more than US\$70 million.

¹⁹ For a more detailed study of Chilean railroad legislation, see Dittborn and Martínez (1981).

²⁰ Sjaastad and Cortés (1981), p. 355.

Apart from removing from the railroads their right to obstruct the entry of buses competing for the same routes and allowing the firm to decide its own fares, the problem of reforming this state company was more a question of internal rationalization than one of deregulation. Redefining the purpose of railroads —i.e. emphasizing heavy and homogeneous freight transport, rather than all types of transport— made it possible to reduce the firm's investment budget.²¹ The number of employees was cut to 12,000 in 1980 and between 8000 and 9000 by 1982. Free passes were abolished as well as seldom-used branch lines. As result, the railroad ceased to report operating losses for a couple of years. However, in 1982, the company once again lost US\$20 million, and considering the recent changes in its board, the prospects for non-deficit operations in the future are not very bright.

C. Air Transport

Up to 1977 all aspects of air transport and cargo were strictly regulated by the *Junta de Aeronáutica Civil* (JAC). JAC considered it its basic duty to protect the interest of the State air company: *Lan Chile*. Indeed *Lan* regulated all passenger and freight traffic in Chile, both domestic and international. If for, example, a foreign airline sought permission to operate in Santiago it had to reach a prior agreement with *Lan*, an agreement which usually involved revenue sharing (i.e., *Lan* had to receive part of the revenue from the operation). Then both airlines could go to IATA to obtain air fares which were high enough to pass the costs of the agreement on to passengers and freight operators. For new national firms, the procedure was very similar, but in this case the JAC paid more special attention to who the owners were: whether or not they had a good background, the quantity of capital that they had, etc.

Air fares and freight charges were fixed according to IATA recommendations, approved and strictly controlled by JAC. Control was so strict that any discount or differential payment not authorized by JAC resulted in severe fines for the offending airline. Although in fact passengers and cargo were transported, the service was expensive and freight was especially slow. At one time the bottleneck was so restrictive that an airline cargo remained in a New York warehouse for a year before being brought to Santiago.

²¹ It is interesting to note that in 1976 the accumulated value of new but never used equipment amounted to about US\$100 million.

It was one such delay that caused the deregulation of Chilean air traffic to start. In 1977, *Lan* carelessly took six months to send some equipment for the JAC president. The president was understandably very upset, and as he had the power to take reprisals, he arrived at the next session of the JAC determined to punish *Lan* by reducing its permitted flight frequencies. However, other members of the JAC convinced him that *Lan* could be equally punished while at the same time benefiting freight customers, not by reducing *Lan's* flight frequencies, but by lifting air cargo restrictions for other airlines. Thus, in this meeting an 'open-skies' policy for air freight in Chile was instituted administratively, six months before the United States initiated the deregulation of their airline industry.

The next step was to lift restrictions on passenger traffic. Firstly, in another administrative decision, JAC ruled that any request to provide a passenger service of any kind in Chile should be approved, unless *Lan* could conclusively show within one week that the service being sought would be directly prejudicial to it. Finally, in 1979, open skies in Chile passed from being a fragile administrative rule to a full law: DL N° 2.564 expressly prohibits restrictions on type of airplane, ownership or origin, capacities, points of operation, frequencies (schedule or charter), routes or fares. There are two potential exceptions to this complete freedom. In the first place, foreign flights can be restricted for national security reasons (an exception that one day might meet widespread application); secondly, reciprocal restrictions can be applied to firms in countries which restrict the operation of Chilean airlines.

The results of the 'open skies' policy include:

1. Three new Chilean airlines were formed, two of them offering international flights;
2. Foreign airlines expanded services and some began new services;
3. Private-sector Chilean companies overtook *Lan* (immediately in 1979) in terms of passengers and cargo on domestic flights;
4. The air-taxi service jumped 94 percent in 1979, 64 percent in 1980 and 37 percent in 1981;²²
5. Average international airfares fell abruptly, as for the first time Chileans were given access to charters and other special fares offered by North American and European airlines.

Table N° 4 shows the financial impact *Lan* has had on the economy. In the 4 years prior to full deregulation, *Lan* cost Chile a total of US\$ 9.7

²² *Junta de Aeronáutica Civil* (1981).

million, although in 1978 it made a profit of US\$1.5 million. In the first year of open skies, net profits fell to US\$ 219 thousand and from then on losses have risen considerably. At the same time, passenger and cargo traffic declined in 1979 and 1980 only, whereas international traffic has expanded in each year. Thus, although *Lan* lost its privileged position when the skies were opened, having closed skies was not sufficient protection to make it profitable. Now, at least, if the government insists on the luxury of maintaining a national airline that loses the equivalent of more than half of national expenditure on the minimum employment program, it will do so without imposing discretionary additional costs on Chilean passengers, freight operators and competing airlines.

TABLE N° 4 LAN CHILE: OPERATING RESULTS*

	(1) Profits	(2) Transfer from Treasury	(3) Total benefit [(1) - (2)]
1975	- 1.997,7	1.413,1	- 3.410,8
1976	- 1.508,6	238,0	- 1.746,6
1977	17.091,0	23.124,0	- 6.033,0
1978	3.120,3	1.662,3	1.458,0
1979	223,0	4,0	219,0
1980	- 1.900,5		- 1.990,5
1981	-34.592,6		- 34.592,6
1982	n/a	42.500,0	- 42.500,0

* US\$ thousand

D. Maritime Shipping and Ports

With Chile's geography and its traditional dependence on mineral exports, it is obvious how important it is for ports and the merchant marine to work reasonably well. This importance is greater today given the development strategy of opening up the economy through tariff reform. But during the initial years of the present government nobody was concerned about the institutional, economic and legal structure of these sectors. Doubts began to arise towards the end of 1975, due to the emergence of a question that does not have a clear explanation: why did producers, especially those of non-traditional exportable goods, insist that they were physically unable to export their goods? Although an investigation indicated that the complaint

was exaggerated, it also discovered four nucleuses of regulatory problems that need to be corrected: restrictions on the ships to be hired, labor restrictions regarding ships' crews, the monopoly operation of ports and the structure and power of the stevedores union.

The Merchant Marine. Through a series of articles hidden away in various laws, the shipbuilding industry in Chile had gained a lucrative captive market. The most important piece of legislation was Law 12.041, 1956, which set shipping rates. But more important still, it also reserved 50 percent of all freight (both exports and imports) to and from external ports served by Chilean lines, for Chilean ships; furthermore, all cargo between Chilean ports was also reserved for them. In practice, the law could be used easily to suppress all exports in foreign boats. Exporters (or importers) were responsible for verifying the availability of a Chilean boat to transport their goods. If the shipping company replied that they would have a vessel within 24, 40 or 60 days (for perishable, normal and strictly non-perishable goods respectively), the exporter was obliged to wait for the Chilean boat. If the reply was no, the shipping company passed the exporter a permit to hire a foreign boat to load the exporters goods in Chilean ports. As a shipping company faced zero cost by saying yes, and 20, 40 or 60 days later could change its mind, the control it in fact exerted was total. In addition, Chilean shipping lines were authorized to cede their reserved cargo to any other boat they chose. This right obviously meant receiving some sort of donation, entry to international conferences or other types of advantages. Similarly, although shipping rates were legally fixed, they were determined on the basis of costs studies, always with the aim of developing and encouraging the Chilean merchant marine. For that reason, given the existence of such a highly effective monopoly, costs and shipping rates could be anything: any inefficiency was directly passed on to the client via the shipping rates that costs studies had indicated. Even without tariff barriers, the protection afforded to the merchant marine constituted an effective and a general obstacle to trade.

Deregulation in this sector was more difficult than in other cases, as the authorities themselves had to be made to acknowledge there was problem. The first step was to transfer the faculty, held by Chilean firms, of granting permits to use foreign boats, to the Ministry of Transport. Within the Ministry, permits began to be granted in a non-discriminatory way, slowly breaking the captive market. Finally, in 1980 new legislation abolished the reserved cargo and the monopoly this concept created, except in cases of reciprocity.

