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The Politics of RSFs: An Antidote to Reversing the Resource Curse in Latin America?

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ABSTRACT

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Over the past three decades, the world has become highly globalized. As such, most countries around the world depend on exports for a large portion of their national income. However, some countries' dependency on exports is extreme, especially those that heavily rely on natural resource commodities. Despite the natural resource wealth that these commodities grant countries, due to the instability of global prices and the intensive focus of the resource extraction industry, scholars have theorized this type of dependency as a "resource curse." The resource curse is a paradox where countries that are so rich in natural resources have not been able to prosper and are more likely to suffer from economic volatility, political instability and social inequality than those without. Scholars have researched in depth the causes and effects of the resource curse but there has been little literature on how developing countries have attempted to find solutions to this predicament. This paper examines one way that countries have tried to ameliorate the resource curse and that is through resource stabilization funds (RSFs). Resource stabilization funds are generally funds established to save money when there are high revenue inflows during boom times, in order to have money to spend during macroeconomic downturns. The three select case studies of Chile, Venezuela and Ecuador are all similar in that they are highly dependent on exporting and obtaining rents from resources but they vary in the institutions they established in order to minimize the detrimental effects of their resource dependency. This paper further builds upon previous resource curse literature by not only examining RSFs but also the political and historical context upon which they originated. The expected results should demonstrate that it is not only how RSFs are established but also how the political conditions, both domestic and foreign, shape the success, stability, and permanence of resource stabilization funds.

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As elections loomed in 1988, the Accion Democratica (AD) administration of Venezuela discovered that it had little governing capabilities without a loan from the International Monetary Fund (IMF)[1]. Banks were unwilling to consider any negotiations without the IMF and they refused to grant any new credits to Venezuela. Venezuela was stuck—agreeing to IMF loan conditions was politically impossible during an election period even as half of Venezuela's oil revenues went to repaying debt. Instead of turning to the IMF, Venezuela took a more domestically popular stand by declaring that due to falling oil prices, Venezuela would not be able to make a $2.5 billion debt payment in November. Meanwhile, in private, both presidential candidates agreed to negotiations with the IMF as soon as elections were over while simultaneously campaigning on pledges to reactivate the economy without bringing in an IMF loan. Yet despite the severity of Venezuela's economic situation, the AD government under President Lusinchi Caldera decided to initiate a major increase in public spending. In the election year, the economy grew by almost 5%, lulling Venezuelans into a false sense of security and they re-elected Carlos Andres Pérez as president, the candidate most associated with economic prosperity.

Pérez assumed the presidency under promises of a sustained recovery and expectations of increased prosperity. However, the 1988 economic respite was short-lived and its cost was enormous. The Venezuelan economy quickly collapsed as oil prices dropped from $28.47 per barrel in 1984 to a dismal $13.22 per barrel in 1988. Price controls and artificially repressed inflation produced an escalating black market, rationing and the most severe shortages seen in Venezuelan history. Foreign reserves plunged by half and the budget deficit was now 9% of the GDP—up from just 3% in 1985. Real wages plunged and by 1989, the number of people living

[1] This narrative comes from Terry Karl's *The Paradox of Plenty: Oil Booms and Petro States,* 1997

below the poverty line increased tenfold since 1981. Venezuela's economy was now in a serious crisis. Naturally, as the economy worsened, Pérez's policies changed as well. Once democracy's greatest spender and enthusiastic statist, Pérez embraced neoliberal policies such as privatization and austerity reforms. Immediately after elections, he entered into talks with the IMF and in February of 1989 abruptly announced the passage of painful market-oriented reforms. The reforms known inside Pérez's administration as *el gran viaje* ("the great turnaround") was known out on the streets as *el paquetazo* ("being hit by a package") and was a complete shift in economic policy.

In order to receive desperately needed loans, the government agreed to a reduction of tariffs, an elimination of nontariff barriers that covered 94% of local manufacturers, an increase of internal interest rates and Venezuela's system of preferential exchange rates. But perhaps most devastating was the price controls Pérez put on eighteen basic food items, the subsidies he cut for public services, the increase in utility and transport fares, the increase in the domestic price of oil and the freeze in employment and hiring in the public sector. The reforms simultaneously destroyed the "three economic pillars" that had been the foundation of Venezuelan democracy: state intervention, subsidization of organized private interests and social spending. The sudden shock of this new economic plan—the polar opposite of Pérez's electoral promises—was too much for citizens to bear, especially because the costs and pain of austerity were unevenly distributed. Triggered by more IMF-mandated increases in bus fares, massive riots spread throughout the capital Caracas and other cities in Venezuela on February 27, 1989. The riots left approximately 350 people dead but there is an unofficial toll of around 1,000. In just two weeks of taking office, Pérez was forced to declare a state of emergency and suspend civil liberties, arresting thousands involved in the riots and protests.

The impact of *el paquetazo* was drastic and immediate. Venezuela's economy shrank by 10% and unemployment jumped from 7% to 10% in one year. With a collapsing economy, protests continued but without petrodollars flowing into the country any more, Pérez's assurances of stability and change were empty. In 1992, Pérez was forced to announce a second austerity reform in order to stave off hyperinflation and all-out fiscal doomsday after the government spent too much on social projects with too little oil revenue coming in. By 1993, after another deadly riot, two failed coups (one leading to the rise of current president Hugo Chávez), and more economic volatility, Pérez was indicted by the Supreme Court on embezzlement charges. He promptly lost his presidential immunity and was suspended from office, leaving Venezuela in the lurch during its greatest macroeconomic crisis to date. Venezuela lacked government leaders that were competent enough to lead without oil inflows and did not understand how these stop-and-go economic reforms affected long-term economic growth. Thus, many Venezuelans and their subsequent leaders simply believed that "another boom in black gold was just around the corner" ready to save them.

Therein lays the major problem of resource-rich countries: the inevitable cyclical change in global price and demand of the global economy that dramatically impacts their marco- and microeconomy. They often choose to wait out the crises in hopes of another boom in the global price of natural resources instead of wisely utilizing a boom period to create institutions that will provide more stability for a sharp downturn in prices. It has taken Venezuela several years and attempts since the discovery of oil to establish economic reforms and reserves to prevent a recurrence of their 1988 economic, political and societal collapse. Thus, paradoxically the dependency on resource wealth generally leads to a mismanagement of resource revenues, inhibiting long-term economic growth and political and social stability.

“Paradox of Plenty”: The Resource Curse

If countries are so rich in natural resources and resource revenue, why have they not been able to prosper? How has an economy and political system based on a single extractable resource affected the creation of political and economic structures and indirectly affected societal conditions? These questions are not entirely original nor are their answers easy, a point well illustrated by Venezuela’s recent political and economic history. A simplified answer would be that these countries develop paradoxically. Countries that have such an abundance of wealth underground tend to have high inequality in society with large portions of the population living below the poverty line. While governments receive enough income to fund social welfare projects, these countries often have poor education systems. Governments that should have plenty of money to invest in research and development in other sectors of the economy do not actually do so. They have weak manufacturing and agriculture sectors while all technologies are devoted to the resource commodity (“It’s only natural” *Economist* 2010). It is also puzzling how governments that are bestowed with so much wealth are forced to impose serious austerity reforms and quickly transform into authoritarian-like regimes. These enigmas have become the focus of a vast amount of scholarly research and literature that delve into the complexities of how countries, such as Venezuela, are affected by this “paradox of plenty” (Karl 1997).

Over the past three decades, world commerce has become highly globalized. As such, many countries around the world depend on exports for a large portion of their national income. However, some countries’ dependency on exports is extreme, especially those that rely on natural resource commodities. While early economists thought natural resources would be an unalloyed source of wealth, research and evidence show otherwise. Due to the instability of global prices and the sole focus on the resource extraction industry, scholars have come to the general conclusion that countries rich with natural resources are often plagued by a series of defective social, political and economic characteristics previously mentioned. These unfortunate characteristics of the resource-rich have become theorized by scholars as one grand dilemma known as the "resource curse."[2] While there are several "symptoms" that comprise the resource curse, the central problem of the resource is unpredictable but ever-present boom-bust cycle. As further elaborated in the following paragraphs, this problematic cycle is associated with three other derived and serious issues such as the pathologies of a monoeconomy, inflexible state and economic institutions, and severe regime shifts from democracy to semi-authoritarian rule all which create a host of budget and management problems (Bannon and Collier 2003; Ross 2003).

The Basics Behind the Boom-Bust Cycle: "What Goes Up, Must Come Down"

Countries that rely on resource commodities for a significant portion of their national income consequently rely on the global demand and market prices for their resource. Demand for a certain commodity is consistently changing; therefore, the price for that commodity is always changing as well. When demand and price are exceptionally high and revenue inflow is readily available this is known as a "boom" period. Counter-intuitively, boom periods are often the catalyst for long-term economic and political instability. Because there is a plethora of wealth or "bonanza profits" coming into the countries, governments tend to launch huge national development and social projects. Once these projects are established, citizens assume they are there for the long-term and become dependent on the government assistance. The problem is that boom periods are usually temporary and governments are over-extending their present resources

[2] But the idea of the "resource curse" did not originate with the developing Latin American countries. Rather it was much earlier, in the 1970s, after the Netherlands discovered natural gas in the North Sea. Soon after this discovery, The Netherlands contracted what is now called the "Dutch disease." The "Dutch disease" is characterized as a process whereby new discoveries or favorable price changes in one sector of the economy (petroleum, for example) can cause distress and a decline in other sectors (such as manufacturing or agriculture). This malady creates a serious dependency on natural resource wealth through multiple "symptoms" that all add up to a "resource curse" (Humphreys et al. 2007; "It's only natural" *Economist* 2010).

(Johnson "Political Logic" 2011). When other countries experience economic downturns, this decreases the global demand and price for resource commodities and in turn, dramatically affects the national income of export and resource-dependent countries.

Boom periods are generally followed by a sharp decline in prices leading to a "bust" period. During a "bust," governments abruptly find themselves seriously lacking revenue to continue funding the projects they had started during the boom (ibid). More importantly, the drastic decrease in their revenue from exports provides them with little money to continue daily functions expected of the government as well. Instead of spending and saving wisely during the boom period, governments take advantage of the flourishing resource rents to spend without limitations—usually motivated by political and electoral reasons. Conversely, during bust periods governments are forced to implement harsh austerity reforms in attempts to make-up for the careless spending and lack of revenue. To impose these policies, presidents often do so by decree, behaving more like dictators instead of elected presidents. Paradoxically, instead of trying to invest in developing other sectors of the economy, the resource sector becomes so favored that even during a bust period governments will wait and pray for another boom period to resolve their economic crisis.

Derived Evils: Monoeconomy, Inflexible Institutions, and Swift Regime Shifts

Accordingly, the boom-bust cycle leads to an undiversified or monoeconomy—an economy that consists of only one sector, in this case the resource commodity sector. With the rise in value of natural resource exports, the other economic sectors, such as manufacturing and agriculture decline and become less competitive. The "bonanza profits" generated from the over-valued exchange rate enable the country to import most manufactured goods cheaply and at the expense of domestic industries. Boom periods encourage governments and industries to shift domestic labor and material supplies toward the extraction industry and natural resources because they want to export as much of the commodity as possible when demand and prices are high, while the resource is expensive and has little competition. This only increases costs to producers of the other sectors, inhibiting them from developing properly and actively contributing to the national economy—leading to a monoeconomy. In a vicious cycle, this only puts more pressure on the natural resource sector to perform extraordinarily well and provide a majority of the national income. The boom period indirectly then creates a more fixed and inflexible economic infrastructure as the country focuses all its investments and builds its institutions around the only apparent profitable sector (Humphreys et al. 2007; Shafer 1994).

Unsurprisingly, inflexible institutions do little to help the economic and political stability of a country. When a state has such an undiversified economy, concentrating everything on the resource sector, economic and state institutions cannot react appropriately when the "commodity price shocks" or the boom-bust cycles strike (Bannon and Collier 2003; Ross 2003). The dependence on resource revenue often creates a void in the country's tax structure. With high taxes on exports and a high percentage of total tax revenue coming from the tax on resource exports, governments feel little need to establish a domestic tax or heavily tax other sectors of the economy. When a bust period hits, it becomes almost impossible for governments to establish and collect any other taxes because there is no precedent in doing so (Karl 1997; Shafer 1994; Johnson "The Resource Curse and Taxation" 2011). Everything revolves around the resource sector, the monoeconomy. Moreover, civil servant systems or bureaucracies are set-up as patronage positions during the boom period do not hold government officials accountable for their actions. While this can be largely ignored while revenue incomes are high through social welfare projects and nationalist rhetoric, during a bust period the people find the government to be ineffective and illegitimate (Shafer 1994). Because their institutions were structured around the only—and now failing—economic sector, they have little choice but to revolt and demand internal change. This characteristic of the resource curse is exemplified perfectly during the 1988 crisis in Venezuela. Thus, governments that are structured around resource exports with little ability to react during price shocks are more prone to corruption, weakened accountability and heightened rent-seeking.

With no other economic sector to fall back upon when a bust period suddenly strikes and little room to maneuver amongst the state institutions, presidents and their administrations scramble to find available money and often ruin public finances. This leads to cuts in the public works projects that were underway during the boom period. The loss of revenues leads to painful austerity policies with effects distributed amongst the society unequally, hurting the poor more than the wealthy. These reforms are generally market-oriented and include the privatization of national companies (often to foreign companies), increasing costs of goods and services, and dramatic cuts in social spending—a complete 180 degree change in policy-making. To enforce these new laws, the president often does so by decree, acting as an all-powerful authority instead of in conjunction with the national assemblies. In response to their abrupt and complete devastation, people revolt against the perceived betrayal of their government. As chaos replaces the satisfaction once found in communities, presidents behave more like dictators: rapidly suspending civil liberties and declaring martial law to stamp out protests (Karl 1997; Silva 2009). Of course, the cycle only restarts again when the next boom period arrives and the quasi-authoritarian rule ends and society returns to being a dependent, welfare state. The boom-bust cycle and its derived evils all add up to the dreaded resource curse, which only stunts the future economic stability and political consistency of developing nations.

The One Who Got Away: Norway, an Exception to the Resource Curse

While many countries that are excessively dependent on resource exports have fallen victim to the boom and bust cycle of the resource curse, there are countries that have managed to avoid the worst manifestations of the resource curse. Since the discovery of natural gas and oil in the North Sea in the early 1960s, Norway has been cited as an example of "best practices" in regards to natural energy policies and provides an interesting comparison to Chile, Venezuela and Ecuador (Karl 2007). After the discovery of natural gas, Norway's experience with natural resource wealth is strikingly similar to that of the Latin American countries in two ways. Norway immediately became susceptible to the boom-bust cycle (leading to over-valued exchange rates and bonanza profits) and also nationalized their oil company (Karl 1997). These resource curse symptoms consequently caused similar economic and political instability seen in other resource-dependent countries. However, these problems were not as devastating for Norway as for developing countries and reasons why that occurred are explored shortly.

The 1970s boom of natural gas prices encouraged Norway officials to increase resource extraction and exports to gain more revenue.[3] With the new revenue, large public expenditures and development projects were launched and promoted by the political party in power. Predictably, Norway's "bonanza" period in the 1970s created similar problems seen in Venezuela in 1988. Inflation rose sharply, external debt increased, agriculture and manufacturing sectors withered and the new exploitation of offshore oil limited Norway's competitive position in the market as labor costs increased. These economic problems carried over into political issues as the electorate completely shifted their support from the Labor Party to the Conservative Party as political parties had to cope with a daunting economy and country becoming dependent on

[3] Norway's narrative is also excerpted from Terry Karl's *The Paradox of Plenty: Oil Booms and Petro States* in addition to Øystein Noreng's *Crude Power: Politics and the Oil Market*

one economic sector—natural resources. To retain control over the oil production and rents, the Norwegian government nationalized its oil companies. Norway set an explicit role for private and foreign companies under state supervision and a system of corporate taxes for the oil firms. While done so in the name of the "national interest" and to assert their economic independence from foreign companies' control and influence, nationalizing the oil companies keeps the government directly involved in investment in and revenues obtained from the oil industry.

But Norway and Latin American countries differ in four key ways in regards to their natural resource development: Norway was in a better position to manage the sudden influx of resource wealth provided by natural gas; they had stronger, more reactive state institutions, especially in their tax structure; they maintained other sectors of their economy, protecting Norway from a monoeconomy; and lastly, they saved and spent their oil revenue wisely by creating a "petroleum fund." It is particularly this last difference that I will be focusing on in Latin American countries in the remainder of this paper. Thus, even with the same abundant natural resource and similar government involvement, Norway has been highly successful in creating a more stable, diversified economy and cooperative political system (Karl 1997; Karl 2007).

