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Twenty Years After Chile's Free Market Water Code: National and International Lessons about Water Law Reforms

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ABSTRACT

October 2001 marked the 20th anniversary of the passage of the Chilean Water Code of 1981, which has become famous in many countries as the world's paradigmatic example of the free market approach to water law, policy, and management. It has frequently been praised by the World Bank and recommended as a model for other developing countries, particularly in the context of current international debates about the need for fundamental reforms in water law, policy, and economics. This 20th anniversary provides an excellent opportunity to look back and review the Chilean experience and its comparative and international significance.

The paper begins with a brief summary of the 1981 Water Code's principal legal, economic, and institutional features, together with a summary of its broader constitutional and political context in Chile. In the first (and shorter) substantive part of the paper I describe and analyze recent international debates about two major trends of water policy reforms: (1) that water should be recognized and managed as an "economic good," and (2) that water resources

should be managed in an “integrated,” holistic, and multi-disciplinary manner. This in turn raises two questions for which the Chilean case is particularly illuminating: does accepting that water is an “economic good” mean that it should be governed by the rules of the free market and the theoretical principles of neo-classical economics? And under what circumstances are these two trends of reforms really compatible? I then briefly compare different perspectives on the economics of water, distinguishing between a narrow neo-classical perspective (dominant in Chile) and a broader institutional perspective, and conclude by arguing that institutions and processes for conflict resolution are more critical to the functioning of market economics than is usually recognized.

The second and longer part of the paper reviews the practical experience of the Chilean Water Code, focusing on its second decade, after the return to democratic government, during which the Code has been the subject of bitter political debate within Chile. I examine the evolution of several major issues from 1990 to the present day: (i) the continuous but unsuccessful efforts of Chile’s democratic government to reform certain key aspects of the Water Code, particularly to redefine property rights in ways that would alter the economic incentives for water use and allow more consideration of public interests; (ii) the different theoretical arguments and empirical studies about the performance of Chilean water markets; (iii) the little-known impacts on social inequity; and (iv) the problems and limitations of existing institutional arrangements for coordinating multiple water uses, managing river basins, and resolving water and environmental conflicts.

The paper concludes by summarizing the strengths and weaknesses of the Chilean approach to treating water as an “economic good.” While there have been some important economic benefits in terms of private investment and reallocation of water resources, the regulatory framework is too weak and too rigid to deal adequately with long-term environmental sustainability, integrated water management, or conflict resolution. These are necessary consequences of the Chilean approach and there appears to be no realistic prospect of significant improvement.