Ships Crews. The labor laws related directly to protection of the merchant marine. Protected Chilean boats were operated under the Chilean flag and logically had to be operated by Chilean crews. Labor groups were so well organized (maintaining fixed contractual relations either with large shipping firms or according to set geographical areas), that initially they were not included in the reformed labor legislation that was applied to the rest of the economy. As well as this, although the harbour master only had to decide on the minimum crew, in practice he would fix a ship's entire crew. However, as all costs were passed directly to possible customers, the shipping lines with their guaranteed monopoly had no incentive to worry about the problem.

Part of the solution, of course, came about automatically with the abolition of the reserved cargo. But prior to this step, the Ministry of Transport authorized Chilean boats to register in other countries, allowing transport in ships flying non-Chilean flags, and thus abolishing the need to employ a Chilean crew. Following the example of the public-sector firm *Interoceánica*, Chilean firms entered into genuine labor negotiations, and the cost savings were significant. On three boats that *Interoceánica* sent under foreign flags and with foreign crews, the reduction in labor costs was approximately US\$ 350,000 per boat. Other reforms included convincing the harbour master only to specify minimum crew requirements and to bring the seaman's unions under the jurisdiction of the new labor legislation.

Ports: Emporchi. Although there is a small private port in Chile, all significant activities are carried out in public-sector ports operated by *Emporchi*. Perhaps the most important characteristic of *Emporchi* from the point of view of economic efficiency, was the high degree of autonomy in fact exercised by each of the 11 port directors. This autonomy was maintained over time, thereby avoiding a systematic codification of their operations. Prices charged for the wide variety of port services were decided through a complex procedure; so complex that the client only knew that prices were high and that the director himself had complete discretionary power to reduce them, as he alone thought appropriate. In addition, *Emporchi's* investment budget simply took the form of a fixed annual sum (approximately US\$ 20 million in 1975), regardless of whether or not specific investment projects had been identified by *Emporchi* or anybody else.

The process of rationalizing port operations began at the end of 1979, and the constant underlying goal was to bring the private sector in the management and operation of ports. The first step in this process was to reduce the *Emporchi* investment budget and urge private-sector users to undertake new or replacement investment. Existing and underutilized equipment was auctioned

off, and private-sector users were allowed to bring their own equipment and manage their own cargo operations for loading and unloading, with their own crews. At the same time, the number of workers directly employed by *Emporchi* was reduced, firstly by not rehiring, then by giving early retirement benefits and, finally, by offering attractive packages to induce workers to quit. Out of 4700 employees in 1973, *Emporchi* now employs 1400 directly hired workers.

Paradoxically, another important step in port rationalization was the first explicit setting of port charges, which was only achieved in 1981. The importance of these charges was not so much their exact values in terms of marginal costs,²³ but rather the definition of a single and totally known value for each and every one of *Emporchi's* functions. With this information, for the first time private operators had an objective basis for taking their own decisions regarding investments, imported equipment and the most economic way of using ports in general.

Another important aspect in the rationalization of *Emporchi* operations, from the national point of view, was dividing it into a series of independent companies. Each port was put under the authority of an autonomous director who had control over everything including the hiring and firing workers. With the decentralization of port administration, each one had to maintain their own accounting records, and the results were published port by port. The idea, of course, was to force the independent directors to compete among each other and improve port efficiency in the process. In 1981, *Emporchi* was legally transformed into ten separate companies, within a holding-company structure. Future plans involve opening the ports up to greater direct investment and operation by the private sector, auctioning separate piers, loading bays, warehouses, etc.

Stevedores and Pier Workers. Prior to 1981 in Chile there was a total of 77 unions, with up to 17 in a single port. These groups had total monopoly control over loading and unloading in each port; they determined the number of workers in each working squad for loading and unloading, and set wages as a function of cargo type. Each worker had his precise job and could not do anything else; nobody who had been explicitly appointed to do a job could work in another one. In practice the system degenerated to such extent that work squads doubled through labor requirements, and of course, the payroll also doubled. One of workers' biggest

²³ In fact, there were no reliable figures for either operating costs or capital costs. There was unanimous agreement that new prices should be closely controlled and be adjusted according to the effects that were observed.

concerns during the middle of the shift was to find the most comfortable place to sleep.

Inefficient and costly as this system may have seemed for exporters and importers, the social structure that developed around the port workers monopoly was even more remarkable. There were at least 5 categories of workers:

- 1 Stevedores: these were true top-class workers, who had the legal monopoly to work, granted to them by possession of an official identification card issued by the authorities.
- 2 Replacements: these were the first round substitutes for stevedores; logically but not necessarily the first in line to receive the coveted and lucrative card. The replacements were the first to be called to work if there were insufficient stevedores.
- 3 *Pincheros*: these were workers of low-rank (at least in the port hierarchy) who one day might expect to attain the stevedore status. Meanwhile, they would wait around in ports for sporadic work opportunities that the stevedores sold them.
- 4 Workers or hands known as *Medio Pollos*: these were the lower-ranking pincheros.
- 5 Workers known as *Cuarto Pollos*: low ranking *medio pollos*.

For each boat that had to be loaded or unloaded the stevedores were called to determine the work squads and costs. Only stevedores had the legal right to work, and so were the only ones directly paid. They passed work on to the *pincheros*, who in turn shared out tasks between the *medio* and *cuarto pollos*. The stevedores collected all the wages and passed them on, after deducting a kind of “commission”, to those who had participated in each specific job. At the same time, the union leaders collected a separate round of contributions from all workers to finance the union’s social benefit network: housing, schooling, health, etc. This safety net was sufficient to maintain low-level workers’ support for the union leaders, and thereby preserve the structure of port privileges.

Obviously, the only way of reforming the system was to eliminate the monopoly held by the stevedores, but how to do this, given their substantial political influence, was not easy. The strategy chosen was first to suspend the issue of new cards to stevedores, thus freezing the number in the privileged class. Then it was easier to identify stevedores explicitly and compile statistics on the number of days per year each of them was “emplo-

yed". When the moment came to change the legislation and abolish the monopoly (1981), card-holding stevedores²⁴ were "working" between 400 and 600 days per year and earning more than US\$ 2000 per month—substantially above the annual per capita income for the whole economy. These statistics were very useful in suppressing potential opposition to the new law among non-port participants. In fact, only the stevedores were to lose with a reform of the system, and as part of the strategy to gain legislators' approval for the new law, stevedores were offered partial compensation for a fraction of their future lost earnings.

The new legislation abolished the stevedore identification card as a pre-requisite for working in the ports. Now, anyone could participate this activity, provided they complied with a minimum safety requirement controlled by the port authorities. The market worked through direct negotiations between freight operators and competitive stevedore agencies,²⁵ who in turn hired and managed their employees according to the specific separate needs of each shipment. Due to competition and free entry, agencies now are unable to enjoy the luxury of hiring an excessive number of workers, of allowing pilferage by their employees, or tolerating blackmail against ships or importers.²⁶ As was to be expected, port labor costs have fallen by approximately half, and performance has improved. For example, the productivity of timber shipments in southern ports has climbed to 9000 tons a day, compared with, say, 5000 tons per day in Canada. Finally, for the first time labor mobility between different ports is possible; in the past anyone that wanted to move and be able to work at different port, had to receive explicit authorization from the authorities and respective unions.

In summary, before 1976 the use of seaborne transport facilities in Chile required a difficult and costly passage through four legally protected and well organized monopolies, all of them with the power to force users to put up with all the excessive costs imposed by them. Its combined effect constituted an effective non-tariff barrier trade. The process of cleaning up this sector required

²⁴ There were approximately 3200 stevedores and 800 replacements, versus 12000 *pincheros*, and *medio* and *cuarto pollos*.

²⁵ While the new law was in its final discussion stages, and in the initial weeks after its publication, the port union leaders were unusually busy. On one hand they had to direct the campaign against the new law, and on the other they had to move rapidly to form their own stevedore agencies.

²⁶ It was commonplace for payments to be made on the side, by the ship's captain to the foreman, to ensure that loading and unloading would be completed before the end of the shift, instead of forcing the ship to lose another day in port. It was also common to have to pay a "tip" to the supervisor to ensure that a "novice" crane operator would not accidentally drop a new car or a container with personal and household items.

and received the constant implementation of policies and decisions relevant to the four fronts. The underlying philosophical basis for the reforms that have been instituted is that Chile is better served by allowing more access to all these activities, more freedom of action, a broader participation and less centralized and discretionary control. The only losers have been precisely those who in the past had the legal instruments, the power and protection sufficient to expropriate resources from the rest of the economy. Without the labyrinth of protection and restrictions, they would have to generate their own resources by competing openly and efficiently in the markets which have now emerged.