One key factor for Norway's success is that it was historically better equipped to handle the wealth generated by a natural resource. Timing matters in the discovery of natural resource wealth. The discovery of natural resources shapes the nascent government and institutions of a developing country much more profoundly than that of a development and already stable government, such as Norway's. Although power shifted in the government between the two main political parties due to societal changes after the discovery of natural gas, there was in no way a complete regime change from democracy to quasi-authoritarianism seen in several Latin

American countries. Norway already had strong state institutions, high development and a relatively egalitarian society in place (Karl 2007). The country also has a solid tradition of democracy backed by a high functioning and honest, civil-servant bureaucracy system that established a petroleum policy based on consensus. Additionally, Norway was able to protect some of its other exports such as cement, aluminum, pulp and paper, thereby retaining a more diversified and flexible economy. Norway was in no rush to start rapid oil production because it was viewed as adding marginally to an already healthy growth rate and national economy—further emphasizing how timing is crucial (Karl 1997). Norway did not need resource wealth to prop up its government and economy. This made Norway's economy less susceptible to the boom and bust price shocks of the oil market that tend to cause dramatic institutional and political changes.

Instead of structuring institutions and politics to revolve around petroleum, Norway dealt with oil in terms of well-established institutions. Norway did reorganize the governmental agency Ministry of Industry in order to oversee the petroleum industry along with the state oil company. In this manner, Norway created a committee with a wide array of people involved in the economic and political processes of the resource industry. One person, such as Venezuelan president Pérez in 1988, is not able to use the collected revenue for their own personal or political benefit, to create welfare services to appease a majority of the population, or to strength the military for societal repression when the people protest when their welfare is abruptly taken away. Furthermore, Norway was able to limit the rent-seeking of government authorities by not squandering oil revenues on "white-elephant projects" such as those seen in Latin America. In fact, Norway utilized extra oil revenues to protect the state's non-oil fiscal capacity. Norway's politicians have resisted using oil revenues to replace other economic sectors and have managed to retain its domestic tax base. This not only provides more stabilization for the national economy, but also prevents a small group of persons with vested interests in the resource sector from controlling economic policies (Karl 2007; Karl 1997).

But perhaps most importantly, Norway put most of its recent oil revenue (considered "bonuses") into a '"petroleum fund," set up to store wealth for the time when oil starts to run out (Karl 1997). From early on, Norwegian government resisted the urge to spend uncontrollably on development projects and instead saved wisely for a potential economic crisis—usually inevitable with resource commodities. These factors all combined to help protect Norway from the economic and political volatility that other resource-dependent countries currently experience. But recently, Latin American countries, such as Chile, Venezuela and Ecuador, have been trying to implement measures similar to Norway's "petroleum fund" in attempts to cure the boom-bust cycle and turn the resource curse into a manageable condition.

Resource Stabilization Funds (RSFs): The Antidote to the Resource Curse?

As demonstrated in the case of Norway, it is possible for countries to limit the unfavorable effects of the resource curse[4]. In order to do so though, governments need to resist political pressures to overspend during booms and save resource revenues instead. This would help to minimize the negative impact during bust periods. Latin American countries have begun to develop and refine new institutions, similar Norway's "petroleum fund," designed to try and ameliorate the unavoidable boom and bust cycle of resource demand. These funds are commonly referred to as resource stabilization funds (RSFs). Originating in the island Republic of Kiribati in 1956 to store their phosphate mining revenue, today there at least thirty-four active RSFs in resource-rich countries all funded by an array of commodities. These are essentially "rainy day"

[4] Due to limited amount of research on RSFs, the information provided in this section comes from Matthew Johnson's paper: *The Political Logic of Renter's Insurance: The Resource Curse, Institutional Strength, and Resource Stabilization Funds in Chile and Venezuela,* 2011

funds created by the government to store excess revenue and rents during boom periods in order to offset a dramatic drop in revenue during a bust. These funds, primarily, attempt to stop the serious failure of governments to save resource revenue income during boom periods by redirecting a percentage of profits into a special government account that is separate from the fiscal budget. Because only a fraction of resources rents are supposed to enter the budget, the government is forced to plan expenditures as if they were not in a resource boom period and limit spending. Ideally, the initial holdings of the RSF would increase during a boom period and this saved revenue would be used to smooth over public finances during busts. By saving revenues instead of expanding welfare projects during the "bonanza frenzy" of windfall profits, the government would be better able to protect its citizens during an emergency period. This is a much better alternative than imposing harsh austerity measures which tend to increase societal inequality and unrest. Theoretically, RSFs would act as an insurance policy against difficult economic times and help maintain economic and political strength.

Besides diverting from the fiscal budget in order to save money, the funds are supposed to operate under extremely specific saving-spending rules in order to provide another economic option that the government can draw upon when resource prices fall and income is limited. In this regard, RSFs should be maintained by more than one branch of the government with heavy oversight by a variety of partisan and non-partisan people. Ideally, RSFs have high transparency and accountability, making it difficult for political parties to use them for their own personal and political gain or for a time other than a "bust period." Thus, RSFs are intended to counter specific problems that are associated with the "boom-bust cycle" of the resource curse.

The Reality of Establishing an RSF

Still, RSFs are not designed nor are they likely capable to end all problems associated with resource dependency, such as lack of investment in other economic sectors. Moreover, not all RSFs have proven to be equally successful. Not only is the permanence and transparency of RSFs questionable, but the actual establishment of an RSF is a challenge in itself. There are generally difficulties that plague resource stabilization funds as well. For instance, there are great incentives for the political party in power to squander money on unnecessary social projects for their own advantage. Although resource-rich countries have been affected by the resource curse and its boom-bust cycle for several decades, RSFs have only been established worldwide in the pasty twenty years. Resource stabilization funds are only established through laws passed by the national assembly and signed by the head of state. In this way, the national economy becomes a much politicized issue with both domestic political pressure (and opposition) and international influences to pass laws that create a resource stabilization fund.

Domestic political conflicts can occur over the actual necessity to establish such a fund due to the cyclical nature of resource demand as boom periods are seen as the savoir solution, the save-spend rules that regulate the fund, and what the savings in the fund are used for. For example, funds have been established for economic crises but also to repurchase public debt (Murray 2005). The latter usage does little to bolster the country's economy but continually indebts them to foreign countries or international actors such as the IMF. Furthermore, pressure from international organizations such as the IMF that mandate a resource stabilization fund in order to receive a loan or monetary assistance also creates domestic resistance to establishing an RSF. Moreover, once an RSF law is passed and a fund set-up and running, there is no guarantee from politicians of both political parties that they will not dismantle or alter the fund once they are in power. Thus, the politics behind establishing and maintaining resource stabilization funds are a key component in the success of an RSF.

While literature abounds regarding resource wealth and the resource curse, there has been a lack of literature and research on the political aspects in the establishment, the utilization and the longevity of these stabilization funds. This paper investigates several aspects of the resource stabilization funds that have been set up in the Latin American countries of Chile, Venezuela and Ecuador. While these countries all have a version of an RSF, only Chile's has been proven to provide the stability and potential income during a crisis period. This paper attempts to provide answers to crucial questions regarding stabilization funds such as: How are the funds actually utilized? Who manages the fund and how are decisions regarding expenditures from the fund made? Are RSFs saving-spending rules easily changed? If so, how much are transparency, oversight, and accountability actually involved in the management of these funds? Perhaps most importantly is the issue mentioned earlier: how do both domestic and foreign political conditions factor into the establishment and usage of RSFs?

Recent scholars have presented research suggesting that the rationale as well as historical and political conditions under which a stabilization fund was established is a predictor of its success. Chile and Ecuador both set up a stabilization fund under loan conditionalities outlined by the International Monetary Fund yet Ecuador has manipulated, changed and eliminated their stabilization fund three times since its establishment while Chile has only transferred funds from one stabilization to another two times, demonstrating more stability (Johnson "Political Logic" 2011; "Ecuador House" 2002). Are domestic political conditions in a country, therefore, more influential in the success of an RSF? These are critical issues that this paper examines in addition to demonstrating how RSFs can flourish and flounder through three case studies of Venezuela, Chile and Ecuador and the many attempts of these countries to establish RSFs over time—a total of approximately nine funds. They also show the vast complexities of reversing the resource curse through state-established mechanisms and the intricacy of history, politics and economics in resource-dependent countries.

The Present Predicament of the Resource Curse in Latin American Countries

Today, oil is the most frequently cited example of the "resource curse"—analyzed in this paper with the cases of Venezuela and Ecuador. However, similar weak economic and political development can occur with mineral resources—also investigated in this paper with the example of Chilean copper. Exacerbating this problem is the unfortunate fact that these resource-rich countries are also considered "developing" nations. They already have historically weaker state institutions and democratic traditions. Moreover, they depend on continuous extraction of a resource for exportation to modern, developed countries not only for revenue but in return for heavy industry and manufacturing or capital goods. Research has generally concluded that countries that obtain at least a quarter of their income from natural resources are dependent on the easily extractable resource rents. Latin America is therefore uncomfortably dependent on resource exports as they have accounted for 52 percent of the region's exports in the past decade. Natural resources account for three-quarters of total exports from Chile and Venezuela and 45 percent of Ecuador's tax revenues comes from their tax on natural resource exports ("It's only natural" *Economist* 2010). As previously explained, the rents obtained from natural resources create intense pressures for political control, and are highly volatile, subjecting the budget to booms followed by busts (Collier 2009). This volatility in turn causes serious harm to the growth and development prospects of many countries. While many developing nations, several of them in Latin America, experience economic instability, it seems that only the resource-rich and therefore, resource and rent-dependent countries experience the affect of the boom and bust cycles more sharply.

Case Studies of Latin America: Chile, Venezuela and Ecuador

Although each country has unique properties and political histories that make their development of resource stabilization funds distinctive, Chile, Venezuela and Ecuador do share features that make them appropriate research comparison studies. All three countries are dependent on natural resources for a significant portion of their national income, as individual nations their development revolve around the resource industry, and they all experienced relentless political and economic instability. Venezuela and Ecuador have both developed into petro-states—countries that are highly dependent on oil. In comparison, Chile could be considered a "mineral-state" as it is dependent on its copper industry. Yet both of these resources have experienced serious cyclical volatility in world prices. The Latin American region as a whole suffered tremendously during the 1980s, also known as the "Lost Decade." But Chile, Venezuela and Ecuador have all experienced serious economic crises of their own, largely due to their dependency on resource commodities. In addition to economic instability, all three of these countries have undergone major political changes, oscillating between democracy and quasi-authoritarian regimes (in Chile's case, an actual dictatorship under Augusto Pinochet) with several threats of and actual coup d'états. Massive riots and chaotic societal conditions have persistently pervaded the nations. It has only been recently that democracy has been restored to these countries, although Venezuela's democracy is suspicious under the leadership of Hugo Chávez. Nonetheless, the primary establishment of RSFs demonstrates an effort by each country to create more consistency and solidity in their economy, politics, and society.

Further similarities include a state-owned enterprise, nationalized by the government, which is in charge of the majority of the resource extraction and sales. The CODELCO copper company in Chile and the petroleum companies, PDVSA and Petroecuador in Venezuela and Ecuador, respectively. The central government, therefore, is significantly immersed in overseeing the rents and profits generated from the taxation and exportation of these resources. Yet these countries differ in the establishment and regulation of their RSFs that allows for research, cross-comparisons and insights as to why this may not be the ultimate answer for resource-dependent countries. Data for this paper primarily comes from secondary sources and expands upon other RSF literature. In addition, this paper will use primary finance figures from government and Central Bank websites and annual reports that document the spending and saving of the stabilization funds. If available, these reports will demonstrate the utilization and degree of transparency of the funds. I will be supplementing RSF research with political and historical literature on each country that corresponds with the time period that an RSF was established or changed. The expected results should demonstrate that it is not only how RSFs originate and are established but also how the political conditions, both domestic and foreign, shape the success, stability and permanence of resource stabilization funds.

The remainder of my thesis will unfold as follows. Chapters 2 and 3 will focus on Ecuador and Venezuela, respectively, as developing petro-states that are extremely dependent on oil revenues for their national economy. Venezuela and Ecuador have both been reliant on the oil resource sector since the 1970s with Venezuela acting as an "oil tutor" for Ecuador after their oil discovery. Venezuela first had a semi-RSF established in 1974. However, this fund has since been altered and liquated with the new creation of a new RSF in 1998. Similarly, Ecuador first established their RSF in 2002 but it has since been changed numerous times with the most recent modification occurring in 2008. Venezuela and Ecuador both demonstrate how the easy modification of RSFs and their utilization can actually cause more instability and do little to protect a country from the boom-bust cycle of the resource curse. In contrast, chapter 4 will explore Chile's resource stabilization fund first established in 1985 and only altered once since then. Chile has been hailed as a model RSF-country that others attempting to establish similar funds should follow. Hopefully these case studies will provide interesting and insightful comparisons as to how the political setting affects the rationale and establishment of RSFs in the respective countries. The concluding chapter will explore and summarize these results as well as providing suggestions on improving the creation, maintenance and regulation of future RSFs.

Doomed from the Start: The Prospects of Ecuador's RSFs in a Volatile Political Setting

Since its independence, Ecuador has always been reliant on exports for a large percentage of their national income. Known as the "banana republic," banana exports were its original source of commodity dependence until Ecuador discovered large reserves of oil in the eastern rainforests during the early 1970s (Lernoux 1975: 682). Since then, oil has been the cornerstone of the Ecuadorian economy, seen as the ticket to wealth and an easy route out of debt and dependency.

In recent years, world oil prices have increased, providing Ecuador with more revenues and a more favorable economic environment but also a greater dependency on oil. It is these oil revenues that pose the most challenging problems for fiscal policymakers and presidential administrations. To address this problem, Ecuador has been implementing a variety of stabilization and savings funds throughout the past decade as a response to their disastrous economic crisis in the years 1998 and 1999. The crisis promoted an increased awareness for the necessity of sound, responsible fiscal management. Subsequently, efforts to ensure economic stability by accumulating oil revenue surpluses to offset a decline in oil prices and prevent inflation led to the creation of resource stabilization and savings funds. Over the past several years, Ecuador has since created and restructured four funds with the goal of saving, earmarking, or otherwise using exceptional oil income for specific purposes such as welfare projects, education, and environment investments.

Among the three case studies presented in this paper, Ecuador's RSFs are distinctive for three reasons. One, there are numerous funds operating within Ecuador and they are too complex as each has its own set of legal procedures; no less than four RSFs have been established in the past decade, although only three remain in existence today. Two, Ecuador's fund created under strict International Monetary Fund (IMF) conditions was eventually dismantled for nationalist reasons, unlike Chile whose IMF fund in 1985 remains strong and stable today (Bruno 2003: 28). Three, the distribution of Ecuador's stabilization funds are so poorly structured and fragmented that it makes them highly ineffective as a true stabilization or savings source. For example, Ecuador's original RSF is eligible for earmarks within the general budget. Thus, while ostensibly seen as stabilization funds to the outside, in actuality, the funds are actually spent before the fiscal year even begins.

A closer look at Ecuador's political, economic, and social situation over the past decade shows that Ecuador's RSFs are so different from those in Venezuela and Chile because there is a much greater degree of political instability and societal unrest. The years 1997—2006 have been generally characterized in Ecuadorian history as "political instability" as Ecuador went through six presidents in just nine years. One was disposed of by Congress for mental incompetence and two were driven out by mass demonstrations and protests in the streets of Quito, the capital city[5]. Thus, the problems that plague Ecuador's RSFs stem from the short tenures of presidencies. Each new administration has the ability to create a new RSF that can be used to serve their short-term priority interests.

This leads to three main points of contention within the process of establishing Ecuador's RSFs. However, it is not just Ecuador's RSFs that seem to fail on all three dimensions. Later chapters will examine how Venezuela and Chile's funds also struggle with similar problems. One is how the money is going to be used (utilization). The fund established under IMF conditions was politically contentious and eventually eliminated because 70% of the fund went to repaying public debt instead of social projects within Ecuador (Cueva 2008: 9). This leads to a second point of what percentage of each fund is distributed to determined projects or other

[5] "Ecuador", U.S. Department of State, http://www.state.gov/r/pa/ei/bgn/35761.htm

possible purposes (transparency in spending). A portion of one of the funds goes to developing projects in the Amazon, possibly a result of the indigenous people's protests in Quito (ibid: 7). Meanwhile, the original fund is almost entirely earmarked for pre-determined beneficiaries, leaving little money remaining to act as a stabilization mechanism (ibid: 13). Presidents can use this to their advantage and distribute money to public or private companies that may, in turn, support them politically. This makes it difficult to determine the funds' success, utilization, and actual necessity. Additionally, because of the variety and complexity of the funds' rules, there is a significant lack of transparency for the people that these funds are supposed to be protecting. A lack of understanding and transparency also makes it highly difficult to orchestrate an open discussion of public, domestic spending priorities, enabling the government to retain its control to channel the cash in a manner that may serve their best interests. This can lead to societal unrest and political opposition when an emergency arises and there is little money to rescue the economy with—this resulted in one president being temporarily exiled for "abandoning his post" and duty to the people[6].