Prices for “Natural” Monopolies: Public Service Rates

While the military government from the beginning followed a policy which was consistent and even aggressive in freeing the majority of markets from price controls and restrictions, it also tried to keep realistic prices for services in which was unlikely that effective competition would appear (particularly electricity, drinking water and drainage, and telephones).

The authorities stressed two criteria in these cases: firstly that the relevant prices should reflect true production costs, and secondly that the firms in question, nearly all of them public-sector firms, would receive sufficient income to allow their self-financing.²⁷ For electricity and telephones, the guide lines were set out in Decree Law N° 1, 1959, which specified rates that were high enough to guarantee a 10 percent return on invested capital, after discounting costs and depreciation. For water, however, the rules were not so clear, because habitually old laws were appealed to, but in general drinking water companies had always tried to convince the authorities to concede them at least the same guaranteed rate of return.

Electricity. There are currently three subsystems for generation and distribution of electricity in Chile.

1. The Northern Zone constituting 17 percent of electricity consumption in Chile, with generation based on petroleum derivatives.
2. The Central Zone, or inter-connected system, with a preponderance of hydroelectric power.
3. The Southern Zone also based on petroleum derivatives, and constituting only 1 percent of electricity used in Chile.

²⁷ These points were clarified in the first message of the new government on the state of public finances. See Méndez, 1978, pp. 23-45.

The State dominates the market through public-sector firms; 91 percent of electricity generation, 99.6 percent of high voltage transmission lines and 82 percent of direct distribution of energy to final customers is in State hands.

At the beginning of the present government, in the setting of electricity rates, as well as applying DL N° 4 mentioned above, a series of implicit subsidies were maintained along with explicit overcharging, thereby favoring certain groups at the expense of others. The subsidies exceeded the surcharges and so the electricity companies could not avoid operating deficits, and still less pay the guaranteed rate of return on capital. In an effort to resolve these and other problems in the electricity sector, the government set up the National Energy Commission (NEC) in 1978. The NEC has gradually introduced a complete and generalized system for setting electricity rates on the basis of marginal cost, with differentiated charges for periods of peak demand compared with times and seasons which are off-peak.

The (long term) marginal cost of energy is calculated via dynamic optimization programming, which determines the combination of minimum investment costs in generation and transmission capacities needed to satisfy the demand projected for the coming 10 years. Given this program, the central characteristics of the model used to calculate energy transfer prices from generators to distributors in the immediate term (i.e., for the coming four quarters) is the interannual storage capacity of Lake Laja (whose normal capacity is sufficient to generate 30 percent of annual electricity consumption). Based on the hydrological conditions in Central Chile over the last 36 years, the model projects the expected value of the water level at Laja for each of the coming 40 quarters. This in turn indicates which of the alternative energy sources, within the investment program, will be used as the marginal energy source in each quarter. The operating cost of this marginal source is then defined as the opportunity cost of the hydroelectricity which can be generated by water accumulated in Lake Laja and, thus, the energy transfer price. Then a detailed table of transfer prices is published, reflecting the ten most likely levels at Laja for the succeeding four quarters.

At the same time, the marginal cost of capital for new investments in capacity must be determined and included within the electricity rate structure. Currently, new marginal capacity comes from the installation of gas turbines. As the previous discussion makes clear, at no point in the process of calculating electricity charges are the accounting costs (real or unreal) of existing firms acknowledged; rather, rates are set according to what electri-

city *ought* to cost in Chile, and firms are then forced to adjust their operations to these rates so as to avoid incurring losses.

To get from marginal energy and capacity costs (power) to the rates distributors can charge their customers, it is necessary to add in the capital cost of marginal expansions of the distribution network and the inevitable losses of energy that occur along the network. Once again, the cost basis used to determine charges to the final consumer is that of the ideal or model firm, given the real characteristics of the Chilean economy.

To summarize: the electricity rate structure explicitly distinguishes three separate products: energy, normal installed capacity (generation, transmission, off-peak distribution) and additional capacity in peak hours. With a sufficiently sophisticated measuring device the three products can be measured and charged for separately. For those clients whose electricity consumption is sufficiently high and variable as to justify the investment in sophisticated meters, the so-called “hourly-rate” exists. A second option for a less detailed rate structure, known as the “contracted capacity rate”, consists of a fixed monthly charge equal to the capital cost of the capacity required by the client in peak hours, plus a surcharge per kilowatt hour of energy consumed. The third and most common option, the simple or residential rate, consists of a fixed monthly charge (corresponding to standardized fixed administrative costs) and a price per kilowatt hour consumed, made up of the sum of the costs of energy consumed and the capital cost of normal capacity requirements, in peak hours, for this level of consumption. In addition, during the five-month period of peak seasonal demand (from May to September), there is a surcharge per kilowatt hour for additional consumption over and above average consumption in the previous seven (off-peak) months. The surcharge corresponds to the capital cost of increasing capacity in the peak period.

This novel and sophisticated system of electricity rates was gradually brought in from the beginning of 1980 onward, along with the informal introduction of new transfer prices between *Endesa* and *Chilectra*. In May 1980, free rate negotiation was introduced for clients with an installed capacity exceeding 4000 kilowatts, and the winter surcharge was introduced for the first time.

The only significant anomaly in the rate structure resulted from the first attempt to apply this seasonal surcharge. The arrival of the first monthly bills including the surcharge provoked a tremendous political storm:²⁸

²⁸ The storm was greater than it might have been, because the preceding winters Chilectra had mounted a campaign to induce clients to buy electric stoves and take advantage of their artificially low electricity rates. The stoves became up to four times as expensive with the winter surcharge of 1980.

meetings were held at the highest level of government to discuss the problem and even to look at delaying the implementation of the winter rates. This series of meetings probably deserves its own place in the annals of Chilean folklore. The NEC prepared a practical demonstration of the principles underlying the new rate structure. This was convincing enough for the authorities to approve the new rates. However, they remained concerned about the impact the winter surcharge would have on family budgets. In order to get an idea of the order of magnitude of the population's average electricity consumption, a rapid and informal survey was done among those present, and this resulted in an average consumption of slightly more than 200 Kwh per month.²⁹ On the basis of this "data", it was decided to approve the surcharge, but only for clients whose consumption exceeded 250 kilowatts per month.

TABLE N° 5 DISTRIBUTION OF RESIDENTIAL ELECTRICITY CONSUMPTION
(CHILECTRA)

Customers Range of monthly consumption (Kwh)	Consumption Percentage in range	Cumulative percent	Percentage in range	Cumulative percent
0 - 30	17	17	2	2
31 - 70	28	45	14	16
71 - 110	28	73	24	40
111 - 150	12	85	16	56
151 - 250	10	95	16	72
250	5	100	28	100

The same system remained in force in the winters of 1980, 1981 and 1982. It should be pointed out, as well, that shortly before the 1982 winter, the NEC tried to lower the energy consumption limit above which the rate surcharge would apply, from 250 Kwh to 200 Kwh. The local press denounced the change in scandalous terms, particularly stressing the disastrous impact the increase in electricity bills would have on the budgets of the lowest-income families. Table 5 shows the distribution of clients and electricity consumption according to levels of monthly consumption (a table that was not to hand at the meetings described above). Clearly, that initial

²⁹ It was later confirmed that this answer was exaggerated; most of those surveyed had levels of consumption which were below 150 kilowatts per month.

survey gave a highly exaggerated average consumption. As can be seen from the table, only 5 percent of the population consumes more than 250Kwh per month, a percentage which doubtless corresponds to the wealthiest sector, given that in fact they consume 28 percent of all energy distributed.