Consequently, this leads to the third issue of who actually creates and controls the spending/saving regulations and withdrawal procedures of the funds (fiscal and legal management). After the IMF-established fund was scraped, the next fund was established by the Economic Minister and controlled by the Ministry of Finance instead of the Central Bank, allowing them to make different distribution and utilization decisions (Cueva 2008: 9; Giugale et al 2008: 131). A few years later that Minister became the president. This example indicates that the funds are politically connected and can direct a politician's career—in both good and bad ways. These frequent political changes have limited the ability to create lasting rules and

[6] "Ecuador", U.S. Department of State, http://www.state.gov/r/pa/ei/bgn/35761.htm

regulations for a more reasonable and transparent system of managing oil revenues that all parties could agree upon.

Therefore, this interconnection of RSF problems is rooted and worsened by the historic unstable political and socioeconomic environment in which Ecuador developed. We will also see that in Venezuela the creation of RSFs are based more on politics than economics, although Venezuela has managed to keep the number of their RSFs limited to two. Meanwhile in Chile, their funds were established on more solid economic reasoning and in a more controlled political environment, which seems to be the best indicator for their success. However, each country tends to follow a similar chain of RSF problems: utilization, distribution (transparency), and fiscal and legal management. This chapter explores the five RSFs that were established in Ecuador, discussing their utilization and regulations, examining their weaknesses within a political context and timeframe that may help to offer better suggestions for their improvement. The following table provides perhaps a presentation of Ecuador's stabilization funds, including the English names, year established and under what president, key characteristics of the fund and more simplified ("knighted") label to identify the funds throughout the rest of this chapter.

Name of Fund (Acronym)	Year Created; President Associated with Fund	Key Characteristics of Fund	"Knighted" Name in Thesis
The Oil Stabilization Fund (FEP)	2000; Jamil Mahuad	-First RSF established in Ecuador -Earmarked by general budget	The Already-Spent Fund; "Rough Draft"
Stabilization Fund for Investment and Debt Reduction (FEIREP) ***no longer in existence, eliminated in June 2005**	2002; President Gustavo Noboa; President Gutierrez	-Established under IMF conditions -Majority went to repurchasing/paying back Ecuador's public debt	The Fund to Pay-off Wall Street and the IMF
Special Account for Economic Reactivation (CEREPS)	2005; President Gutierrez; Finance Minister Rafael Correa	-Highly fragmented distribution	Where Does the Money Actually Go to Fund?

Savings and Contingency Fund (FAC)	2005; President Gutierrez; President Alfredo Palacio	-Lax definition of "emergency"	The Not-so Emergency Emergency Fund

From *Platanos* to Petroleum

With neighbor and fellow petro-state Venezuela as its "oil tutor" Ecuador stopped cultivating bananas and began drilling oil in the jungles and countryside in the early 1970s[7]. By 1974, Ecuador became the second-largest oil exporter in Latin America. Government revenues immediately quadrupled and oil accounted for more than half the country's foreign earnings and roughly half of the national budget. But the idealized myth of oil quickly wore thin. The discovery of oil led to an inflation of the budget and increased corruption. Unlike Venezuela, Ecuador's government had neither the resources nor the experience to develop the petroleum. Instead foreign oil companies, such as Texaco, were able to exploit the region and drill wherever they pleased. As a result, local communities were devastated, forests hacked down, and land and rivers polluted by waste oil and toxic discharges. Moreover, the government was not prepared to handle to the sudden inflow of revenues available. Semi-feudal social relations still dominated in society when oil was discovered, making it so that old elite factions still remained in power while the poor became "the dust left by hundreds of newly imported vehicles"—vehicles that were imported by the elite as luxury items, adding to government expenses.

During the decadent decade of the 1970s, public spending ballooned, financed by oil revenues and extreme borrowing. Oil wealth was used up by military spending, inefficient public projects and massive subsidies on petroleum product (the government kept the local price of oil at approximately a third of the outside market value). But in the 1980s and 1990s, oil opened the

[7] Ecuador's historical narrative is excerpted from the following sources: Chris Jochnick's "Perilous prosperity", 2001; Penny Lernoux's "Ecuador: Rags to Riches", 1975: 681-686; and "It's only natural: Commodities alone are not enough to sustain flourishing economies." 2010, http://www.economist.com/node/16964094

floodgates to foreign debt that has left Ecuador with one of the highest per capita debt in Latin America. Public spending and subsidies did little to increase employment or address poverty and basic welfare needs. Lastly, petroleum production simultaneously weakened other economic sectors as agriculture was virtually ignored—Ecuador was succumbing to the "resource curse.' While this was all manageable in during the 1970s with high oil revenues, by the 1980s public spending had skyrocketed and debt servicing was consuming a larger share of the national budget. Oil prices eventually collapsed, foreign credit dried up, and Ecuador was hopelessly over-extended in its budget.

Subsequently, Ecuador experienced a macroeconomic and financial disaster during the 1990s, largely resulting from a steep decline in international oil prices but also from "the Lost Decade" of 1980s during which all Latin American countries, large and small, suffered economically and politically. Throughout the 1980s and the 1990s the government slashed public services like education, healthcare and social security. By 1999, the end of Ecuador's crisis, the share of the budget directed to healthcare had fallen to less than 3%. Meanwhile debt repayment took over more than 50%. Deep in debt, wracked by inequality and political corruption, Ecuador has now become more dependent on oil than ever with tax revenue from oil accounting for almost 50% of the total tax revenue as recently as 2008. Thus, the ultimate question of this chapter is how successful has Ecuador been using their excess oil revenues to stabilize the economy and save for future needs?

"The Already-Spent-Fund:" The Oil Stabilization Fund (FEP)

Ecuador's first RSF, the Oil Stabilization Fund (FEP) was created as a response to their disastrous economic crisis. However the roots of this economic crisis stem from a political instability beginning in 1996 and continuing until 2006. In 1996, Abdala Bucaram won the

Ecuadorian presidency based on a campaign platform that promised populist economic and social policies. However, during his short term in office, Bucaram's administration was severely criticized for corruption and a downward spiraling economy decreased his popularity. Eventually known as "El Loco," Bucaram was deposed by Congress in 1997 on grounds of alleged mental incompetence and an interim president was elected for the remainder of his term ("Sane and sober" 1996; "Ecuador"). Shortly after the government of a mentally incompetent and corrupt president, Ecuador experienced their worst economic crisis ever. Ecuador's politicians and policymakers quickly learned that proper fiscal management and responsibility needed to be a top priority for each presidential administration; thus, forever rooting their resource stabilization funds as a political necessity.

One of the first reforms passed by the new president Jamil Mahuad was the Law for Reform of Public Finances (*Ley Para la Reforma de las Finanzas Publicas*), published in the Ecuadorian Official Registry on April 30, 1999 (Cueva 2008: 7). In attempts to stabilize Ecuador's economy, the most significant aspect of the bill was that it authorized and implemented the dollarization of Ecuador's currency—making the U.S. dollar the official currency of Ecuador. However, the reform also established the first stabilization fund, the Oil Stabilization Fund (FEP). As the first RSF established in Ecuador, the FEP can be seen as more of a "rough draft" for an ideal RSF in light of Ecuador's continued construction of more RSFs and a more stable political environment. Ideally, the FEP should accumulate light crude revenues that were unexpected or that were higher than initially budgeted. When oil prices are high, excess revenue is saved in the FEP and it is used to compensate budgetary accounts in case of unexpected costs—these are often due to the price of imported refined petroleum products (Giugale et al 2008: 131);. Under management of Ecuador's Central Bank, the FEP's main objective is to help counter fluctuations and lessen the impact of volatility of world oil prices on the government expenditures. However, the most problematic feature of the FEP is that it is earmarked. In other words, the fund is entirely and pre-determinedly spent by the government budget (World Bank Study 2005: 26). Thus, earning it the more appropriate title of "The Already-Spent Fund." This may have been seen like a way to ensure that all beneficiaries received enough resources in order to keep the economy functioning, but we will see that it does very little to help act as a stabilization mechanism and leads to two other major problems: burdensome budget problems for those who manage the fund and a severe lack of transparency in the distribution and utilization of money.

One of the overall problems with the RSFs in all three case studies of this paper is that funds can be overly complex with convoluted legal procedures. This certainly applies to all of Ecuador and Venezuela's funds, although less so in Chile. In recent years, legal reforms in Ecuador have created more incentives to earmark the money in the FEP[8]. The FEP has been designated as fund that is to be liquidated at the end of each year. This means that at the end of each fiscal year whatever is not withdrawn from the FEP is transferred to another stabilization fund which is not part of the general budget and can therefore not be used to cover general government expenditures. Because this money will be emptied at the end of the fiscal year to an account unavailable to the government budget and in turn, government beneficiaries, the money is often earmarked and its usage decided before the fiscal year even begins, leaving little left as a potential emergency fund and essentially destroying the concept of fiscal management. Since its establishment, the FEP has almost entirely been used up by its allocated budget[9]. In fact, this

[8] Information regarding the earmarking system and its changes are from Cueva 2008: 7-8.

[9] The FEP's budget is as follows: 45% goes to the FEIREP, 35% to *Troncal Amazonica* (a special account for projects in the Amazon that is **not** part of the general budget), 10% for development projects in selected provinces and 10% for the National Police, to be used for equipment and institutional strengthening, for a period of 5 years. In

practice of withdrawing money from an account that is to be liquidated throughout the year can actually lead to withdrawing beyond the actual year-end value if oil prices falter. The earmarking and liquidating procedure thus creates a far more complicated budgetary plan than necessary if the fund was to just be managed as a true stabilization or savings fund.

As a rough draft RSF, the FEP was immediately subject to political modifications in utilization and distribution that abound in all of Ecuador's future RSFs as well. Although the FEP was created in 1999, by March 2000, it was quickly revised under a new omnibus bill passed on a variety of economic issues known as the Law for the Economic Transformation of Ecuador (*Ley para la Transformación Económica del Ecuador*). The new law made changes regarding oil revenue and clarified the parameters of the development projects occurring in the Amazonian provinces. These border province projects and police funding were directed through the budget while the funds related to the *Troncol Amazoncia* (a special account for projects in the Amazon) were directed to a special account with a different earmarking system (Cueva 2008: 7). This change in the distribution of funds may be linked to the demonstrations and protests in Quito led by indigenous groups in January 2000. Frequently ignored and marginalized the indigenous struggle to have a voice in the political and economic arena. However, in 2000, demonstrators entered the congressional building and declared a three-person "junta" in charge of the country, causing President Mahuad to flee the presidential palace[10]. This may have caused policymakers to include the provision that would eventually direct half of the FEP money to Amazon projects. The rapid modification indicates how easily the fund can be manipulated for political appeasement and for advantages by those managing it. Simultaneously, the change also

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2005, the allocations changed so that half of the funds went to the CERPS and half went to the Amazonian projects (Cueva).

[10] "Ecuador", U.S. Department of State, http://www.state.gov/r/pa/ei/bgn/35761.htm

adds another layer of obscurity to the utilization and distribution of the fund as there are now two ways the fund can be earmarked.

After this reform to regulations regarding the FEP, the money could now be earmarked as off-budget (such as the Amazon account) or in-budget expenditures, making the budgetary process more onerous and less transparent. Off-budget spending implies the transfer of funds to public or private entities, such as the Defense Board for military expenditures, before the money is otherwise allocated for budgetary purposes. These budgets, however, are excluded from the General Budget, thus limiting transparency in the use of the funds for the general public. In contrast, in-budget expenditures are subject to a slightly higher level of public accountability and transparency through the general budgetary process. Still, once the funds are allocated to the budget, the legal provisions imply that the beneficiaries receive all their earmarked money, ensuring that any available money is used up (Cueva 2008: 20). With the FEP it would almost appear that those in charge of managing the fund are actually the entities that will receive a share of the money. For example, Ecuador subsidizes a large portion of its oil derivative products as the government has frozen consumer prices for regular gasoline, diesel and cooking gas at prices well below international market price levels since 2003. As a result, the subsidies have presented a growing cost for the state through import costs. Therefore, the budget revenues expected from oil exports have not been realized and the government has had to use FEP funds to make up the difference. In 2006, Ecuador's state-owned oil company, Petroecuador, actually had greater import costs than expected revenues. In turn, the Treasury had to repay the costs, taking money away from the FEP (ibid: 17).

Thus, Ecuador's earmarking system for such things as subsidies essentially amounts to permanent and undisclosed lobbying from already powerful groups that limits the budget flexibility, lacks transparency, and depletes the stabilization funds of emergency resources. As a historically and sadly corrupt country, Ecuador's FEP raises concerns of accountability, corruption, and bribery instead of transparency and genuine, proper fiscal management to help stave off another macroeconomic crisis. As a "rough draft" RSF, the FEP demonstrates how these funds initiated for the economy can be become politically contentious and charged and are highly shaped by the domestic political conditions of the country. The lack of available money, the fund's distribution, and Ecuador's political instability may have triggered the IMF's participation with the next RSF.

"The Fund to Pay-Off Wall Street and the IMF": (FEIREP)

Ecuador's second RSF, however, was not set-up to be a more successful stabilization mechanism than its first. What was different about this fund was that it was established as part of a conditionality agreement with the IMF. This meant that the IMF controlled the three significant aspects of the establishment process: the utilization, distribution and management of the RSF and Ecuador had little choice but to go along with it. The rigid rules of this fund stem from the "junta" and demonstrations that ousted President Mahuad from his post. After President Mahuad fled from the "junta" demonstrations in the capital city, Vice President Gustavo Noboa took charge with Mahuad endorsing him on national television as his successor[11]. Noboa was able to restore some normalcy and stability to Ecuador after Mahuad's downfall. He fully implemented the dollarization of the economy and obtained congressional authorization for the construction of Ecuador's second major oil pipeline financed by a private consortium. Although Noboa quickly turned over the government in January of 2003, his administration did manage to establish another stabilization fund known as the Stabilization Fund for Social and Productive Investment

[11]Historical and political contextual information obtained from: "Ecuador", U.S. State Department, http://www.state.gov/r/pa/ei/bgn/35761.htm

and Debt Reduction (Fondo de Estabilización, Inversión Social y Productiva, y Reducción del Endeudamiento Público— FEIREP).

In January of 2002, Ecuador had been seeking a loan from the IMF but negotiations dragged on as talks became deadlocked due to concerns over the government's ability to control spending ("Ecuador House Scraps Fund Plan" 2002). Thus, a new oil stabilization fund (the FEIREP) was designed to help pay off the country's debt as well as distribute a small portion of the money for welfare expenditures and save cash to ward off future economic problems. However, because the FEIREP was designed under IMF conditions, President Noboa had to send a package of reforms to Congress in order tighten controls on how the oil fund was spent and expand the amount of crude cash flowing into the fund to include heavy-crude output as well (ibid). Almost three-quarters of the fund were to be used to repurchase Ecuador's public debt (Cueva 2008: 9; Giugale et 2008: 131; World Bank Study 2005: 26). Thus, while this fund had few transparency concerns because almost all the money was being returned to the IMF and other foreign banks, the fund raised political issues due to its utilization ("Ecuador hikes social spending" 2005). This stabilization mechanism was forced upon Ecuador by outside political influences instead of created by fiscal policymakers within Ecuador. Unlike Chile's IMF-established resource stabilization fund which continues to prosper, the FEIREP soon fell victim to nationalist rhetoric and political opponents that demanded a change in its distribution regulations.

When the FEIREP was first introduced in June 2002 by the *Organic Law on Fiscal Accountability, Stabilization and Transparency* it was designed as a special trust fund that was managed by the Central Bank, although the true fiscal and legal management was orchestrated by the IMF (Cueva 2008: 9). Therefore, the distribution of the FEIREP fund was allocated as follows: 70% of the fund went to the repurchase of public debt and service of the debt with the Social Security Institute of Ecuador, 10% for health and education expenditures, 20% to a different stabilization account of up to 2.5% of the GDP that is to be used during legally declared emergencies (such as earthquakes and landslides) and to compensate for the decline in revenue when oil prices are low (Cueva 2008: 9; Giugale et 2008: 131; World Bank Study 2005: 26). But in just three years, political pressure and instability would again change the utilization and distribution of the fund (see Chart 2.2).

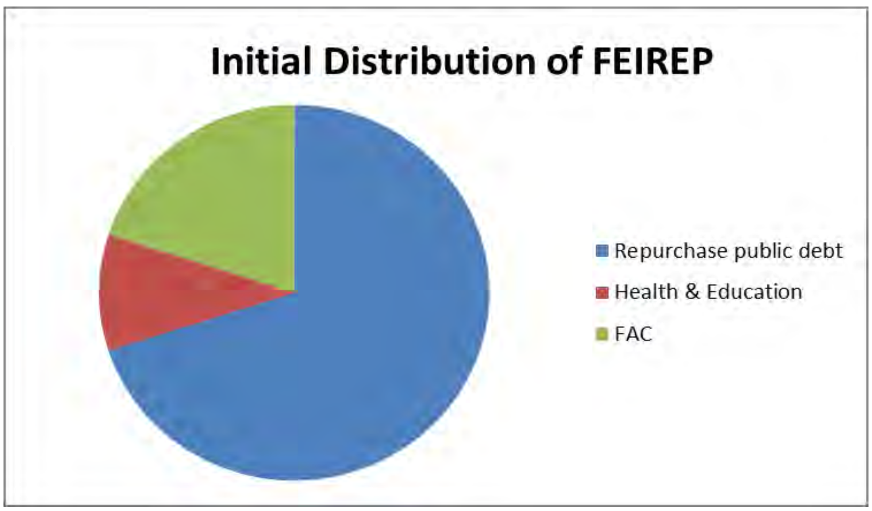

Chart 2.1.: *Ecuador's initial distribution of money in the FEIREP fund*

Thus, ostensibly the FEIREP's three main objectives were to repurchase public debt, to act as a macroeconomic stabilization fund, and to contribute to social expenditures. Yet because the IMF wanted to ensure that enough money would be stored in the fund to pay-off the debt, the fund's rules stated that it receive its money from light crude oil windfall profits when prices were above a certain price **and** revenues from heavy oil transported through pipelines that are beyond a set production level.

Accordingly, the fund could still earn money even while oil prices are decreasing because it receives its revenue inflow from both light and heavy crude oil (Cueva 2008: 8). As a result, debt can always (supposedly) continue to be repurchased and paid back. The complexity of this formula makes it so that the FEIREP actually saves more money than optimally desired for when oil prices are lower and save less when prices are higher (World Bank Study 2005: 27). Furthermore, the FEIREP account was highly controlled as the money was registered in the budget but not to be considered current revenues. A highly controlled account also further ensured that the fund would be used almost exclusively to pay back the IMF and not for a variety of other potential purposes. The FEIREP's website, which reported the funds' transactions, was not done in real time but still managed to remain up to date. While the availability of website reports indicates that the fund had more transparency in its utilization and distribution than others, reports not done in real time may offer very little insight to citizens and policymakers in a country that consistently experiences economic, political and social instability (Humphreys et al 2007: 231).

The combination of a strictly controlled withdrawal procedure and saving more during crises times instead of spending forces the government into a more restrictive fiscal policy than necessary. In turn, increasing the temptation for politicians or presidents to alter or bypass the rules—this happened in 2004 under President Gutierrez (World Bank Study 2005: 27). Thus, in reality, the complexity of the fund's rules (set-up by outside political forces but enacted domestically to obtain a necessary loan), the distribution and utilization of its money, inhibited the fund from acting as a fallback resource for Ecuador's dependent economy. Naturally, the FEIREP became more of a source of political and societal opposition than economic insurance as some politicians saw the fund as only benefitting the interests of private banks and foreign political figures rather than Ecuador itself.

The political concerns over the management and distribution of the FEIREP money did, however, actually represent true economic conundrums when it came to utilizing the fund as a stabilizing or savings source (although it is questionable whether policymakers fully recognized this as they were more concerned with short-term priorities). Studies of Ecuadorian poverty reduction done by the World Bank (2005) indicated that the FEIREP did not accumulate enough revenue to protect the budget while the target available pool of money (2.5% of the GDP) in the FAC stabilization fund (which receives a part of the money in its restores from this "pay-off Wall Street and the IMF fund") would not provide sufficient revenues to back-up the economy as a countercyclical fiscal policy if there was ever an economic shock. It is estimated that approximately 6.9% of the GDP would be necessary for a useful stabilization fund and large natural disasters can also cost far more than 2.5% of the national GDP. It is clear how some policymakers could believe that this fund did little to protect Ecuadorian interests in a time of crisis when almost three-quarters of the fund were going to foreign banks.

Inciting more political instability, President Noboa turned over his government in 2003 to his successor, Lucio Gutierrez, a former army colonel who first came to public attention as a member of the short-lived "junta" of January 2000 that ousted President Mahuad[12]. Gutierrez promoted himself as an anti-corruption politician with leftist, populist ideals. However after taking office, Gutierrez adopted more conservative fiscal policies and defensive tactics. Politically, this included replacing the Supreme Court and declaring a state of emergency in the capital to fight off growing opposition, and fiscally, he continued allocating 70% of the FEIREP fund to pay back the IMF. Political, social and economic unrest escalated until April 2005 when political opponents and societal uprisings in Quito caused Congress to strip Gutierrez of the presidency for "allegedly abandoning his post." In other words, Gutierrez neglected to govern with Ecuadorian people's interests being his top priority. He used the power of his presidency to

[12] Information on Gutierrez's short-lived presidency comes from: "Ecuador", U.S. State Department, http://www.state.gov/r/pa/ei/bgn/35761.htm; and Seelke et al. *Ecuador: Political and Economic Situation and U.S. Relations*. Congressional Service Reports, May 2008.

control other branches of government and let parts of Ecuador's financial resources continue to be dominated by foreign interests. We will see that this is in extreme contrast to Chile, whose resource stabilization funds and politics have managed to flourish even under foreign political and economic influences. Meanwhile in Ecuador, the military withdrew its support and Gutierrez went to temporary exile. Shortly after, Congress declared Vice President Alfredo Palacio the new president and a semblance of stability returned to Ecuador's political environment but not for its RSFs.

The lack of economic insurance provided by the FEIREP is one intricate example of President Gutierrez "abandoning his post" as president. With Gutierrez ousted, this allowed his political opponents to restructure the IMF fund[13]. The restructuring plan was presented by the Economic Minister, Rafael Correra (who incidentally is now the current president). Correa was one of the main policymakers who claimed there was a need to direct a larger share of the oil funds to social investments and projects instead of debt repayments. In fact, Correa wanted to eliminate the whole fund altogether but this was almost impossible at the time as Ecuador's loan from the IMF rested on the distribution and regulations of this particular fund (remember, in actuality it is seen as the fund to pay-off Wall Street and the IMF). Still, the restructuring plan was highly criticized by both the World Bank and Wall Street, which feared that without a large part of the fund dedicated and committed to debt repayments, Ecuador would be more likely to default or not pay as much as their loans back within a prompt time period.

Nevertheless, not wanting to remain puppets of the foreign banks nor disrupt the sense of political stability now present in Ecuador, Congress and President Palacio agreed to restructure

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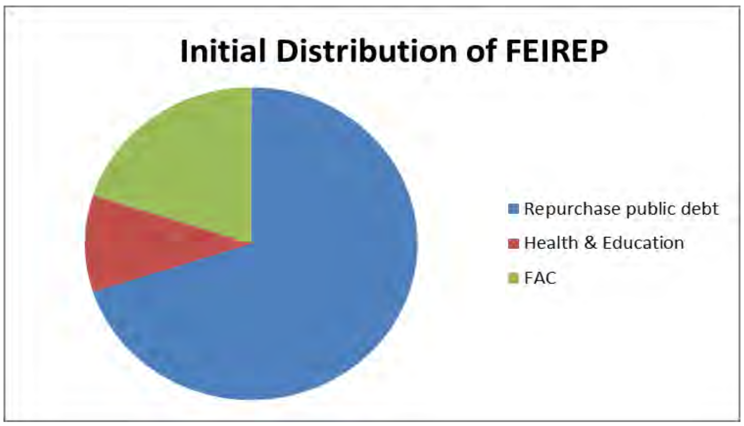
[13] There are a multitude of sources from which such anti-IMF and anti-FEIREP distribution information comes from: "Ecuador approves new oil fund." The Oil Daily. 15 July 2005; Acosta 2005; Murray 2005

the oil fund so a greater portion could be for social investment—clearly a domestic politically motivated decision. Under the new approved law, the FEIREP would be integrated with the government budget and only 35% of the oil fund was to be for financial services, such as debt repurchases—dramatically downsized from the original 70%. The remaining resources were divided up with 30% of the fund going to finance social projects, 20% to cover budget deficits, 10% of the fund was earmarked for environmental and infrastructure projects and 5% for scientific research ("Ecuador approves new oil fund." July 2005).



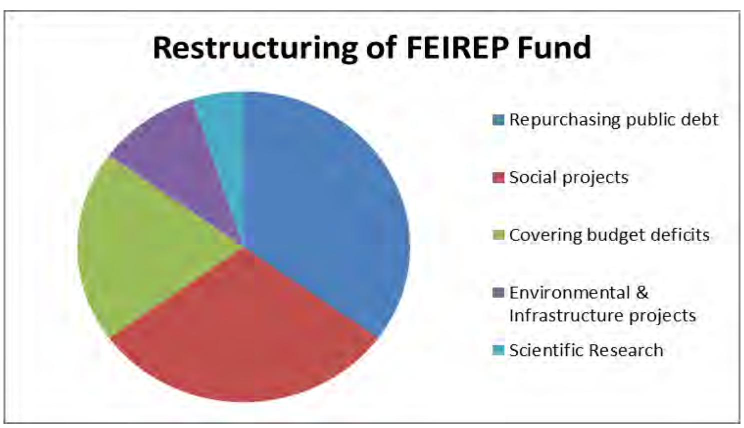


Chart 2.2: Before the restructuring (initial) and after restructuring (the new distribution of the FEIREP's resources)

Quite obviously, the new restructured FEIREP fund under the fiscal management of President Palacio and Economic Minister Correa acted much more as a stabilization fund that was in place to benefit Ecuador instead of the IMF.

Where Does the Money Actually Go To Fund?: (CEREPS)

In the two years since the FEIREP was established, Ecuador went through three presidents and all dimensions of the FEIREP changed dramatically: its utilization, distribution, and fiscal management. The constant changes in the political environment directly enabled changes with the RSF funds, further demonstrating how the RSFs are essentially doomed by Ecuador's instable politics.

But changes to the FEIREP were not done yet. Even after the restructuring plans, Correa and other policymakers were not pleased with the FEIREP fund and its regulatory repurchasing of the debt—its utilization and distribution. Subsequently, in June 2005, Congress passed legislative reforms that completely scraped the FEIREP all together. *The Amendment of the Fiscal Responsibility and Transparency Law* (FRTL I) eliminated the oil stabilization fund FEIREP and replaced it with a new account under the control of the Ministry of Economy and Finance (MEF) (Giugale et al 2008: 131). This was the origin of the CERPS fund—a new stabilization fund essentially established by Correa's political undertakings and now under his control as Economic Minister. This allowed Correa to dictate the distribution percentage and usage of its money, guaranteeing domestic utilization and fiscal management but only under the guiding hand of Correa. This change is a clear indicator of the strong political ties and connections that these stabilization funds have: they are not just tools for saving or stabilization the economy but sources of political contention that officials use as influence for their political advantage.

In light of this, it should be no surprise that CEREPS was created as a special and separate account in the budget (not as a trust fund) so that government representatives such as those in charge of the FEP ("the already-spent fund") do not control the CEREPS fund and cannot earmark it. Although the fund is not in the budget, it is still prohibited from use for current spending (Cueva 2008: 9). Thus, while the distribution of the money is definite, the divisions are so many that it becomes highly confusing to understand where the money in this fund actually goes to and how it is spent. This dramatically decreases the transparency and public knowledge of how the fund is operating. The fund operates by receiving revenues from several sources, mostly those that previously went to the fund to pay-off Wall Street and the IMF: state revenues from heavy crude oil production, 45% of the light crude oil revenues from the "already-spent fund" (after what is left from earmarked revenues), central government fiscal surpluses as well as what was left at the closing of the FEIREP and the account's investment revenues (ibid 9-10).

As an account designed especially to be more pro-Ecuador, CEREPS directs a much greater percentage overall of its resources to social welfare projects in Ecuador but it is a highly fragmented and indeterminately structured fund. The fund is distributed in the following manner: (1) 35% for four possible alternative uses: (a) credit lines at below-market interest rates to finance productive projects for agriculture, industry, fishing, small business, and micro enterprises, through first and second-tier operations by two state-controlled development banks (the *Corporación Financiera Nacional*, CFN, and the *Banco Nacional de Fomento*, BNF), with some constraints related to the beneficiaries' creditworthiness; (b) the payment of longstanding debts to the Social Security Agency; (c) debt buyback operations on domestic and foreign public debt, with the understanding that the new funds released through these buybacks should be used for infrastructure investments, credits to the productive sector, and education, health, and housing; and (d) infrastructure projects aimed at enhancing competitiveness and productivity (with a ceiling of 10 percent of the total funds earmarked for this item)[14].

Quite obviously, we see that the central problem with this fund is that in the first possible distribution of this fund, there are several areas to which the money could be directed toward. Moreover, the fund does not establish any minimum amount to spend on debt buy-back. So although debt repurchasing is an option, so are financing credit lines, debt payments to the Social Security Agency, and infrastructure projects. There is no stated and permanent utilization of that 35% portion of the fund—it is left to the discretion of the Ministry of Economics—making the management of fund susceptible to political motives and discretion as it could change with each president without anyone truly noticing. Given that Ecuador has had six presidents in just nine years this could potentially lead to huge variations in the fund's utilization and distribution. In turn, this limits a public, engaging discussion on the success of the fund.

The Fund of Savings and Contingencies (FAC)

Under the same fiscal law, cosigned by Economic Minister Correa in 2005, that established the CEREPS fund, Ecuador established their last stabilization fund to date. What is distinctive about this fund is that it appears to be ostensibly successful because it can only be used for revenue stabilization and emergency spending and nothing else. Thus, the utilization and distribution of the fund is relatively clear; however, we will see that the term "emergency" has taken on a very loose definition and can be twisted for "not-so emergency" needs as declared

[14] The fund continues to be divided in five other ways: (2) 30% for social investment projects, half in education and culture, and half in health and sanitation, both within the priorities of the Social Development Plan; (3) 5% for research and development, in the form of research and technological projects through several specialized agencies and universities; (4) 5% for road improvement and maintenance, through the Public Works Ministry; (5) 5% for environment and social projects to address negative externalities from hydrocarbons and state-controlled mining activities; and (6) 20% to stabilize oil revenues and address emergency situations. (Cueva 2008: 10)

by the President. Therefore, the fund is still very much connected to the current needs of the political environment and not just about stabilizing the economy.

The Fund for Savings and Contingencies (FAC) is designed as a trust fund to collect resources to stabilize oil revenues and is managed by the Central Bank, instead of the Ministry of Finance like the CEREPS fund. The fund receives 20% of its money from CEREPS as well as all unused money in the CEREPS account at the end of the year. The fund also has a ceiling of 2.5% of the GDP for the relevant cumulative funds (Cueva 2008: 11). The FAC seems to be the only fund truly designated to help stabilize the economy during a fiscal crisis and appears very straightforward. The money can be used to compensate any shortfall in budgeted oil revenues; for example as a result of declining international oil prices (bust periods), which may also lead to an emergency situation.

According to the Ecuadorian Constitution, the President can declare an emergency state in case of an imminent external attack, war, natural disaster, or an acute internal upheaval. The President must notify Congress of the state of emergency within 48 hours, and Congress could potentially revoke it. The state of emergency can last up to 60 days, and can subsequently be renewed or revoked. In practice, governments have used the state of emergency rather liberally. Several presidential decrees have declared an emergency in a wide array of sectors—electricity, jails, education, health, national roads, areas affected by a volcanic eruption, and the police—paving the way to channel FAC resources to finance spending in all those sectors (ibid). Consequently, this fund acts more as a “Not-So-Emergency Emergency fund” and there is a high probability that it would do very little to help Ecuador in a **true** declared emergency.

Recently, the growing cost of oil subsidies has *fueled* the need for more creative ways to finance them. Rising costs have led to a situation where net direct import costs have become larger than budgeted revenues from oil sales. Thus, the state has had to devise alternative ways to cover the costs. This has been done by either withdrawing funds from the FEP-to-be-liquidated account or by using FAC funds to finance Petroecuador sales of diesel and other products derived from petroleum to thermoelectric generation plants. Such a move has been justified by politicians declaring an "emergency status" of the electricity sector as aim to avoid blackouts (ibid 11; 17). As a result, the initial objective of being a genuine mechanism for stabilizing oil revenues and facing natural disasters has been largely diverted and undermined as rules for withdrawing from the FAC have become significantly more relaxed, similar to how earmarking has undermined the original stabilization fund (Giugale, Marcelo M. et al 2008: 131). While the FAC's rules have not been altered since its creation, indicating more political stability in Ecuador since Correa has been president, the RSFs are still susceptible to the present needs and priorities of the political environment instead of future economic conditions.