It can also be seen that 85 percent of customers are below 150 Kwh of consumption. Consequently, to have lowered the limit above which the surcharge would be applied from 250Kwh to 200 Kwh per month, would only have slightly affected the population's 5 percent best off, and not as the press stated the poorest households. The fact that lowering the limit was rejected indicates that this 5 percent of the population continues to exert an undue power of interested influence over Chilean economic policy.³⁰

The new rate system was in fact institutionalized in October 1980. However, given that the immediate application of the new rates would have meant bigger increases in certain monthly bills, particularly among low consumption residential clients, an adjustment program was introduced to bridge the gap between the new and old rates. By the end of 1982 only minor adjustments remained to be made.

To complete the reform of the regulation of this sector, a new general law for electricity service was published in September 1982, replacing DFL 4. This law is extensive, and covers topics such as the rules for granting franchises, safety standards and quality of service, the general principles of pricing policy, etc. In preparing the new legislation two basic principals were consistently applied. Firstly, as far as possible, the law opens the electricity sector up to participation by private-sector agents. Secondly, in those aspects where it is not possible to eliminate government regulation, for example the setting of electricity charges, the rules to be decreed should be as clear and objective as possible. Special emphasis was given to the limitation, or better still the elimination, of purely subjective or discriminatory political judgments, in favor of the application of objective and general criteria.

Although the new system of electricity rates has been in forced for only three years, notable positive effects have already been seen. Power cuts such as those that occurred in the winter months of 1978 and 1979 have not been repeated. In 1981-1982, maximum peak capacity demand diminished³¹ by approximately 60,000 kilowatts, implying a cost saving in investment of US\$ 100 million. As acceptance of the new system grows, particu-

³⁰ Recall the speech by Cauas, cited above.

³¹ The load factor has risen from 0.60 in 1980 to 0.63 in 1982.

larly particular among commercial and industrial customers, the benefits will increase.³²

Telephones. Since the nationalization of telephone services by the UP government, this sector has remained almost completely under the control of public firms³³. The two most important companies are the *Compañía de Teléfonos de Chile* (CTC) and *Empresa Nacional de Telecomunicaciones* (Entel). The latter specializes in providing and renting transmission channels for the long-distance network.

In Chile the telephone system in general, is a public service that simply does not work well. There is a notorious scarcity of lines: government policy has allowed free exchange of existing lines³⁴ so that at least those who need a line most urgently can buy one from those whose need is less. Nevertheless, the scarcity of telephone services continues to be very great, a remarkable situation given that, until very recently and even in the current recession, the price of a line was much higher than the total cost of installing a new one. This incredible phenomenon, which turns project evaluation in this sector into a very simple task, underlines the serious planning deficiency which today exists in Chile as regards management and organization in the telephone sector.

In addition, the lack of much-wanted new lines, as well as the unsatisfied demand for different types of communications services, has led to a problem of excessive congestion in the existing network, especially in the metropolitan areas of Santiago, Valparaíso, Viña Del Mar and Concepción. It was believed that this problem would be resolved by the implementation of the local metered service, in which charges were higher for telephone calls made during peak congestion hours. However, the implementation of a sophisticated set of metered service charges would have significantly raised residential telephone bills, and for that reason it was rejected. Instead in April 1981 a simpler system was put into practice but charges were set too low. In the new structure, the fixed monthly residential charge was set very low, as also was the variable charge depen-

³² In other words, if these customers begin to spend as much time and effort in minimizing their electricity costs (by choosing the correct tariff structure) as the time they actually spend complaining to the authorities about electricity rates.

³³ The exceptions are two new and small private companies set up in Santiago in 1981. In the first half of 1982, CORFO's interests in two small companies in the South of Chile, *Compañía Nacional de Teléfonos de Valdivia* and *Compañía de Teléfonos de Coyhaique*, was sold to the private sector.

³⁴ CTC is free to set its selling price on new lines; this price has consequently been lower than that paid in private transactions, but even so the capital costs of a new line (urban service only) are normally recovered immediately with the sale price.

ding on length of conversation during peak hours; in turn, the variable rate for off-peak night time calls was set too high, and so the impact on congestion was nil, if not negative. Recently CTC has announced a new set of local service rates which go some way toward correcting the level of the fixed charge, and which distinguishes between three separate periods in the day: maximum, medium and low-congestion, with differentiated charges according with the duration of calls.

In general, the remaining shortcomings in the rate structure of the present telephone system, are only part of the overall telecommunications problem. More fundamental still is the total absence of a clear and consistent policy on the way the sector should operate in the short term, and even more with regard to its future development. During the past two or three years at least five different ministries have issued independent, often mutually contradictory directives on the course of action CTC and/or Entel should take, with the result that there are absolutely no criteria for orienting their decisions.

Water. With the exception of two small private companies in Santiago, the provision of drinking water and drainage services has been always considered a public-sector responsibility. In fact, all the existing infrastructure was built under the concept of a public service with no consideration of costs, rather than as an economic entity which had to finance itself. As a result, there is no basic information on the existing infrastructure, such as the physical location and extension of the water canal network, the volume of water produced, and in some cases not even simple accounting costs. Recently, efforts have been made to rationalize the system and convert this service institution into a profit-making (or at least not loss-making) firm, but given the starting point, progress will probably continue to be frustrating and slow.

Water prices were traditionally set on the basis of a general notion of average cost, i.e. once it was decided that the service should be charged for and that prices should be sufficient to self-finance. Within each of the 13 regions of Chile, the water rate structure was a rising scale, comprising three levels, with the volume of consumption allowed per level rising according to the diameter of the client's connection to the water-system network. In addition, for regions served by *Sendos*³⁵, water rates involve a significant degree of cross-subsidies between regions, as consumers in the central regions partly finance consumers in the extreme North and South of the country.

³⁵ The whole country, except Santiago and Valparaíso which have their own public-sector firms.

In 1981 and 1982, the rate structure was altered. Firstly, at least as a first approximation, inter-regional subsidies were abolished. Secondly, within each region³⁶ the tiered rate was replaced by a uniform price that was very approximately equivalent to estimated short-term marginal costs for all clients during the winter months, i.e. in off-peak months. Thirdly, in all regions clients pay a fixed monthly charge, which rises in line with the diameter of the connection, aimed at financing estimated fixed and administrative costs. Lastly, in December 1982 a surcharge was introduced in order to ration demand in regions and subregions that experience systematic drinking-water deficits during the summer months. The current water-rate structure, in line with short-term marginal costs, is a definite improvement on the pre-existing system, but still very far from the system of long-term marginal cost pricing in force in the electricity sector.

Other Public Sector Rates. The Economics Ministry, together with other ministries, still has to approve prices charged by the Metro, the postal service, highway tolls and other minor charges which even include entry price into the Metropolitan Zoological Park and its swimming-pool. With regard to these sectors, the problems of deregulation go beyond mere pricing policy. The Postal Service, for example, was converted from a general service into a legally established public-sector company only in 1981. Although in recent years private firms delivering correspondence have appeared, motivated by the state company's apparent inability to provide an efficient service, the Post Office still retains a legal monopoly.³⁷ Against this background the chances of developing and implementing an efficient infrastructure for setting postal rates seem genuinely remote.

Highway tolls, on the other hand, can currently be said to be locked in a holding pattern until more fundamental decisions are taken, like what amount of government funds should be dedicated to highway construction, whether or not such costs get recovered, the extent to which private-sector investment is permitted, and if it is permitted whether it is effectively carried out. At the present time, tolls contribute minimally to recovering the costs of building and maintaining highways. Toll rates are not set under any systematic criterion for regulating traffic congestion—their most direct effect in fact is probably to tie up traffic even more—and tolls are uniform regardless of the highway concerned. As well as this, they represent a

³⁶ The only exception is the 1st. Region.

³⁷ Private-sector firms which in fact openly deliver local mail in Chile, are so far operating outside the law and so could disappear at any moment.

rallying point for organized protests by truck-owners and drivers, protests which are reasonable in the absence of a clear and well explained policy.

Pricing Policies for Oil-Derivative Fuels.

In 1952, Law 9.618 declared that all petroleum deposits in Chile were the absolute and exclusive property of the State, and the National Petroleum Company (ENAP) was set up to explore and exploit them. ENAP (naturally) was granted all the tax and tariff exemptions generally granted to public-sector firms. Furthermore, Supreme Decree Nº 20 prohibited importing petroleum products whenever there was sufficient national production. Thus, in the production and sale of oil, the State monopoly was complete and, of course, prices charged and received had to be controlled. During the UP government, the complete structure of oil prices and their derivatives, from producer to final consumer, were rigidly regulated, specifically through taxes, tariffs, subsidies, quotas and exemptions applied with the aim of achieving the retail price desired by the government. It is interesting to note that special emphasis was put on keeping prices low in paraffin and liquid gas, supposedly, but mistakenly, for the benefit of low-income groups.

The military government abolished most of the taxes and special exemptions. The pricing policy was controlled by the Economics Ministry who set fuel prices “in line with costs”. From 1974 until mid-1978, ENAP provided annual cost estimates which were used to determine the price of a barrel. The ministry set fuel prices, somehow distributing the per-barrel price between the different fuel derivatives. In September 1978, prices were freed on all oil derivatives, except for 81-octane gasoline, paraffin and liquid gas. At the same time, all import restrictions were lifted on refined petroleum products. Since then ENAP has followed a pricing policy consistent with freedom of prices in an open international market, setting its prices to private distributors on the basis of the dollar opportunity cost of oil in the world markets most relevant for Chilean imports.

In the subsequent four years, up to May 1982, there was a continual series of efforts to abolish the remaining price controls and subsidies in the three types of fuel that were still regulated. The biggest obstacle was an obstinate belief, similar to that held by the UP, that the maintenance of low (explicitly subsidized) prices on paraffin and liquid gas, was a policy mainly benefiting low-income families, and to remove this benefit would cause serious political problems. This reasoning has never been correct. In the first place, surveys indicate that in the Santiago area families among the 40 percent lowest incomes consume only 24 percent of liquid gas, and 23 percent of the paraffin sold in the

area. Secondly, when the subsidy and price control on paraffin were eliminated in May 1982 there were a few political repercussions, although prices rose by as much as 10 and 15 percent. Ironically, any problem that might have been generated was overwhelmed by the devaluation that occurred one month later, as the price of fuels went up 60 percent by the end of 1982.

Antitrust Policy

As was mentioned above, the military government launched into an immediate strategy of liberalizing prices and allowing free prices to determine resource allocation, despite the enormous mistrust to which the presence of monopolistic tendencies in domestic markets gave rise. This mistrust was in fact well founded: one direct consequence of 40 years' widespread intervention in markets was the creation and protection of domestic monopolies. In December 1973, the government modified the Antitrust law, giving the institutions³⁸ charged with protecting free competition a broader field of action and greater powers to declare certain practices as abuses of monopoly power and to apply the respective sanctions.

Of course, demonstrating monopoly abuse is no simpler in Chile than in other economies, and it is always easy to discover specific rules that apparently have been badly understood. However, certain tendencies do raise doubts regarding some of the basic aspects that have been pursued in Antitrust policy. Firstly, the broadening of its field of action may be too large; it is not imperative to show monopoly abuses have existed, but rather the authorities should determine that they potentially could occur. Secondly, the Central Preventive Commission has declared, as a general principle, that equal prices for the same product may only be consistent with competition if the participating firms have identical costs, apparently even in the short run.³⁹ Finally, when the commission effectively prevented a flour mill con-

³⁸ There are regional Preventive Commissions and a Central Preventive Commission that handle cases of alleged monopoly practices, emit opinions and suggest courses of action. There is a Commission for Resolutions which makes legally binding rulings, and there is an inspector for the defense of free competition who represents the "general interest" in the meetings of these commissions and in the judicial process.

³⁹ In 1981, the Commission ruled that price collusion had obviously had occurred when 12 bus companies raised their fares between Santiago and Valparaíso /Viña Del Mar on one national holiday weekend. Apparently among the questions not asked were whether or not there had been any restriction in the number of buses; whether there had been potential passengers who did not obtain tickets, and whether these 12 firms had managed to stop other buses running the same route during the holiday weekend.

glomerate due to its potential monopoly power, it ignored the role played here by imports in creating greater competition, and freedom of market entry; both set a natural limit to the possibility of maintaining and charging monopoly prices.

IV Aspects of Labor Market Reform.

The Chilean labor market was another huge labyrinth of legislation, restrictions, direct state intervention, special favors, privileges and categories, all legally defined. We can only consider here some of the most egregious aspects of this market and the corresponding reforms.

Firstly, consider the case of professional bodies or “colleges”: although this is a minor issue in the context of the fundamental reforms that have been made, it is indicative of significant aspects of the field of economic regulation. Professional bodies are basically associations of highly skilled people, set up to protect the interests of the profession practiced by their members. Each “college” was set up by a law stipulating its faculties and legal responsibilities.⁴⁰ If one was not a registered member of the college and with dues paid up to date, independently of the professional qualification held, one could not work as, among other things, lawyer, public administrator, architect, librarian, accountant, journalist, doctor, nurse, pharmacist, teacher, etc. The specific laws gave the colleges the right to set the fees their members could charge for their work, as well as setting their standards: they also prohibited the public sector from hiring non-registered professionals, forbade non-members from offering professional services to the public which usually were cheaper, and ensured that only professionals who paid their dues could be considered as real members, etc.

These monopolies, so fiercely protected, could only be liberalized by eliminating their legal basis, and that is exactly what happened in Chile in February 1981. Decree Law N° 3.621 expressly establishes that freedom of employment necessarily implies freedom of association in any group. Thus, nobody can be obliged to be member of any college in particular to be able to carry out their profession, and no employer can make such a requirement an explicit condition of employment. In this way, if the colleges wanted to continue as legal entities, it became neces-

⁴⁰ At the beginning of 1981 there were 26 “Colleges” representing professions that required university training. With the single exception of geologists, the corresponding laws were in force prior to the UP government.

sary for them to register as union associations, and there could be more than one association in each profession.

Perhaps the most important labor market reform, at least in terms of its widespread impact, was social security reform. Chile was the first Latin American country to introduce an obligatory social security system, with the first pension funds appearing in 1924 and 1925. By the middle of the 1970s there were 35 different pension funds covering about 75 percent of the labor force. Each one had a group of captive members and distributed different benefits determined in their own way. For example, private employees could retire with a pension after 35 years service, public-sector employees after 30 years, and after only 15 years in the case of senators. Compulsory contribution rates depended on the wage level and the general classification of the job,⁴¹ but in practice these contributions constituted taxes on employment, with rates averaging out at 40 percent of an employee's taxable income. The larger part of the total contribution, depending on each pension fund, was born by the employer (80 percent on average). Finally, pension benefits, if and when they were received, were independent of the contributions the retired worker might have made during his life. Some governments prior to the present one had tried to reform the social security system, but only the most recent government managed to do so. Beginning in 1974, discriminatory benefits were slowly eliminated, family allowances and the retirement age were made uniform, and contribution rates were gradually reduced. But the massive reform that transformed the pay-as-you-go system into a program of mandatory personal saving and insurance paid by the employee, was approved in 1980 and put into practice in 1981. In the first place the payment of social security contributions was transferred from employers to employees, thereby eliminating the disincentive to hire new workers.⁴² Secondly, employees that were already in the old system could choose between continuing to contribute to their traditional pension funds or register in a private fund manager known as an AFP. In the latter case the net wage increased (contributions fell from 26 percent to 17 percent) and each worker kept his own personal account, thus coming to hold his own savings with accumulated interests. In this way, from the moment a person retires he or she has available a fund on which to live; the law stipulates the

⁴¹ Private employees in the period 1970-79 were subject to an average contribution rate of 57 percent of their taxable income, workers 48 percent, public sector employees 28 percent , etc.

⁴² More precisely the tax component was lowered to 3.85 percent for 1981, 2.85 percent for 1982, 1.85 percent for 1983 and 0.85 percent for 1984. The 0.85 percent corresponds to payments in compliance with the law on accidents at work.

use of the fund should be through the withdrawal of annual installments.⁴³ People entering the work force for the first time had to join the new social security system.