Conclusion

Issues pertaining to the resource stabilization funds in Ecuador still remain ongoing in the recent years. In April 2008, Ecuador's Constituent Assembly approved a new bill that, yet again, modifies the FEP (the original RSF) and the CEREPS (highly fragmented fund) funds and existing fiscal rules associated with the funds (Cueva 2008: 5). Yet the fundamental flaws of these funds still remain. There are still far too many funds operating within Ecuador whose legal procedures are far too complex for the average citizen to understand. Their utilization and distribution also remains so poorly structured, fragmented and obscure that it makes them highly ineffective as a true stabilization or savings source. Resource stabilization funds have been deceptive in many countries and Ecuador is certainly not an exception. In fact, the RSFs established in Ecuador have particularly misleading in their true purposes. The FEP continues to be earmarked, the FEIREP was eliminated all together, the CEREPS fund continues to be arbitrarily distributed to several different sources, and the FAC fund is not truly used for emergency situations.

RSFs in Ecuador, Venezuela and Chile all struggle with three problems that prevent their funds being completely successful as stabilization and savings sources: how the money is used (utilization), the distribution of monies in the fund (transparency), and fiscal and legal management. However, Ecuador's problems are exacerbated by the fact that their RSFs stem from the historic unstable political and socioeconomic environment in which Ecuador developed and today, are interconnected with the short presidency terms. In the past decade, Ecuador has gone through six presidents and two large political and societal uprisings. After each one, an RSF was either established or modified, indicating how the instability in the political arena transfers over to inadequate structures and economic utilizations of the RSFs. In the four years after Ecuador first created the FEP, the original RSF, governing administrations have created three different funds and one of those subsequently disappeared. Although they are expected to solve the problems of volatility and unpredictable oil prices by saving revenues for future "bust periods," Ecuador's RSFs continue to fail to fulfill those expectations.

Although Ecuador certainly provides us with a prime example of a nation seriously suffering from the resource curse and its dependency on oil, it is not the most notorious country cited for resource curse studies. In fact, Ecuador was only able to develop its petroleum production with the help of its neighbor Venezuela and "Uncle Hugo Chavez." Thus, the following chapter will discuss how Venezuela's politics and economy developed around their abundance and exportation of oil with a central focus on their establishment of an RSF. We will see that Venezuela presents a very similar yet different case to Ecuador in the types of political problems that plague the utilization, distribution, and management of their RSFs.

Venezuela: The Ultimate Petrostate

If there is ever a time when you need a one-word description to define a petro-state (a country whose income depends on oil), *Venezuela* should be the first word that comes to mind. Venezuela first discovered oil in the 1920s and since then, it has played a major role in the Venezuelan economy. For the next fifty years, Venezuela would be the world's largest oil producer and one of the fastest growing economies in Latin America. Eventually, oil became the dominant export in the 1960s as "the non-oil economy, and particularly the manufacturing sector, experienced a dramatic decline" (Johnson 2011: 17). By 1974, with oil income exceeding $48 billion, other economic sectors were seen as virtually meaningless and unproductive. Foreign debt, meanwhile, grew from $3 billion to $18 billion[15].

Here we see the beginning of the resource curse and the problematic nature of Venezuela's one-dimensional economy, especially with the sharp fluctuation of oil price that would come in the 1970s. Oil prices first skyrocketed and then plummeted soon after, deepening Venezuela's dependence when the prices were high, and then rapidly creating macroeconomic instability with a shocking drop. This essentially epitomizes the economic consequences of the boom-bust cycle. While oil booms helped sustain and expand Venezuela's economy, the busts during "the Lost Decade" of the 1980s-90s seriously crippled it and the non-oil economic sectors essentially collapsed. Despite this knowledge and experience of instability, it was too tempting for politicians to spend the oil rents instead of saving them and even more politically difficult to establish any type of stabilization mechanism until 1998 (Johnson 2011: 17). Oil has always and, unfortunately, continues to be the foundation of Venezuela's economy, political, and social

[15] "Timeline Venezuela"; http://timelines.ws/countries/VENEZUELA.HTML

environments, with tax revenue collected from oil exports accounting for 50% of the total revenue as recently as 2008 ("It's only natural" *Economist* 2010).

This story should seem familiar as it is very similar to Ecuador's history with oil. And like Ecuador, today, Venezuela still relies on oil for almost three-quarters of their total exports and as the seventh largest net oil exporter in the world, Venezuela is also one of the world's most dependent nations on oil inflows (Corrales 2009: 103). Long established as a true petro-state, policymakers knew that their oil dependency led to frequent financial, political, and societal unrest. However, any reforms initiated to create a resource stabilization fund always failed once oil prices increased again—the logic being that the new, rapid oil inflows would help restabilize the economy. Only when the surge of a populist, charismatic political leader threatened the traditional political setting in place since 1998 did a stabilization and savings source become a top priority. Thus, domestic political factors were, and still are, constantly at work in the creation and modification of Venezuela's stabilization fund.

Among the three case studies presented in this paper, Venezuela's RSF is distinctive for three reasons: it was politically-motivated, domestically established, but still subject to several changes and in reality, used for current spending instead of saving. One obvious difference is that unlike Ecuador and Chile there has actually only been one RSF established. Venezuela's RSF was also not set up by a particular presidential administration or an outside political actor such as the IMF. Rather it was a creation of the Venezuelan Central Bank. However, simply because there is only one fund does not mean that it does not come with several complex legal procedures and modifications because we will see that this fund certainly does. The politically motivated rationale behind the fund has caused it to be modified to almost oblivion, even though there has only been one president in the last fourteen years: Hugo Chávez. While this is a notable, large difference from Ecuador's six presidents in nine years, Chávez's unusually long presidential term has been marked by political and societal unrest, including an attempted coup d'état to unseat him from power.

Second, although Venezuela's fund was not designed by one specific presidential administration, it was only established by the Central Brank and President Caldera to place limits on a succeeding president; thus the fund was acting more as "political insurance" instead of economic insurance (Johnson 2011: 18). The rise of Lieutenant Hugo Chávez unnerved many long-time politicians because of his political outsider status, the 1992 coup attempt he had led, and his populist rhetoric. But mostly they were threatened because no one from their political parties had a chance of winning the presidency. Venezuela's RSF law was implemented just a mere month before Chávez's sweeping presidential win and thus, designed to constrain Chávez's ability to access and spend excess oil funds (ibid). It was not part of a larger package of legislative reforms for the economy. This caused instability because not only was the RSF newly designed and thus, malleable, but it was not established for macroeconomic stabilization. Therefore, as a new president, Chávez had few reasons to maintain the rules and regulations that the RSF's creators had in mind. Manipulations to the fund not only exacerbate economic instability but fly in the face of a democratic structure, causing political instability.

Third, the distribution of Venezuela's stabilization fund is also very politically motivated so that it makes it rather ineffective as a true stabilization or savings source. For example, like Ecuador's original RSF, Venezuela's fund is eligible for earmarks. Additionally, there has been increased presidential discretion in regards to withdrawals to the fund. Thus, while ostensibly seen as stabilization funds to the outside, in actuality, the president very frequently spends the excess oil revenues and leaves close to nothing for a potential "rainy day fund."

A closer look at Venezuela's political, economic, and social situation over the past decade shows that Venezuela's RSF is different from those in Ecuador and Chile because there is a different *type* of political instability and societal unrest. Ecuador experienced constant political instability between the years 1997—2006. Meanwhile, in Venezuela, such political instability was seen in the late 1980s to late 1990s. From 1988 to 1999, Venezuela went through five presidents, with two only lasting a few months. It was during these years that Venezuela also struggled mightily with neoliberalism, austerity measures and deadly social protests, culminating with little progress in the creation of a stabilization mechanism until Chávez stepped into the spotlight (Silva 2009: 195-229).

Thus, the problems that plague Venezuela's RSF stem from the short tenures of presidencies in the 1980s—1990s and also from the extremely long but unstable tenure of the extremely popular president, Chávez. In the 1980s and 1990s, each new administration did not have enough power or support to pass an economic stabilization plan and was far too dependent on the hope of oil revenues increasing. Exacerbating this is the fact that the RSF was primarily created to stunt Chávez's abilities as president (Johnson 2011). However, that plan has failed miserably and as president, Chávez has essentially granted himself unlimited powers and ability to spend oil revenues. This has led to a substantial base of hostile political opponents and an anti-Chávez movement that has promoted strikes and violent means of disposing of Chávez. He continually tests his limits of power with referendums regarding the Constitution and presidential term limits, frequently sending sectors of the population into a political frenzy. Chávez's stability rests precariously with oil revenues as he remains popular because he has chosen to spend the revenues on creating a vast number of social welfare and development projects and by promoting Venezuelan nationalism.

This leads to the main points of contention within the process of establishing Venezuela's RSF, quite similar to Ecuador's. However, Venezuela's RSF fails to a slightly different degree on the three dimensions of utilization, distribution, and fiscal management than Ecuador and Chile. Recall that the chain of problems seen in all three countries was: how the fund was utilized, the transparency of the monies' distribution, and the institutions responsible for its fiscal management. In Venezuela, only one fund was created under the premise of focusing on short-stabilization of the oil revenues of the central government, regional governments and the state-owned oil company. Yet its true purpose and utilization was to act as a restraint on the succeeding president. Thus, how the money was going to be used was never truly a point of contention or really a point of consideration. Once Chávez was in power, he had little incentive to adhere to any of the rules and quickly changed the distribution procedures of the fund. The fund has been divided the same way since 1999. This leads to a second point of what percentage of the fund is distributed to determined projects or other possible purposes (transparency in spending). A majority of the money in the fund goes to another fund run by the military known as the Single Social Fund that promotes and sponsors large social welfare projects (Johnson 2011: 21). This strengthens the popular support for Chávez's presidency and his reforms and allows him greater control and discretion in the spending of oil revenues. Moreover, as a former military leader, Chávez is giving the military more power in the political arena as a main authority of the fund.

Consequently, this leads to the third issue of who actually creates and controls the spending/saving regulations and withdrawal procedures of the funds (fiscal and legal management). Although the Central Bank was the original creator of the RSF law, they codified it in such a rush after years of deliberation that notably absent were measures to create broader macroeconomic policy, to increase the non-petroleum export sector's sustainability, or to create other economic policies that act as a potential stabilization plan. In reality, this resource stabilization was a one-time political reform instead of a life-long economic stabilization decision (Johnson 2011: 19-20). This serious lack of legislative deliberation and consideration of the future legal management and use of the fund has enabled Chávez to place himself in charge of the distribution and utilization of the fund.

The original rules of withdrawal and saving for the fund determined by the Central Bank were fairly transparent in order to keep the president in line; however, Chávez has already modified the fund five times, severely weakening the fund as a stabilization mechanism and destroying any transparency that was once associated with the fund. For example, in 2000, Congress' oversight committee found irregularities with deposits in the fund and accused the Central Bank of acting "illegally" by approving some of Chávez's withdrawal requests; but this has not stopped Chávez from continuing to use the fund as his own personal expense account nor has he been disposed of from the presidency (ibid: 21). This clearly indicates the actual amount of (or lack of) power that Congress or the Central Bank has in regulating this fund anymore. The management of Venezuela's RSF has turned into a one-man show—a show lasting fourteen years at that and only seems likely to continue. Thus, it is not so much the frequent political changes that has limited the success of the Venezuelan RSF as seen in Ecuador, but more so these two facts: the hurried confusion and political rationale with which the RSF law was passed and the frequent modifications made to the fund over a fourteen year period by one president for his own personal political gain.

While the fund provides a large majority of people with social welfare care, there is still little money left to rescue the economy if a macroeconomic crisis were to occur. Welfare projects help to appease the people now, but do little to protect them during a dire economic situation. Unlike Ecuador, societal unrest and political opposition have not stemmed from a lack of funds being redirected back to Venezuela but rather from Chávez's blatant disrespect of the laws and his quest to obtain more power within the government. His ability to go above and beyond the confines of the law without any checks or balances or negative consequences makes it highly difficult to orchestrate an open discussion of public, domestic spending priorities that would help to reform the RSF law.

Therefore, Venezuela's RSF problems are interconnected with and worsened by the unstable political and socioeconomic environment in which Venezuela has developed. This as we have seen is very similar to Ecuador; while Chile remains the single case where their funds were established on more solid economic reasoning and in a more controlled political environment, which seems to be the best indicator for their success. This chapter further explores the single RSF that was established in Venezuela, discussing its utilization and regulations, examining its weaknesses within a political context and timeframe that may help to offer better suggestions for its improvement.

"Sowing the Oil": A Political and Economic Environment Fueled by Petroleum

Oil has not only dominated Venezuela's economy since the 1920s, but it has also significantly shaped the political environment and development within the country[16]. After the discovery of oil, the state decided to "sow the oil" and expand petroleum production with a large influx of direct investment. The state strongly promoted the natural-resource-based industrialization that focused on the development of state-owned enterprises in petrochemicals and oil-refining and import substitution policies. The state did so under the assumption that oil

[16] The following two paragraphs contain information from Eduardo Silva's Challenging Democracy in Latin America, "Venezuela", 2005: 196-199

provided benefits for everyone—and until the 1980s it did. Oil revenues in the 1940s and 1950s made it possible for the state to increase spending in public education and health services while also creating more jobs without having to tax the wealthy. It was these under prosperous economic conditions that Venezuelan democracy was finally consolidated and political conditions improved. In 1958, the main political parties of the time, the military, and business sectors signed an agreement known as the Pact of Punto Fijo. The Pact cemented the political and economic understandings that would last until the 1980s: the political parties agreed to respect each other's rights to compete for power, the military agreed to civilian oversight, and the business leaders agreed to recognize unions in return for the state's commitment to maintain macroeconomic and support for import substitution industrialization. Quite clearly, oil has been the single most important factor in shaping the political and economic development of Venezuela.

During the era of the Punto Fijo political system, social harmony prevailed because oil revenue allowed the inclusion of working and lower classes without threatening the wealth of the upper classes. However, oil price shocks in the late 1970s and in the 1980s would cause economic crises that shattered the illusion of Venezuela as a wealthy country with an inclusive economy and a society that promoted and permitted social mobility. When oil prices dropped in the mid-1970s, the treasury had to borrow heavily in order to finance their over-expansive social spending and welfare projects. By the early 1980s, Venezuela had entered into the Latin American debt crisis. In 1982 and 1983, the economy shrank by over four percent per year. The poverty rate skyrocketed as unemployment rose due to the decline in public spending and public services. Meanwhile, the fiscal deficit continued to grow as governments continued to spend money they did not have.

The 1980s Debt Crisis and an Acknowledged Need for an RSF

The drop in oil prices did not just create an economic crisis though; it also created the instability in Venezuela's political environment that persists today[17]. During the debt crisis, the system of clientelism established by the Pact of Punto Fijo collapsed as oil income could longer be distributed. As long as there was a constant inflow of oil revenues, politicians from both parties could use it for public spending and service projects. In this way, the benefits of oil trickled down to everyone. But once oil prices decreased, the inequalities of clientelism became more noticeable and eventually, intolerable as money no longer filtered its way down to the middle and working classes. Only the politicians and the already rich and powerful benefited from the oil revenue during this time period. This political and economic dynamic caused by the volatility of oil prices quickly caused violent societal protests and riots as several administrations were forced to introduce austerity policies in order to front the large cost of borrowing money. And herein lays the danger of relying on just one economic sector for a majority of the national income. Yet despite the apparent oil-driven economic and political instability, many economists and policymakers found it too difficult to permanently control oil rents and establish any time of stabilization mechanism.

In fact, any attempt at economic reform or stabilization source during this time period was scraped once oil prices began to rise again. Recall the story that opened the introductory chapter, demonstrating how the resource curse dramatically affected the governing policies of Venezuelan president Carlos Andres Pérez (Karl 1997). In 1988, Pérez ran on a populist platform and promises to gradually solve the debt crisis in order to bring prosperity back for everyone. However, oil prices only continued to drop and consequently, the economy worsened. Within two weeks of his presidency, Pérez announced a neoliberal economic and structural adjustment

[17] This paragraph contains information from Silva 2005: 200

reform called “The Great Turnaround.” The reform called for a “shock therapy approach” to stabilize the economy with deep cuts to public spending, deregulation of prices on private sector goods and services, elimination of price controls on public sector goods and services, and the privatization of banks, telecommunications, and other state-owned enterprises (Silva 2005: 200).

Although the Pérez administration promoted the harsh austerity program as “The Great Turnaround,” it was known as “The Great Trick” or *el paquetazo* (“being hit by a package”) by the working class, who had to bear the brunt of the reform in their daily lives (Silva 2005: 203; Karl 1997). However, what is less documented is that Pérez’s reform actually contained provisions for an RSF, which would have benefitted all citizens of Venezuela by providing some sort of savings source to prevent another *paquetazo*. Internal economic planning documents said that this oil stabilization fund would be up and running in 1992, but the fund was never established as the government abandoned the idea as oil prices began to rise again in the late 1990s—clearly demonstrating the cyclical nature of the boom-bust cycle and how it lulls resource-rich countries into a sense of false security (Johnson 2011: 17). Thus, even though fiscal policymakers were aware from first-hand experience that their dependence yielded economic instability and fiscal responsibility was crucial, an RSF was still seen as unnecessarily difficult to create.