The second front of reform in the labor market concerned the Labor Code and the laws regulating individual labor contracts. Starting with the publication of the Labor Code in 1931, the legislation that regulated labor relations had been turned into a complex network of 70 labor laws by the end of 1973. Apart from numerous different statuses conferring special privileges, two general types of legislation are worth considering. On the one hand, in individual labor contracts it can be seen that the legislator started from the premise that the employer could always commit any kind of abuse, and that in fact such was his normal way of proceeding; in addition, there is a presumption that the employee has no means of protection available to him. Thus, legislation was designed that was over-protective of the employee or worker, which regulated hours of work (normal and maximum overtime), wages (at least the minimum wage), working conditions, duration of vacations and when they should be taken, etc. In another words nothing remained to be negotiated between the parties, nor was there any room for making contracts flexible in the case of adverse situations occurring in the economy.

Apart from minimum wages, there were three other characteristics of this legislation that artificially raised the cost of using manpower. Firstly, due to insolvency among the pension funds, together with the non-existence of unemployment insurance and the deficient saving alternatives that existed in the economy, the concept of 'compensation' became institutionalized. Basically, this concept gave the employee the right, at the employer's expense, to receive one month's salary for each year worked with the same employer, if he retired or if was dismissed. Faced with this prospect, employers avoided having to hire more people as far as possible.

Secondly, according to the concept of the worker's right to work, and with the aim of off-setting other incentives for dismissal, legislators created a law of job tenure, which, among other things, established a further compensation payment when an employee was dismissed without sufficient justification. Thirdly, to promote a sense of worker participation in the firm, a bonus, or profit share to the workers was made mandatory; the amounts to be shared among workers would depend on the type of activity and the

⁴³ For a more detailed account of social security reform in Chile, see Costabal (1981a, 1981b).

profit rates. All these payments mandated by law, together with the social security tax (and in combination with a commercial policy that reduced the relative cost of capital) are what explain the very high normal rates of unemployment in Chile.

In 1978, and again in 1981, efforts were made to soften the negative impact of these regulations. The main motive behind the changes in 1981 was to allow greater freedom to workers in negotiating holidays, compensations, bonuses, etc. Also, the restriction imposed by the minimum wage was reduced, by taking people under 21 and over 65 out of its jurisdiction.

The third area of significant labor market reform was the establishment and definition of the scope of union activities. Initially, legislation on collective bargaining was designed to restrict union power, thereby giving rise to collective agreements only at the level of the individual firm.⁴⁴ However, with the passage of time unions began to acquire more and more political and economic power, especially those formed inside protected industries. As unions extended their influence, and with growing state intervention in the economy, any labor problem rapidly became a political problem which was habitually resolved by conceding what the unions were asking for. Given the ubiquitous state of Treasury intervention, once the firm or industry had conceded to disproportionate union demands, it would proceed to seek some compensatory measure from the State, such as for example, that the price fixing on their products be lifted, or that higher protectionist tariffs be decreed or stronger import restrictions, or that they be given a tax break. This, therefore, was a totally distorted economic system.

When the new government took office, union leaders' political actions of were severely curtailed. In 1979 the new Labor Plan for collective bargaining was put into practice. The Plan establishes absolute freedom of association, provided members vote to accept the union as its bargaining agent. However, no union could exercise the exclusive right to organize itself even in a single firm; there was no obligation for workers to join a specific union, as previously had been granted to the single union; the management of the firm could not participate in union finances, and the legal distinctions between workers and staff disappeared. All negotiations had to take place at the firm level, and only working relations directly affecting union members could be discussed in formal negotiations. Finally, strikes were prohibited in certain public-sector firms. If negotiations did not

⁴⁴ See Pencavel (1981) for a more detailed discussion.

reach an agreement, mandatory arbitration was applied and the arbitrator was required to choose between one of the two opposing positions. In summary, the new Labor Plan encouraged collective bargaining, but within a context that forced the costs to be assumed by the directly interested parties alone.

The Labor Plan, however, institutionalized one of the few aberrations to emerge from the economic policies explicitly implemented by the current government: the so called wage floor. When negotiating new contracts, the minimum offer employers were legally allowed to make, was equivalent to the wage package of the previous period, indexed to the CPI over the period in question. This legal restriction on collective bargaining, together with the continuous policy of conceding periodical wage increases, in compensation for inflation, to workers in the public sector and others in the private sector whose wages were not determined by collective bargaining, meant that in fact the government was setting a lower bound for real wages, which in the long run proved to be damaging because of the recession the country suffered.

It is easy to understand the existence of wage increases for workers not belonging to a union, particularly at the beginning of the new government, when inflation was spiraling upward, and one of the pillars of the economic policy was the new security in markets and free prices. Without wage increases to offset inflation, political support for the regime, not to mention its economic policy, would have rapidly vanished. However, it is not easy to understand the wage floor in the case of collective bargaining. Why give a permanent legal advantage to one of the parties in a negotiating process between equals?

As has been widely recognized, once the current recession exceeded certain limits, the policy of downwardly rigid real wages was inconsistent with a fixed exchange rate; sooner or later this inconsistency was bound to present problems for aggregate adjustments in the economy. However, it is also easy to exaggerate the importance of this inconsistency when trying to explain the deep recession in Chile. In the first place, it should be remembered that the last general salary increase, of 14 percent in August 1981, was the only increase since 1973 that imposed a net cost on entrepreneurs. All previous adjustments were lagged in an inflationary environment and only allowed workers to momentarily catch up from inflation, whereas in the intervening period between one wage increase and another, firms gained through lower labor costs. The 1981 wage increase was costly, however, because the abrupt reduction in domestic inflation caused by the revaluation of the dollar in world markets surprised all economic agents. Secondly,

during the first half of 1982, most of the rise in aggregate unemployment occurred in the construction industry, and there, even if salaries had fallen precipitately, the same decline in activity would probably have occurred. The real guilty parties in explaining the recession were the rise in the real rate of interest and the breakdown of a financial system that was shown to be fundamentally rotten. Nevertheless, the fixed real wage has helped to raise unemployment levels in Chile. On December 29th, 1982, corrective legislation with regard to the wage floor was at last approved.

Regulating Financial Sector Deregulation in Chile: An Acute Ambivalence.

The Chilean capital market has always provided a worrying variety of avenues for government intervention and regulation, and the temptation to test them has seldom been resisted any time during the past 50 years. The most common form of intervention was the obvious one of setting nominal interest rates at “reasonable” levels, regardless of the rate of inflation. Another popular tool among the economic authorities in different governments was to open special credit lines to promote the particularly “productive” activities of the moment. Thus, with negative real interest rates and strong quantitative credit controls, banking activities were reduced, on the one hand, to acting as intermediaries for Central Bank rediscounting, and, on the other, to managing the political influence that led to arbitrary distribution of loans at negative interest rates, which for that very reason were highly desired.

The marxist government of Allende, as in other areas, did not have to change the legal structure of the banking system to expropriate and nationalize it: the existing regulations were simply taken to their extreme. Rapid inflation, with nominal interest rates still fixed, meant that real rates were more negative than ever. Selective credit lines were directed towards the “social area” owned by the State and in general towards expropriated firms. By setting a 100 percent marginal reserve on bank credit, the Central Bank’s quantitative controls were absolute. Finally, the government intervened and “bought” national banks (through CORFO), while foreign banks were directly nationalized. In sum, at the end of Allende government, there was no private banking sector, and the operations of the few private-sector savings and loans institutions were severely restricted.

From the end of 1973 onward, the new government launched a long series of legal and institutional initiatives designed to promote the formation

of a private-sector financial system consistent with the philosophy of the market economy. Unfortunately, despite the enormous steps taken, the final goal was never reached; possibly it is a goal that will never be reached especially considering the strength and magnitude of the financial crisis that Chile has been suffering since 1981. The reform process consisted basically of issuing numerous laws, decrees and circulars, and only part of this regulatory framework can be analyzed in this paper.⁴⁵ Firstly, in December 1973, a decree was issued allowing the existing banks under state control to renew their operations, keeping the management of the banks in the hands of government appointed auditors. The same law temporarily prohibited the formation of new private banks as well as the opening of branches of foreign banks in Chile (the latter restriction was lifted at the end of 1974). It also abolished the reserves banks were obliged to constitute when granting certain type of credits. Finally, the control function was transferred from the Presidency and Comptroller General to the Central Bank and the Superintendency of Banks and Financial Institutions (SBIF).