The political exclusion and economic hardship imposed on the working and lower class by Pérez’s new policies created an immediate explosion of societal unrest that would eventually end Pérez’s term by six months. It began on February 27th, 1989, with what is now known as the “Caracazo,” (named for the capital city of Venezuela: *Caracas*, where the riots began) when cities across Venezuela erupted into rioting and looting that lasted for almost a week. To control the huge escalation in violence, looting, and all-out rebellion, Pérez’s government suspended constitutional guarantees, called a state of emergency and ordered the military into neighborhoods to repress the protests (Silva 2005: 203-4). This left an official toll of 350 citizens dead and an unofficial of 1,000 to 5,000 according to human rights organizations (Karl 1997: 180; Harnecker 16; Silva 2005: 204). After the "Caracazo," Pérez's presidency only continued to spiral downward. His militaristic response to the "Caracazo" and the thousands of Venezuelans searching for affordable food and available work was the spark and motivation for the two military coup attempts in February and November of 1992 (ibid: 215).

Although both attempts were unsuccessful, they indicate the desperate and unstable economic and political times Venezuela was experiencing. By May of 1993, all political parties wanted Pérez out of the presidency and impeachment proceedings began against him on charges of corruption. Congress then shortened his presidential term by six months and went through two interim presidents to fill the void before the next presidential elections (ibid: 219). Here we see a similar political instability in Venezuela as Ecuador with very short presidential tenures that prevent the administrations from passing any potential economic stabilization plan. Moreover, these interim administrations in Venezuela were solely in place in attempts to control the violent protests and were still far too dependent on the hope of oil revenues increasing but far too in debt to achieve any progress.

With the Venezuelan economy still suffering from the volatility of international oil prices, president-elect Rafael Caldera cobbled together a coalition of 16 parties in order to win the presidency[18]. He campaigned on an anti-neoliberal platform and promised political and economic inclusion for the working and middle classes. However, low international oil prices pushed the fiscal deficit and inflation far above the government targets and, like Pérez, Caldera

[18] The Caldera administration's narrative comes from Silva 2005: 220 and Matthew Johnson's paper: *The Political Logic of Renter's Insurance: The Resource Curse, Institutional Strength, and Resource Stabilization Funds in Chile and Venezuela,* 2011: 18-19.

was forced to enact another round of economic reforms and austerity policies. In addition, Caldera's reform also contained an outline for plans of a "debt rescue fund" that would apply rents to Venezuela's public debt and thus, act as a stabilization source. But a fund was not established once again, because Caldera withdrew the plan once oil prices boomed in the late 1990s. Once oil prices were high again, Caldera's administration had little interest in saving the excess oil revenue or minimizing the role of rents in Venezuela's economy. For example, Teodoro Petkoff, the Economic Planning Minister pushing the *Agenda Venezuela* at the time, was not deeply involved with the Central Bank's promotion of an RSF law. The stop-start and boom-bust cycles of potential stabilization reforms and international oil prices together created a severely unstable political and economic environment in Venezuela for two decades. This constant wavering of policies subsequently led to the rise of today's most prominent Venezuelan leader, Hugo Chávez, and in turn, a very weak and politically-motivated resource stabilization fund.

The Rise of Hugo Chávez and the Actual Creation of an RSF

Although the military coup attempts during Pérez's presidency were unsuccessful, they launched Lieutenant Colonel Hugo Chávez Frias into the political spotlight. As one of his first acts as president, Caldera publicly pardoned Chávez for his involvement in the coup d'état attempts (Silva 2005: 221). He emerged as a prominent national anti-neoliberal and populist leader to the people. Chávez's rise is crucial to the final creation of the Venezuelan RSF because he is the primary reason for its formation. Although Caldera proposed and outlined a blueprint for a similar type of fund in the beginning of this presidency, the idea was pushed to the side for the remainder of his term. However, as the Caldera administration "limped toward the end of its mandate with waning public support," the establishment of a resource stabilization fund became a top priority (Johnson 2011: 18). The establishment of an RSF only became important as the political opposition began to impose a real threat to the politicians who were presently in power: Hugo Chávez. Political needs prompted the administration to grow serious about the actual creation of an RSF in order to keep the succeeding president in check. Widespread poverty, anger, and betrayal among the lower and middle class basically prohibited anyone associated with Caldera's coalition to run, leaving no obvious successor. Those running as political outsiders and rejecting the established political parties led early on in the polls of the 1998 presidential election. Chávez quickly gained 39% of popular support because of his outsider and radical status, the 1992 coup attempt, and his populist rhetoric (ibid).

It was becoming clear that Chávez could likely win the election and this unnerved many politicians and the elite, upper class concerned about a new era of socialism[19]. Accordingly, regular meetings between the heads of Treasury and the Economic Planning ministries, the Central Bank, and Congressional leaders were held in order to facilitate the passage of the RSF fiscal law. The Central Bank had to work through thirteen different versions of the law before the stabilization was finally approved and codified in November 1998—only a month before Chávez won the presidential election in a landslide victory. Several of the drafts did not pass due to "grave design flaws" that provided too much presidential discretion over important RSF regulations and decisions. The final law corrected this and tried to prevent potential manipulation by the president.

Thus, the passage of the RSF law was clearly a political maneuver timed to place constraints on Chávez's ability to spend oil revenues. There were no other macroeconomic reforms passed in order to stabilize the economy or increase the non-resource economic sectors production nor was there much legislative discussion on any other future savings mechanisms for

[19] Remainder of information on Venezuela's RSF excerpted from Johnson 2011: 18-20.

the country. The RSF in Venezuela was created solely as a political tactic by nervous politicians who were intimidated by a populist outsider. Consequently, this created a very weak stabilization fund that Chávez has easily manipulated to his advantage. The following section will elaborate on how the fund has changed during Chávez's fourteen long and unpredictable years as president, which has only exacerbated the inherent weaknesses of the fund in terms of proper and intended utilization and distribution.

The Macroeconomic Stabilization Fund (MSF)

The MSF Pre-Chávez

On November 4, 1998, Venezuela finally established its own RSF known as the Macroeconomic Stabilization Fund (MSF). Although created for political reasons, the economic goal of the MSF was to insulate the budget and the economy from changes in oil prices. The fund was supposed to stabilize oil revenues coming into the central government, regional government, and the state-owned petroleum company—Petroleos de Venezuela (PDVSA). While the politicians who created the fund believed that it would be able to achieve its economic and political goals, the MSF was practically "dead on arrival" as it was undermined by the conditions and timeframe under which it was created (Johnson 2011: 20).

Originally, the MSF had rather transparent saving and spending rules[20]. The MSF received its money from oil inflows when the price was higher than a determined reference value and withdrawals could be made when the price was below. Every dollar over the determined reference value had to be deposited into the MSF and credited to the account of each of the three beneficiaries. Resources could be withdrawn from the fund only following approval by Congress if: a) the oil revenues in a given year were lower than the reference point or b) the resources in

[20] Statistics and data on the spending-saving rules of the MSF from Ugo Fassano's: *Review of the Experience with Oil Stabilization and Savings Funds in Selected countries*, 2000: 9-11.

the fund exceeded 80% of the annual average oil revenues in the preceding five years. Any excess funds taken out by the central government when resources exceeded 80% had to be earmarked for repayment of the debt and for capital expenditures by the regional governments. Additionally, the fund balance at the end of the fiscal year could never be less than a third of the resources at the end of the preceding year. The fund also invested its resources in foreign assets, which were managed by the Venezuelan Central Bank—limiting presidential access to the total monies in the fund. Clearly, the beginning of Venezuela's stabilization did have stringent saving-spending rules and transparency and oversight by Congress. This was seen as a positive indicator that the MSF would succeed in stabilizing Venezuela's economy and its president.

The MSF under Chávez's Presidency

But from the very start the regulations of the fund failed to place limits on Chávez's spending abilities as one of his first decisions was to the change the laws regarding the MSF. While the 1980s were politically and economically unstable due to short presidency tenures and drastic austerity policies, Chávez's radical rise to the presidency produced another form of political and economic instability. Because almost all policymakers from the Caldera administration were discredited after the debt crisis and were now a legislative minority, Chávez had no opposition in Congress and little incentive to adhere to any of the rules of the RSF law they had passed (Johnson 2011: 18). This permitted him to make changes that benefitted him and his political agenda. Thus, Chávez began to over-extend his powers as president and ignored any established checks and balances, threatening the fragile democratic system that existed in Venezuela at the time. In early 1999, several modifications to the MSF were introduced such as changes to the reference values (mentioned in the previous section) for the price of oil and more presidential discretion for withdrawals to earmark the use of resources to social expenditures and the repayment of debt. The new reference values were fixed at a significantly lower level for the years 1999 through 2004 and only half of every dollar was deposited into the fund instead of ever dollar (Fasano 2000: 11).

Thus, although less money would be directed to the MSF, making withdrawals with a lower reference value as it would now be far easier for the oil price to drop below a lowered reference value. Money transfers from the fund to the budget and other state entities would be based on these new reference values. Moreover, “discretionary transfers” also became applicable to the fund (Davis 2001: 15, 26). Thus, Chávez clearly entitled himself to more discretion over the funds usage by making these amendments to the RSF law. This change in the fiscal management obviously weakened the fund’s stabilization abilities and objectives and consequently, exacerbated the economic and political instability. Moreover, because changes to the MSF occurred right after its implementation, other economic sectors were not able to benefit from the exchange rate stability that the MSF was supposed to provide (Johnson 2011: 20). Thus, the MSF did little to help increase the viability of non-oil sectors and help maintain long-term macroeconomic stability.

As Chávez was making these modifications to the MSF in 1999, he also created the *Fondo Unico Social* (FUS) or the *Single Social Fund*. The FUS was viewed as “an institution run by the military that disbursed billions of dollars of oil monies” for social development projects (ibid: 20-1). This new fund was an obvious politically-motivated change that quickly increased the popular support that Chávez enjoyed and allowed him to spend more oil revenues. The changes to the MSF engineered by Chávez provided him with more access to politically valuable oil revenues that he could direct toward his new fund. In fact, under Chávez’s new changes, 40%

of the MSF was to be allocated to the FUS[21]. In the 2000 budget, the MSF financed 230 billion of the 241 *bolivares* (the Venezuelan currency) allotted to the FUS—in other words; almost all of the FUS was paid for by the RSF (Johnson 2011: 21). This would have never been possible without Chávez's changes to the fiscal law for the MSF. Clearly the oil money being deposited in the MSF is actually used for current spending through Chávez's new social welfare fund and not used as a savings source or stabilization mechanism. Once Chávez began changing the rules of the MSF it became like his own personal bank account.

Chávez continued to change the MSF four times in the following four years[22]. Importantly, these modifications were decreed by Chávez himself, not by Congress, indicating a serious shift in power and a lack of congressional oversight over the regulations of the fund. In 2001, Chávez lowered the percentage of rents deposited in the MSF from an already-lowered amount of 50% down to a tiny 6%[23]. Then in January 2003, Chávez revised the MSF again: this time by suspending an article that stipulated that a maximum of 2/3 of the fund's total revenue could be withdrawn annually for five years, effectively allowing unlimited spending from the fund to ensue. The collective effect of these changes was that Chávez was able to enjoy more oil revenues for current spending and have greater discretion over their use (thereby having his cake and eating it too). The common reasoning for the modifications to the MSF being that there was a "delay" of deposits into the fund. However, in reality, this meant that Chávez was not able to access enough money in a fast enough time period to fund his social welfare projects. Without

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[21] The remainder of the MSF is divided as follows: 25% to the Fund for Retirement of Venezuelan Public Debt, 35% to the Venezuelan Investment Fund, the share applicable to the state entities should be transferred to them exclusively for investment spending, and the share applicable to the Petroleos de Venezuela (state-owned oil company) should be transferred to that company. As indicated by the term "share applicable" there is little transparency regarding how much of the fund is actually distributed back to state entities and the oil company. Thus, it could very well be a large amount and little money is left in the stabilization fund. (Johnson 2011: 21; "Law of the Investment Fund for Macroeconomic Stabilization, 1999, http://www.bcv.org.ve/ifms/ifmslaw2.htm)

[22] These changes have been nearly impossible to find on the Venezuela Central Bank's website, however.

[23] The modifications of percentage deposited in the MSF and unlimited spending are documented in Johnson's paper, 2011: 21

his FUS and *misones*, missions designed to address issues in health, education, public transportation, housing, food shortages and more, Chávez would have very little political support (Buxton 2009: 64). Chávez's political stability rested upon the constant inflow of oil revenues and his ability to spend the money as he pleased.

Consequently, this form of popular presidency actually causes a very serious instability within the political environment as Chávez's supporters can turn on him very quickly if oil prices declined. Moreover, there is a very strong and bitter anti-Chávez movement that has further threatened his long yet fragile presidential tenure. This was best demonstrated with an attempted coup d'état in 2002 and a presidential recall referendum in 2004; however, Chávez' loyal working class sector re-elected him to the presidency in 2006 (Silva 2005: 225). The combination of Chávez' populist rhetoric and nationalistic economic policies has created a deep and contentious divide in Venezuelan politics and society, creating a precarious political setting that depends heavily on volatile international oil prices. Thus, there is currently a façade of stability in Venezuela under Chávez's leadership that inevitably will one day collapse, causing a major political and macroeconomic crisis. And unfortunately, because the MSF was designed for political reasons and has not been remotely or appropriately used as a stabilization or savings source, there is no safety net for the economy or the working class sectors. Venezuela's RSF can be considered the epitome of potential pitfalls with RSFs with its problems of usage, lack of transparency, and no responsible fiscal management.

Conclusion

Venezuela's political and economic dependence on oil has only deepened as Chávez has acted the same all other Venezuelan presidents since the 1970s: as oil rents pour in, he spends them as quickly as possible and saves none for a potential fiscal crisis (Johnson 2011: 22).

Venezuela has been experiencing inconsistent growth in recent years, leading to one of the highest inflation rates in the world. This has forced Chávez to devalue the *bolivar* several times in order to adjust to domestic economic imbalances. Not only is this economically unsound but Chávez's usage, distribution, and management of the oil revenues has led to antagonistic political policies. The MSF is no longer controlled by the Venezuelan Central Bank, which has acted "illegally" by approving some of Chávez's requests for withdrawals in the past, but instead it is under Chávez's supervision (ibid: 22; 21). Thus, Venezuela's economy and political environment are still cursed by oil despite an attempted institutional reform.

However, the MSF demonstrates that resource stabilization funds constructed under politically-pressured conditions often yield weak results. Venezuela's RSF, like Ecuador, has been plagued by contentious politics with short and long-term presidencies. Not surprisingly, today, the MSF creators see the MSF as a failure and "a senior Central Bank advisor has said that although still on the books, the MSF "doesn't exist anymore"' (ibid: 22). By 2009, the MSF was no longer receiving excess oil rents. Instead, these monies are directed through FONDEN (*El Fondo de Desarrollo Nacional*—The Fund for National Development), Chávez's own social stabilization fund that is outside of Congress' legislation which was established in 2005[24]. The fund is often referred to Chávez's "slush fund" as it operates beyond the scope of public scrutiny, its transaction only truly known by Chávez and a small board of directors. FONDEN was established with an initial funding of $6 million in oil revenues as a private company under control of the executive branch and its mission was to finance national investments in education, health, agriculture and any other project that was deemed necessary in the opinion of the board

[24] Information and statistics on FONDEN are from: Johnson's paper, 2011: 22; Pallais, "Venezuela's Vanishing Billions", November 2011, http://100r.org/2011/10/venezuelas-vanishing-billions/; "FONDEN: a black box", http://wikileaks.ch/cable/2006/04/06EFTOCARACAS943.html# –it is interesting and perhaps pertinent to note that this particular article was obtained from Wikileaks cables from Venezuela, indicating that the FONDEN account is very much controlled by Chávez and a select few and has no transparency.

of directors and approval of Chávez. But much like the MSF, this fund just provides another discretionary, although smaller, budget for Chávez to advance his political agenda. Thus, like Ecuador, the MSF was seen as a solution to all political and economic problems regarding oil dependency, however, the MSF has completely failed to live up to its expectations and today is no longer even used.

Given the obvious risk of the price volatility thoroughly exemplified in the previous two chapters, it is most sensible to save some of the bonanza profits during the boom period. The following chapter focuses on the Chilean stabilization fund and how it has managed to do just that: save. As the price of copper, Chile's main export (still a resource albeit not oil), has been high for the past few years, Chile has been able to accumulate a substantial amount of money in their stabilization fund. While Chile's stabilization fund is not perfect as it also has problems with utilization, distribution, and transparency like Ecuador and Venezuela, their RSF has proven to be the most successful and is promoted as a model example for other countries who wish to create a stabilization mechanism.