At the end of 1974, another law defined the conditions for applying for ownership of financial institutions, as a pre-requisite to returning banks to the private sector in 1975 and 1976. Two of this law's provisions deserve mention. In the first place no individual could own more than 1.5 percent of any bank and no firm more than 3.0 percent. This restriction was impracticable from the outset and was repealed in 1978. The second restriction, which was more serious and lasting, prohibited the private sector from acquiring any additional participation in financial institutions.

The process of freeing interest rates only began in May 1974. Up till then, the Central Bank could arbitrarily fix the simple rate of interest, and the banks could not charge more than 120 percent of that rate. In addition, there was no distinction between real and nominal rates. The first change was to define simple interest in real terms, as the average of the market, and permit a maximum rate of 50 percent above the simple rate so determined. At the end of 1974, interest rates on short-term deposits (60 days, and later 30) were freed, as were rates on short-term loans in 1975, although the monetary authorities "suggested" maximum rates on loans and deposits until the end of 1975. From then on, virtually all interest rates were freely determined until the end of 1982, when the Central Bank once again began

⁴⁵ For an excellent chronological and comprehensive description of the detailed process of financial reform, see Errázuriz (1982). The following paragraphs are based on that document.

to “suggest” maximum rate for deposits (those who decided not to follow this suggestion were denied rediscount privileges).

Once the banks began to return to private-sector hands, the legislative measures that followed were aimed at equalizing and rationalizing the legal basis on which the different types of financial institutions allowed to operate. At the end of 1976, for example, the detailed and discriminatory list of quantitative controls was abolished in favor of special deposits, which in turn were equalized and reduced. In July 1976, the reserve on sight-deposits stood at 85 percent ; with rates of 55 percent and 30 percent on short-term deposits (30 or 90 days) in the banking system and financial companies, respectively; 55 percent and 9.2 percent on 90 - 360 day-deposits; and zero on long-term deposits. The different rates for banks and financial companies were abolished in May 1977, and at the end of December 1980 special reserves were set at 10 percent on sight deposits and 4 percent on all short-term deposits (of less than one-year term). Likewise, the *Banco del Estado* monopoly on ordinary savings accounts was abolished in August 1978.

A second legislative front was dedicated to defining, strengthening and limiting the attributes of the monetary authorities. In April 1975 the Monetary Council of Chile was set up; this body, composed of the Ministers of Finance, and Economy and Planning, the President of the Central Bank and a delegate of the Presidency, was charged with setting overall policies for the exchange rate, as well as the capital market, international trade and savings. At the same time, the Central Bank underwent a radical restructuring, and its operations were confined to the financial system and monetary policy, eliminating its previous ubiquitous roles in policies relating to economic and sectoral development. More significantly, at the same time, the authorities legally prohibited Central Bank financing of public-sector spending. This same prohibition was later incorporated into the new Chilean Constitution of 1980. Finally, from July 1975 to the present, a series of rules have been issued, along with legislative amendments and new laws aimed at strengthening, refining and improving the control faculties, sanctioning powers and operating procedures of the SBIF.

The above outline of legislative initiatives shows the direction in which the authorities gradually tried to lay down the legal-institutional foundations necessary for the development of an efficient and competitive capital market in Chile. Other aspects of policy oriented towards capital-market formation, however, were not consistent with the non-interventionist philosophy of the free market supported by the government. The clearest example of this was the treatment of international capital flows. In fact,

Chile was virtually closed to the world capital market until September 1977. One result of this, of course, was an extraordinarily high cost of capital —at times in 1976 it was possible to earn more than 80 percent real interest on one-year deposits.

This restriction was gradually relaxed. Starting in 1977, the banks were allowed to take in foreign currency loans with a minimum two-year term subject to an upper limit on total foreign loans. In addition there were fixed monthly entry quotas and special deposits of 25 percent on loans with terms of between 24 and 36 months, 15 percent on loans of 36 to 48 months, 10 percent on those of 48 to 66 months, and no special deposit on loans of periods longer than this. In June 1979 the overall upper limit for foreign loans was suppressed, and in April 1980 the monthly entry quota was also abolished. Finally, in May 1982, banks were allowed to take in short-term deposits subject only to a 20 percent reserve requirement.

Apart from the quantitative restrictions and special reserves, at no point in the process where the banks permitted to arbitrage funds, as the Central Bank authorities were concerned that unduly risky positions would be taken. This prohibition on arbitrage, together with the special reserve requirements, apparently constitute the most likely explanation of the fact that despite massive capital entry, the spread between rates on domestic deposits and the rates Chilean banks were paying to foreign lenders stayed almost constant at 1.5 percent per month between 1978 and 1982 (Sjaastad, 1982a). On July 14th 1982, exactly one month after the devaluation, arbitrage was permitted, but by then, of course, few banks were interested in this. At the same time, special deposits were eliminated on any new capital entry, but 8 days later they were restored at 5 percent for all capital entry of less than 71 months' term.⁴⁶ In retrospect, Chile in its adjustment path coming out of the 1975-76 recession probably paid a higher cost than necessary for having isolated itself from the world capital market. In addition, the capital account was apparently finally opened up as a result of pressures from the financial community. But then, at the end of 1980 the economic authorities were increasingly coming under criticism for allowing too much foreign debt, for not exerting sufficient controls on the banking sector and for

⁴⁶ This policy reversal was symptomatic of the conflict inside the Central Bank, as many of the economists of longest career in the bank denied that such restrictions had any influence on the high interest rates in Chile. In fact, it is always been ironical to see that Central Bank economists were among the first to condemn public-sector intervention in any other sector of economic activity, but simultaneously defend their own interventionist policies jealously in the capital market.

allowing (even promoting) a significant and threatening degree of concentration of (particularly financial) ownership. The authorities' defense was based on the principles of the free market and an economy of private ownership. Firstly, the government emphatically refused to give guarantees on any foreign loan. Secondly, as long as interest rates were set freely, concentration in itself should not present a special problem. Thirdly and more importantly, both banks and other financial institutions should be treated like any other business. In particular, maladministration of a bank would earn the automatic sanction of bankruptcy, implying losses for its owners and creditors. In summary, the government's responsibility was to manage the public debt and not to interfere with transactions within the private sector. *Ex post*, as the government did not want or was unable to put the theory underlying its defense to the test, what would have been irrelevant criticisms were proven totally correct in practice.

In fact, the underlying basis of the financial structure was full of contradictions. Despite criticism of excessive liberalism in this sector — a word that was very commonly used was “profligacy”— and despite assurances by the authorities as regards the overall benefits of moving towards private-sector competition without obstacles to banking activities, the financial institutions were always subject to myriad controls and regulations. Even so, the first test of those controls and of the intention to treat badly managed banks just like any other business soon arose: at the end of 1966 the *Banco Osorno* was intervened instead of being allowed to go bankrupt.

With this decision, the precedent for future action was set; at least, now in September 1983, we can reasonably come to this conclusion. Nevertheless, the official response was to:

1. Introduce modest but universal deposit insurance in January 1977.
2. Strengthen control over the SBIF and increase sanctions for infractions of the banking law.
3. Continue the rhetoric that, from now, on badly managed banks would, in fact, be allowed to fail.

The banking law contained clear prescriptions regarding the maximum amount of loans that could be granted without guarantee, and the maximum that could be given to any person or firm, etc. But businessmen associated with the sector found it very easy to evade those limits, mainly by creating new firms such as investment and insurance companies. The practice was so widespread among the economic-financial conglomerates with their own captive banks, that it was one of the common topics of

conversation at all levels of Chilean society. However, it was only in mid-1981, when the current recession began to be felt, that the authorities took the first steps to try to restrict the action of these groups. In August of that year, the modified banking law made it illegal for banks to continue lending money to owners and affiliated firms; it also abolished shares as a legitimate form of bank capital, thus halting the, probably unique, private-sector practice of monetizing assets.

But these measures were very few and came very late. In November 1981 the authorities again faced the decision of whether or not to allow part of the financial sector to go bankrupt. And once again, the proclaimed principles were cast to the wind when the government intervened in eight banks and financial institutions, including the *Banco Español*, an example of unscrupulous financial management of a banking institution. From then on, the fundamental feature of the Chilean economy has been financial crisis, reinforced by the severest recession since the 1930s. The most recent step, taken in January 1983, was to liquidate two banks and a financial company, and take over the five largest private banks in the country. In terms of direct control over the capital market, in ten years Chile has done a complete circle, virtually returning to its starting point.