Chile Strikes (Red) Gold with a Model RSF

Chile shares with Venezuela and Ecuador a history of natural resource dependence. However, Chile's natural resource curse stems from its dependence on mining copper. Since 1825, British and American companies have been competing with other foreign investors to control Chile's copper and silver market. By 1860, copper had taken over economic sectors and accounted for about 55% of the country's economy[25]. Thus, copper has long dominated the economic landscape of Chile, even before the copper industry was nationalized in the 1970s. In Chile, copper is popularly referred to as "oro rojo" (*red gold*) or "el sueldo de Chile (*the wage of Chile*)—small indications in the everyday language that many Chileans are dependent on the money that copper brings into the country (Singh 2010: 61). Consequently, this dependence put Chile at the mercy of the world market price of copper. Just like Venezuela and Ecuador with oil prices, when copper prices fluctuate, Chile's economy was susceptible to volatility. For example, in 1984, the Treasury Ministry noted that "every 1-cent change in the price of copper leads to a $26 million change for the country" (Johnson 2011: 22). Obviously, policymakers were aware of the repercussions that this instability would have on the national economy. Moreover, there are no reliable substitutes for copper which means that Chile's economy will remain susceptible to the boom-bust cycles of global copper prices requiring dutiful fiscal responsibility.

Like other Latin American countries, Chile experienced serious political, economic, and social instability during the 1970s and 1980s. Although Dictator Augusto Pinochet enforced tough neoliberal reforms during his military regime, these policies did not really change the significant role that copper played in the Chilean economy. Only when the price of copper fell to

[25] Trade and Environment Case Studies: Chile Copper Exports, 1997; http://www1.american.edu/TED/copper.htm

its lowest level in the early 1980s, leading to a massive drop in government income and a severe banking crisis, did policymakers begin to seek alternative means of revenue. There were attempts for greater diversification amongst other export products prior to the mid-1980s, but the plan of resource stabilization did not appear until Chile agreed to a structural adjustment loan from the World Bank in 1985[26]. However, this chapter will demonstrate that unlike Venezuela and Ecuador, Chile has learned the simplest but most important lesson from their dependence on copper revenue: "spend that which is permanent and save that which is transitory."

Among the three case studies presented in this paper, Chile's RSFs are distinctive for three reasons: Chile is not a petrostate, their fund was designed purely for economic reasons by foreign political actors, and perhaps most importantly, their fund actually saves money. First and foremost, Chile's funds derive their monies from copper instead of oil. Although Chile is not a petrostate like Venezuela and Ecuador, their reliance on copper demonstrates that the resource curse is applicable to a variety of natural resources. Two, similar to Ecuador, Chile's RSF was established under a conditionality as part of a Structural Adjustment Loan from the World Bank in the 1980s during economic crisis of the "Lost Decade." Part of the loan agreement stated that this RSF would help pay back Chile's debt (23). However, unlike Ecuador, Chile did not dismantle their fund for nationalist reasons. Rather, the loan conditionality ensured that the RSF also be used to support non-copper sectors of the economy, such as agricultural. Thus, although an RSF was forced upon Chile by an outside political source, the fund was still going to help domestic producers who were marginalized by the copper sector. Third, the fund was created for economic stabilization goals such as limiting the effect of exchange rate and copper price fluctuations. Thus, it was not politically-motivated. In fact, it would have been hard to create an

[26] Information regarding the Structural Adjustment Loan (SAL) from the World Bank comes from Matthew Johnson's paper: *The Political Logic of Renter's Insurance: The Resource Curse, Institutional Strength, and Resource Stabilization Funds in Chile and Venezuela*, 2011

RSF in Chile for political reasons during this time because Chile was under the control of Augusto Pinochet, a Chilean military leader who was dictator from 1973 until 1990. Chile only dismantled their original RSF by converting it into two new funds in 2006 because they had so successfully saved enough money that they could split the balance into these two new funds. Today one fund is used for savings while one is aimed at assisting the poor and the elderly.

Lastly, Chile's RSF is the only case presented in this paper that is considered a successful model of a resource stabilization fund. Chile's RSF truly saves its capital and excess oil revenues for a macroeconomic crisis instead of using it for current budget expenditures. While this has been difficult, it has proven wise as seen in 2008 when Chile was able to finance a huge stimulus package to offset their fiscal problems and still have money leftover (Johnson 2011: 28). However, there have still been some issues with the transparency and distribution of Chile's fund. Moreover, Chile's fund had to survive a complete regime change from Pinochet's seventeen year dictatorship to a newly restored democratic government; quite a different type of political and economic instability than seen in Venezuela and Ecuador. Chile's fund could have easily been modified and manipulated by the new democratic governing coalition in 1990 as Chávez did when he assumed the presidency, but Chilean policymakers managed to put their goal of long-term political stability ahead of short-term gains.

A closer look at Chile's political, economic, and social situation over the past decade shows that Chile's RSFs are so different from those in Venezuela and Ecuador because there is actually a much greater degree of political stability and societal amity, although Chile did experience their share of instability in the mid-1970s. In 1973, Augusto Pinochet led a coup d'état against socialist president Salvador Allende, killing the president by bombing the presidential palace. Pinochet then headed a brutal dictatorship during which thousands of young intellectuals and students were "disappeared" (known today as *los desparecidos*), tortured, and killed (Silva 2009: 249). In addition, like Venezuelan leaders, Pinochet also enforced harsh austerity economic reforms in the 1980s due to a rapidly declining global copper price. It was during these dire economic conditions that forced Pinochet to request a loan from the World Bank which led to the first RSF. Thus, while there was definite economic and societal instability, Pinochet remained as the stable political figure. Moreover, as the stoic political figure, Pinochet was determined to strengthen Chile's economy again which is why the RSF regulations were so strictly followed and money was truly saved. However, once Pinochet was out of power in 1990, via his own plebiscite, and democracy was restored, there was conflict amongst politicians as to what to do with the RSF. Thus, there are concerns and issues with Chile's RSF that stem from Pinochet's dictatorship and the strict usage of oil revenues, although they are relatively minor compared with the previously examined RSFs.

Just like Venezuela and Ecuador, the political environment surrounding the RSF lead to points of contention within the establishment process. One is how the money has been used (utilization). The fund established under World Bank required that some of the copper monies be used to pay back public debt. However, unlike Ecuador, this did not prove to be too problematic. Rather, there was criticism and opposition to the government saving too much money and not using it enough on social projects as other presidents in other countries were doing. Critics have called it a "crime" to be saving that much money instead of investing it in new industries or in education development (Davis 2007: 3). This leads to a second point of what percentage of each fund is distributed to determined projects or other possible purposes (transparency in spending). In 2006, the original RSF was annulled and split into two new funds, each receiving a portion of the balance of the old RSF. One of these funds continues to act as a savings and stabilization fund while the other is in place to provide economic support for the poor and the elderly. With a new higher life expectancy rate, the elderly population has grown considerably in Chile and poses and new challenge for the government[27]. Thus, one of the new funds acts more a social spending fund and provides more for Chilean citizens. This may have been a direct response to some of the opposition to the stringent savings fund.

Additionally, the new funds are held to the highest of transparency standards[28]. These funds are considered property of all Chileans that are supposed to guarantee stability in social spending and future public investments. Chileans have access to information regarding the funds via different means of communication, in particular the sovereign wealth funds website (available in English and Spanish) which provides monthly financial reports on the funds. For its efforts in transparency and public access in information, Chile ranked eighth among 34 countries with funds that were evaluated for best practices by the Peterson Institute for International Economics in 2008. This appreciation and concern for transparency most likely stems from the public oppression and lack of public knowledge of government procedures during the Pinochet dictatorship.

Consequently, this leads to the third issue of who actually creates and controls the spending/saving regulations and withdrawal procedures of the funds (fiscal and legal management). Because the first RSF was motivated by economic rationale and attempted to better protect Chile's economy in the long run, it was far more successful than Venezuela or Ecuador's RSF even though this one was established by the World Bank. However, there were transparency and utilization issues with the original RSF and there is limited information as to

[27] Chilean Ministry of Finance website; "About the Funds"; http://www.minhda.cl/english/sovereign-wealth-funds/about-the-funds.html

[28] Information regarding public access to information and transparency are from the Chilean Ministry of Finance website; "About the Funds"; http://www.minhda.cl/english/sovereign-wealth-funds/about-the-funds.html

who oversaw the fund domestically during Pinochet's dictatorship. After Pinochet stepped down from power, the new democratic *Concertación* coalition was in charge of the RSF and worked with the Finance Minister to decide what to do with the monies. When the new funds were created, the institutional framework provided an adequate environment for prudent and responsible fiscal management. There was a clear chain of management for the fund as well as the potential for good oversight. Sound fiscal management is certainly one characteristic that has allowed Chile to operate a successful stabilization fund.

This chapter will be fundamentally different from the two previous ones in that it will discuss how a relatively stable political and social environment has created a stable RSF instead of political instability leading to instability in the RSFs. Therefore, this interconnection of the Chilean RSF success is rooted in the historically stable political and socioeconomic environment in which Chile developed. Some might question this given Pinochet's seventeen year dictatorship. This paper does not advocate that repressive dictatorships are the solution for political and economic instability but rather a stable political environment is necessary. Pinochet's dictatorship provided a consistent political environment and time for the RSF to develop. The rules and regulations firmly established during his dictatorship ensured that the RSF would remain strong and viable after the transformation. The democratic coalition formed after Pinochet's dictatorship has proved incredibly stable and provided a solid environment for the RSF to continue prospering. Chile's political environment is in stark contrast to Venezuela and Ecuador's. This chapter explores the three RSFs that have been established in Chile, discussing their utilization and regulations, examining their weaknesses within a political context and timeframe that may help to offer better suggestions for their improvement.

"Two Paths Diverged": Two Regimes in Three Years

Over the course of just a few years, Chilean society would undergo two completely contradictory changes (Valdes 1995: 6-7). The first was the presidency of Salvador Allende. The electoral victory of Salvador Allende in 1970 marked the first democratically elected Socialist president[29]. From 1970 until 1973, Allende introduced and implemented several substantial political and economic changes, in turn, causing a dramatic shift of societal power. Allende was the head of a radical, albeit peaceful and legal, transformation of Chilean society and a political shift to socialism. Under socialist politics, Allende's administration goal was to help the poorest of Chileans through income distribution, reallocation of public investment, and a reorganization of that nation economy—principally through nationalization. Nationalization was a process by which foreign-owned companies would now become owned by the country; thus, their revenues became the nation's revenues, not the foreigners.

Nationalization of natural resources, foreign-owned companies, agrarian reform (mostly land redistribution) and state intervention in the economy were significant part of Allende's socialist plan. The nationalization of the copper industry and the copper company, *Coproracion del Cobre* (CODELCO—The Copper Corporation) in 1971, was the first and most durable of Allende's reforms. Not surprisingly, Allende's radical reforms angered many Chileans and provoked a sharp class conflict. Many of the elite class and the military were particularly upset as their wealth and livelihood as they knew it would be redistributed to those beneath them in society. And as a country that was leaning closer and closer to communism, the United States was very uneasy with the Allende administration. Consequently, on September 11, 1973, a military coup d'état, supported with armed training by the United States, bombed the presidential

[29] The following paragraphs on Salvador Allende's presidency come from Angela Vergara's *Copper Workers, International Business, and Domestic Politics in Cold War Chile*, 2005: 155-57.

palace with Allende inside and brought an abrupt end to 43 years of democratic rule with the military dictatorship under General Augusto Pinochet.

A ruthless, repressive authoritarian regime was immediately enforced under Pinochet[30]. Any remainders of national populism or socialism were completely eliminated from the sociopolitical and socioeconomic landscape. To both regain and establish control of the economy and society, Pinochet quickly implemented neoliberal reforms that were quite the opposite of what Allende had tried to install. Price controls were lifted, interest rates rose, and fiscal spending on welfare projects such as education, health, and transportation were drastically reduced, if not entirely wiped out of the budget. Privatization of a numerous public industries occurred, although mining and copper remained state-owned. This was probably because the copper industry was the most profitable and the government wanted those revenues, indicating that complete privatization was not viewed as entirely beneficial. The military enforced a trade reform that restructured Chile's economy to protect domestic industries such as mining, fishing, and timber. Finally, in the late 1970s came a second neoliberalization package that privatized the pension system and the educational system. These policies may have had a serious impact on the new government-sponsored Pension Reserve Fund, recently established in 2006. Going into the 1980s, power in Chile was extremely concentrated in the hands of Pinochet and his free-market economists known as the Chicago Boys.

Slowly, Chile began to recover from the neoliberal and free-market policies imposed upon them by Pinochet with strong economic growth in 1981. Rapid growth occurred in several economic sectors, real wages improved, inflation was under control, and more international investment increased as well. However, economic growth came at a huge sociopolitical cost. The

[30] The remainder of this section with information on Augusto Pinochet's dictatorship comes from Eduardo Silva's *Challenging Neoliberalism in Latin America*; "Peru and Chile", 2009: 248-56.

military ruled through centralized power and terror. Pinochet closed Congress indefinitely, banned all political parties, and removed state universities. To further eliminate any remnants of socialism or opposition, activists, intellectuals, or anyone considered "left-leaning" were persecuted by the military. Thousands of people "disappeared" to prisons where they were tortured, imprisoned, or killed. Many were also exiled or blacklisted. Thus, Chileans lived in constant fear under the force and secrecy of the Pinochet dictatorship, unsure if they, too, would soon be disappeared.

Yet few in the international community knew of the gross human rights violations that were occurring in Chile during this time. Instead, the controlled Chilean media only broadcasted the macroeconomic success Chile was having with its new market-oriented policies. Meanwhile, in reality, the poor and working classes were suffering, bearing the brunt of the economic burden. Unemployment skyrocketed, income inequality increased drastically while expenditures on social welfare drastically decreased. This cycle repeated itself in the mid-1980s when the Latin American debt crisis hit. The military regime re-imposed austerity policies along with political exclusion that only aggravated the recession. In 1985, almost half of the population of greater Santiago, a large metropolitan Chilean city, lived in poverty. It was during these economic times that policymakers decided that Chile needed a stabilization mechanism and savings source. This coincided with the structural adjustment loan they would receive from the World Bank to assist with their economic crisis.

Along with a recovering economy, Pinochet also needed to recover his political standing. Thus, the military regime began to try and legitimate its rule through a process known as political liberalization. The military submitted the Constitution of 1980 (naturally ratified) to guide Chile through a transition from military to rule to a limited democracy. In 1988 a plebiscite would be held to decided whether Pinochet should continue to be president for eight more years (until 1997) or if national elections would be held in 1989 for a new Congress and president. This provided a sliver of hope for political opposition as they rallied stealthily through the years preceding the plebiscite. Eventually, people began to lose their fear and political mobilization and opposition occurred in public, cohesively challenging the dictatorship. A coalition known was the *Concertación* de Partidos por el NO (Coalition of Parties for the NO vote) organized and encouraged repressed citizens, particularly the lower classes, to vote NO at the polls on plebiscite day and defeat Pinochet. Miraculously, Pinochet was defeated and his hand-picked successor would not be the new president. The *Concertación*, today is known was the *Concertación* de Partidos por la Deomcracia (Coalition of Parties for Democracy), won on a platform of political inclusion and socioeconomically equality. The *Concertación* has governed valiantly and uninterruptedly since 1990.

The Copper Stabilization Fund (CSF)

The CSF under Pinochet

Chilean policymakers had long been aware of the necessity of prudent fiscal management, after all Pinochet had established neoliberal, austerity economic reforms in the 1970s in order to keep the Chilean economy stable and inflation under control. However, it was not until the 1980s that policymakers began to address the serious problem of copper dependency and the consequences volatile world market prices could have on their economy. In 1981, they established rules pertaining to the treatment of excess copper revenues and tried to promote non-copper exports and other economic sectors (Arrau and Claessens 1992: 14). While this was a step in the right direction, it was not until 1985 that Chile established their own resource stabilization fund—the Copper Stabilization Fund (CSF)—under the instruction of a Structural Adjustment

Loan (SAL) from the World Bank during a dire economic crisis (Johnson 2011: 23). The CSF was envisioned to play a central role in the development of the non-copper industries and stabilize the long-term macroeconomy in addition to minimizing short-terms problems of price fluctuations. Thus, although the CSF was forced upon Chile through a World Bank loan, similar to Ecuador, it was realized that a long period of adjustment was necessary for the fund to actually work. Chilean politicians were determined to make the fund beneficial for them, not for the foreign political actors, even if it meant waiting a few years before seeing any results. Their main goal was to prevent another economic crisis not prevent a future president from having access to the fund, especially given the fact that Pinochet would be in power for another four years. Furthermore, the CSF was the main pillar of more ambitious reforms that were focused on strengthening the economy and promoting diversification of exports, leading to an invested interest in the fund's success. These differences in the foundation of a "forced" RSF were essential for the success of Chile's fund and further explain the failure of Ecuador's.