What the SBIF did between 1977 and 1981 is not at all clear, although one should reject the idea that the SBIF was unaware of the financial structure of these conglomerates. Perhaps it was thought that bankruptcy would be permitted or maybe supervision was ineptly limited to simply controlling strict compliance with the letter of the law. The hypothesis of ineptitude is qualitatively supported by a declaration published by SBIF:

“It is clear that a reasonable adherence to the spirit of the law would have been sufficient to prevent excessive concentrations” (SBIF, September 1982). The SBIF apparently was incapable of detecting violations of the spirit of its own law.

Whatever the explanation may be, the current financial crisis in Chile reflects the abject failure of regulatory and deregulatory policy which, by error or omission, was or was not, implemented in this sector. The inability to choose between fierce controls, or application to the ultimate consequences of the rules of a market economy, led to the *de facto* combination of the worst of two worlds. The monetary costs have been enormous, and Chile will have to plough a difficult road to emerge from the crisis.

Worse still, the costs of this failure have in no way been limited to the financial and monetary field. Given the rhetoric (but not the fact) of promoting a free-market model for the financial system, and the visibly negative result in this sector, the opponents of economic libera-

lism in general have been able to use the financial crisis and current recession as a politically persuasive argument against the philosophy that underpins the economic policies adopted by the military government since 1973. At the present time all the deregulatory measures described in this paper—with the exception until now of price fixing—are coming under fire from a series of high-sounding objections and criticisms.

VI Conclusion

In this paper I have tried to present a detailed description of the most important measures implemented by the military government in Chile, as regards the regulation and deregulation of a wide variety of economic activities. Of course, it has been impossible to discuss many others that were also undertaken.

On this point, however, it is useful to put the Chilean experience of setting up a freely functioning economy into some perspective, as both supporters and enemies have managed to project a somewhat exaggerated (even distorted) view of what really has happened in Chile. The Chilean economic model has been broadly caricatured as an extreme version of monetarism and liberalism. However, the Chilean economy has never become as liberal as the United States, for example, not even in the goods and services market, where free-market policies were applied with greatest vigor. The clearest confirmation of this statement is to be found in the huge role public-sector firms still play.

More emphatically still, from the viewpoint of standard economic models in which labor and capital are the two factors of production, the whole national income of Chile, in terms of factor payments, has always been subject to controls accompanied by regulatory and discriminatory intervention. (In fact the critics of economic liberalism would do well to explain the fact that the most dramatic current problems of recession, unemployment and financial crisis, have occurred precisely in those markets where liberal free-market policies were never completely implemented). In a brief, the transformation of the Chilean economy, from September 1973 onward, only represented a vigorous movement towards economic liberalism compared to the previous standards of Chile itself, not so much in relation to those of the disastrous Allende years, but rather in relation to standards imposed by the governments that preceded the marxist experiment of 1970-73.

But the reform process has visibly lost vitality and is now practically at a standstill. Apart from three episodes of banking intervention, the first break with the principle of non-discrimination in the implementation of economic policy arose in April 1982, when *Iansa* was directed to undertake a special program in favor of sugarbeet growers. Then, along with the successive devaluations came the implementation of the “preferential dollar”, also accompanied by the application of (ill-named) antidumping tariffs on the import of certain goods, as well as the spectacle of a Central Bank setting exchange controls and “suggesting” interest rates, the prohibition of imports of used buses and trucks, a 50 percent cut in electricity rates for agriculture and mining in the 3rd. Region of Chile, and so on. Today the pendulum is moving in the direction of greater intervention, discrimination and regulation. Future prospects are rather gloomy and the only realistic question that can be asked now is how far back the reversal of economic policy will go. It is to be hoped that at least some of the most fundamental reforms may manage to survive the current assault. Regardless of the outcome, however, the military government of Chile, whatever its possible defects, deserves a large dose of credit for at least making a genuine attempt, albeit costly in its incompleteness, to establish economic freedom in the country.

REFERENCES

- Banco Central de Chile, *Evolución de las Principales normas que Regulan el mercado Financiero Chileno*, Santiago de Chile (1981)
- Comisión Nacional de Energía (NEC), *Tarificación Eléctrica o Costo Marginal en Chile*, Santiago de Chile (1980)
- Comisión Nacional de Energía (NEC), *Tarifas Eléctricas y Precios de Combustibles*, Working Paper N° 52/82, mimeo (1982)
- Cortés Douglas, Hernán, Butelmann, Andrea and Videla, Pedro, “Proteccionismo en Chile; una visión retrospectiva” in L.A.Sjaastad and H.Cortés Douglas (eds.), *La Economía Política de la Reforma Comercial en Chile*, *Cuadernos de Economía* (1981).
- Cosas, Interviews with J. Tobin (March 25, 1982), P. Samuelson (July 15, 1981), L. Klein (August 22, 1982) and W. Leontief (November 18, 1982).
- Costabal, Martín, “El Precio del Trigo”, *La Bolsa* (January, 1977).
- Costabal, Martín, “La Reforma Previsional” *Ercilla Económica*, January (1981a).
- Costabal, Martín, *Efectos Económicos de la Reforma Previsional*, V Jornada de Estudios, Fundación Facultad de Ciencias Económicas, Catholic University of Chile (1981b).
- Danús, Luis, *Exposición de los representantes del Gobierno de Chile*, Public Firm Seminar, Brasilia (1982).
- Dittborn, Julio and Martínez, Guillermo, *Empresas Públicas y Legislación*, mimeo (1981).
- Errázuriz, Hernán Felipe, “Evolución de la Legislación Bancaria y Financiera (1973-1981)”, in Banco Central de Chile, *Legislación Económica Chilena y de Comercio Internacional*, Santiago de Chile (1982).

- Harberger, Arnold C., "The Chilean Economy in the 1970s: Crisis, Stabilization, Liberalization, Reform", in K. Brunner and A. Meltzer (eds.), *Economic Policy in a World of Change*, Vol. 17 Carnegie-Rochester Conference Series on Public Policy, (1982).
- Junta de Aeronáutica Civil, *Chile 1981: Aviación Comercial*, Santiago de Chile (1981).
- Méndez, Juan Carlos (ed.), "Somos Realmente Independientes Gracias al Esfuerzo de Todos los Chilenos", *Documento de Política Económica*, Budget Directorate, Santiago de Chile (1978).
- Méndez, Juan Carlos (ed.), *Chilean Economic Policy*, Budget Directorate, Santiago de Chile (1979).
- Méndez, Juan Carlos, *Un Intento de Medición del Tamaño del Sector Público y de la Presencia Empresarial del Estado en Chile*, paper prepared for the International Conference on Economic Policy, Viña del Mar (1981).
- Ortúzar, Waldo and Arriagada, Jorge, *Ley Antimonopolios: Jurisprudencia de la Comisión Resolutiva 1974-1977*, Santiago de Chile: Editorial Jurídica de Chile (1978).
- Pencavel, John H, *El Marco Legal de la Negociación Colechua: Las Lecciones de la Experiencia Chilena*, paper prepared for the International Conference on Economic Policy, Viña del Mar (1981).
- Sjaastad, L. A. and Cortes Douglas, H., "Protección y Empleo", in L. A. Sjaastad and H. Cortes Douglas (eds.), "La Economía Política de la Reforma Comercial en Chile", *Cuadernos de Economía* (1981).
- Sjaastad, L. A., *The Role of External Shocks in the Chilean Recession 1981-1982*, Centro de Estudios Públicos, June (1982a).
- Sjaastad, L. A., *The Failure of Economic Liberalism in the Southern Cone*, 1982 Bateman Memorial Lecture, The University of Western Australia, September (1982b).
- Stigler, George J., "Comment", in Gary Fromm (ed.), *Studies in Public Regulation*, Cambridge, The MIT Press (1981).
- Superintendencia de Bancos e Instituciones Financieras, *Información Financiera*, September (1982). □

Translated by: Tim Ennis
Lenguaje Services for Economists
e-mail: timennis@mailnet.rdc.cl