Although established in 1985, the CSF actually began to accumulate revenues in 1987 with its first deposits by CODELCO and the CSF monies increased rapidly in 1988 thanks to a copper boom (Arrau and Claessens 1992: 14; Johnson 2011: 23). The fund's operations solely applied to the revenues of the state-owned copper company, CODELCO, while its resources were treated as international reserves and were managed by the Chilean central bank. The CSF operated under saving-spending rules that were based on an estimated long-term copper price, determined by authorities and not in the most transparent way (Fasano 2000: 7). The regulations of the CSF stipulated that deposits and withdrawals be proportional to the excess of the copper price over trigger prices which are best represented as a narrow and wide band around a reference price. The reference price was set in real terms, adjusted for dollar inflation, and could exceed a six year moving average of the reference price. Within the narrow band there could be no deposits or withdrawals, indicating that the global price was below the reference price established by policymakers. However, outside the wide band all excess copper revenues could be deposited or some money could be withdrawn from the fund, indicating that the global copper price was above the reference price and there was excess revenue available (Arrau and Claessens 1992: 14).

While this seems logical, there was actually no explicit formula used every time the benchmark copper price was calculated. Moreover, the saving rule that was established transfers money into the fund depending on the size of the gap between this reference price and the actual copper price for that year. Therefore, the larger gap the more resources were deposited into the fund (Fasano 2000: 7). This varied the annual amount deposited into the fund and was, in a way, unstable. There was no determined amount of copper revenue that was automatically directed to the CSF no matter what. The spending rule stated that the government could withdraw resources from the CSF if the price differential is negative as long as there were resources in the fund. However, withdrawals could only be used for "extraordinary amortizations of the public debt" (Arrau and Claessens 1992: 14).

These rules established a stabilization mechanism that was resistant to political pressures to spend the excess copper revenue during boom periods. It also dampened political pressure to increase expenditures by reducing available budget revenues as the rules for savings and spending did not take into account the available resources in the fund. Yet from an economic standpoint, the mechanics and procedures of the fund are not only a bit confusing but lack a solid foundation. For example, the reference price is set without taking into account the underlying process of generating copper price formation (Fasano 2000: 7-8; Arrau and Claessens 1992: 14).

Thus, while policymakers appropriately saved excess copper revenue during boom periods and supported their stabilization fund instead of waiting for the boom period to restart their economy, there were also certain drawbacks regarding transparency and distribution of the CSF that made it less than optimal. The Pinochet government did not use these revenues for any current spending, except to help pay back some of Chile's enormous debt—it will be explained later how this could have led to serious problems after Pinchot lost his plebiscite and was no longer in power. Nonetheless, unlike Ecuador and Venezuela, it is obvious that the CSF had a high degree of responsible fiscal management.

Throughout the 1980s, prudent management and high copper prices enabled a steady flow of deposits into the CSF. This allowed the government to subsidize domestic gasoline prices in addition to paying off some of their debt (Fasano 2000: 15). Additionally, CSF monies were used to help agricultural exporters that were hurt by a temporary ban on Chilean grapes to the United States (Johnson 2011: 24). This actually helped the development of non-copper exports which was one goal of the structural adjustment loan. Deposits to the CSF finally peaked in 1997 at $3.9 billion and began to decline in the following years as the price of copper decreased and the government needed the money to offset the drop in revenue (Fasano 2000: 9). But that was the point of the fund! The Chilean government actually succeeded in establishing a stabilization and savings fund that did its job. Although the CSF had questionable transparency, especially since the fund's full available resources were not clear as the authorities only made gross deposits into the fund public information, they had developed and strengthened operating procedures that would allow the fund to survive Chile's transition to democracy.

The CSF under the democratic Concertación coalition

Pinochet determined his own fate by establishing the 1988 plebiscite. The historic vote brought end to the Pinochet regime and in 1989 Chileans voted a center-left opposition coalition to power known was the *Concertación*. Interestingly, once the new government was installed, the World Bank did not pressure the government to comply with the CSF rules (Johnson 2011: 25). The success that the CSF had in the new democracy suggests that domestic political conditions are more important for a successful fund than outside factors. Apparently, it seems as though Chile's economy was thriving enough and did not warrant World Bank concern at this time. Moreover, unlike the MSF in Venezuela, the Chilean stabilization fund's regulations did not impose constraints on the *Concertación* and their ability to use the fund as the regulations had been firmly established for four years already under Pinochet. Additionally, recall that the CSF monies were outside of the annual budget—this is what limited political pressure to spend the revenues on current projects under Pinochet. This meant that the Congress, which Pinochet had purposely stacked in his favor before the plebiscite, (ironically) had little power to make the new democratic administration follow the old CSF regulations. Furthermore, as there was no regular recording of the CSF's financial transactions (just the annual total deposits into the fund) the new government could completely obscure new financial information and act "under a cloak of secrecy." But perhaps most significantly, the new president could have entirely changed the institution of the CSF by decree without Congress' approval (ibid).

Thus, like Chávez after he first took office, the *Concertación* coalition could have granted themselves much greater access and spending privileges with the CSF monies. And after seventeen years of oppressive military rule, harsh neoliberal economic reforms, and little knowledge of the inner-workings of the Pinochet administration, many politicians of the left-leaning coalition wanted to immediately and dramatically increase social spending and welfare projects to offset the preceding years of economic hardship (ibid). Moreover, it was frequently Chile's poorest citizens and its working class that was the brunt of Pinochet's policies. The large reserve of money in the CSF provided a source for social spending for a large portion of the electorate, and thus, was quite tempting for the new administration. Thus, the CSF could have easily been manipulated by new domestic political conditions and interestingly, a lack of a foreign political actor exerting an influence of control.

Furthermore, the coalition did face extreme pressures to increase expenditures with the large CSF money at their disposal and virtually no political or regulatory restraints[31]. Yet there were others in the coalition that saw that problems in neighboring countries, such as Venezuela and Ecuador, had encountered under irresponsible economics policies and spent their resource revenue just as fast as it was coming into the country. The *Concertación* administration foresaw the connection between economic stability and political permanence and stability that enabled a country to prosper. The *Concertación* needed to remain in power in order to fulfill its social policy and promises over the long-term. Thus, the coalition faced two diverging options: either use the CSF for social spending which would yield immediate political benefits or continue respecting the rules and regulations of the CSF that were already in place and ensure political stability in the long-run. In the end, the *Concertación's* first finance minister, Alejandro Foxley, summed up their decision by saying: "We have already paid the social costs of these policies…so we might as well reap the economic benefits." Thus, there were stakeholders from both political parties that were invested in the success of the RSF. Having a diverse group of policymakers that were invested in the success of the fund certainly added more of an incentive to maintain the restrictive yet successful regulations of the fund. Policymakers decided that

[31] Information from this paragraph comes from Matthew Johnson 2011: 25-26.

continuing the prudent fiscal management of their predecessors of the CSF was the only reasonable solution to maintain the new democratic regime and not abruptly return to high social spending and welfare expenditures. A key difference to note is that the *Concertación* did not adhere to the Pinochet's policies out of an ideological reverence and agreement of these reforms but did so because it would benefit both the politician's overall goals and the Chilean people.

Gradually, the coalition was able to avoid volatility and expanded steady economic growth[32]. With the help of the CSF, macroeconomic stability flourished and the poorest sectors were among the first beneficiaries instead of the bearing the economic burden per usual. Real incomes rose and export-led growth provided more domestic employment. The coalition encouraged non-copper exports to expand in order to benefit such exporters who suffered under the severe macroeconomic instability, furthering the original goal of the structural adjustment loan and the CSF. While copper exports continued to grow under the democratic regime, non-copper exports grew even more quickly. In fact, they surpassed copper rents as the country's primary export revenue source which helped to secure the viability of several sectors of Chile's economy instead of just the copper industry.

Additionally, the coalition's softer social policies began to alleviate poverty and inequality that was persistent under the Pinochet's regime. Government investment in public hospitals and public health care increased as well as spending on education services and housing subsidies. By fulfilling its promise and goal of "growth with equity" the *Concertación* proved reliable and successful and was, impressively, able to maintain its political power through the 1993, 2000, and 2006 elections. Thus, the preceding Pinochet rules of the CSF actually aided the new democratic regime to achieve political, economic, and social stability over the long-term

[32] Information on the utilization of the CSF under the new democratic regime comes from Matthew Johnson 2011: 26-27; Eduardo Silva 2005: 260.

rather than give in to the short-term political gains that would have been made by using the remaining CSF balance on current social spending.

The Economic and Social Stabilization Fund and the Pension Reserve Fund

The CSF did more than survive the transition to democracy; it thrived and it made Chile a more prosperous country and a more inviting place for foreign investment. Ironically, the huge success of the Copper Stabilization Fund made the institution obsolete—but in a good way, unlike the RSF in Venezuela. In 2006, the *Concertación* drastically changed economic policies to reflect the diminished importance of copper in the economy. Under the Fiscal Responsibility Law, the CSF was annulled and its balance was split between two new stabilization funds: the Social and Economic Stabilization Fund (ESSF) and the Pension Reserve Fund (PRF) (Johnson 2011: 27-8). While the funds do receive a majority of their money reserve from copper revenues, other economic sectors are also thriving so much that their revenue surpluses are also directed into the funds. Hence, the names of the new funds have absolutely nothing to do with a resource that they are dependent on. Although the CSF was no longer in existence, the government maintained the same fiscal management and practices for the two new funds as it did over the CSF.

To preserve prudent fiscal management and increase transparency, the government created a new institutional framework regarding which branches of government are in charge of the new funds. The Minister of Finance delegated the funds' management to the Central Bank of Chile, an independent institution of the executive branch, given the Bank's established experience in managing Chile's international reserves. In addition, a Financial Committee was also set up by the Minister but with members appointed by the Central Bank in order to advise him on investment policies and daily operations of the funds. There is also a team of external managers working to implement an investment strategy[33]. The Committee reports to the Minister who then reports to the President. Obviously there is a distinct chain of responsibility among several partisan and unpartisan policymakers overseeing the funds, resulting in potentially good oversight procedures.

Lastly, the ability to access information on the stabilization funds (transparency) has increased dramatically with the new funds and the newest *Concertación* government. Because the new funds are controlled as sovereign wealth funds, they are considered the property of all Chileans and are accordingly managed by the most stringent transparency standards. Access to relevant information regarding the funds is guaranteed to the public through various means of communication, including the Sovereign Wealth Funds website which is extremely easy to navigate and the Chilean Ministry of Finance website which is readily available in English and Spanish languages and financial reports. Chile's policy on public access to information earned it eighth place for best transparency practices among 34 countries with similar funds by the Peterson Institute for International Economics in 2008[34]. While still maintaining the fiscal prudence of their predecessors, new policymakers were able to further improve the stabilization fund institution by adding a greater element of transparency, most likely stemming from the severe lack of it during the Pinochet and CSF-era. Heightened transparency enables more political participation among the electorate, which was another goal of the *Concertación*

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[33] The investment strategy is being implemented slowly and intends to diversify assets in the fund by putting 15% of the portfolio into variable income assets and 20% in corporate fixed income papers. The fund is primarily invested in currencies and foreign government agency bonds and financial institution bonds. The strategic asset distribution for both the PRF and ESSF is made up of 66.5% in sovereign bonds, 30% in money market instruments, and 3.5% in inflation-indexed sovereign bonds. The funds are exclusively invested in low-risk asset classes, similar to those used in international reserves, which the Chilean Bank is accustomed to working with. The currency composition of the funds is broken down as follows: 50% USD, 40% Euro, and 10% Japanese Yen. The diversity and distribution of currency composition provides Chile with more flexibility in adjusting the money according to inflation when necessary; Sovereign Wealth Fund (SWF) Institute website, http://www.swfinstitute.org/fund/chile.php

[34] Chilean Ministry of Finance website, "About the Funds", http://www.minhda.cl/english/sovereign-wealth-funds/about-the-funds.html

coalition. This new level of transparency further indicates the high degree of influence domestic political conditions can have on RSFs.

The Pension Reserve Fund (PRF)

Today, the Pension Reserve Fund is essentially a savings fund as no withdrawals are allowed to be made from the fund for a minimum of ten years (or more currently, at least another four years)[35]. After receiving a one-time payment of $600 million from the CSF to jump-start the fund, the PRF receives between .2% and .5% of the GDP depending on the size of Chile's overall budget surplus each year. The PRF was established in response to Chile's new demographic landscape which has seen a large increase in life expectancy and the growth of its senior citizen population. This has added another challenge for the government in terms of providing future retirement expenditures and the need to guarantee basic pensions to those who are not able to save enough for retirement. Thus, its main goal is not so much stabilizing the economy but ensuring individual economic resources. Its objective is to support financing government obligations of guaranteeing old-age and disability financial support, stemming from pension reforms enacted by the recent *Concertación* government. The fund aids other pension agencies by acting as a supplementary source of money.

As a savings fund for the elderly, the PRF has a "longer-term view" and the responsibility of providing a transfer of wealth from one generation to the next and so forth for the purpose of future prosperity and sustainability. Additionally, the PRF may have been implemented due to the serious lack of care of the elderly during the Pinochet regime. It may have also been a response to those critics of the stabilization funds that believe saving so much money is "a

[35] Information regarding the Pension Reserve Fund is available in English and Spanish on the Chilean Ministry of Finance website, http://www.minhda.cl/english/sovereign-wealth-funds/pension-reserve-fund.html; and the SWF Institute website, a website dedicated to monitoring sovereign wealth funds like stabilization funds around the world, http://www.swfinstitute.org/fund/chile.php

crime" and not for the benefit of the people. Thus, utilization of the funds has become an issue in that some suggest there has actually not been enough utilization of the money for social means. While the PRF is more of a savings than spending fund, its main goal is to provide for a more marginalized section of the population: the elderly and the disabled. Thus, the funds will eventually be used for more welfare-like purposes and provide an income for those will need it most.

The Economic and Social Stabilization Fund (ESSF)

Under the same Fiscal Responsibility Law, the new government also created the Economic and Social Stabilization Fund (ESSF), which was finally established in March 2007[36]. The ESSF and the PRF are controlled under sovereign wealth funds which became the cornerstone of the new fiscal policy of the Chilean government enacted in 2006. Although the PRF stems from a remaining balance of the CSF, it is the ESSF that formally replaced the original stabilization fund. The ESSF received a one-time payment of $5 billion as a result of the closure of the CSF to jump-start the fund and continues to receive fiscal surpluses which are above 1% of the GDP. The fiscal surpluses the ESSF receives are the positive balances resulting from the difference between the surpluses and the contributions to the PRF and to the Central Bank of Chile, omitting the payment of public debt made the previous year as this would already be taken out of the fund.

The primary objective of the ESSF is macroeconomic stabilization. It accumulates excess copper revenues and other fiscal surpluses during boom periods in order to offset times when the price of copper drops as this is still Chile's primary export and a significant source of their

[36] Similar to the PRF, information on the ESSF can be found on both the Chilean Ministry of Finance website, http://www.minhda.cl/english/sovereign-wealth-funds/economic-and-social-stabilization-fund.html, and the SWF Institute website, http://www.swfinstitute.org/fund/chile.php

income. It aids in creating a smooth government expenditure and budgetary process by channeling monies into the budget when copper prices are low, creating a more stable political scene through stable economic practices. The ESSF also continues financing deficits (budget reductions stemming from economic downturns can be financed in part with ESSF monies) and repayment and amelioration of the public debt. Overall, the ESSF continues to reduce Chile's dependency on copper and stop their economy (and in turn, politics) from oscillating as global copper prices do.

Conclusion

Although Chile has eliminated and changed their RSFs from one to two in 2006, the strong institutional characteristics of their original stabilization fund have not changed and the government continues to be cautious in its spending. In the past where transparency, distribution, and utilization issues were a concern regarding the CSF, there have been dramatic changes to improve upon these weakness. Monthly financial reports are readily available for concerned or interested citizens and watchdog groups and a new fund has been created to ensure the financial safety of their elderly and future generations of Chileans. Policymakers continue to advocate slow but steady growth and do not dip into the stabilization funds to finance special projects or to gain a political advantage, even if there are demands for it. Where Ecuador and Venezuela demonstrate that there is a connection between economic volatility and political instability, Chile is a counterexample. Even the transition from the Pinochet dictatorship to a democratic government went relatively smooth, given the circumstances. Thus, Chile demonstrates the positive impact that stable domestic politics can have on RSFs. There continues to be a strong connection between stable politics and stable economy in Chile

Today, there continues to be a strong connection between stable politics and a stable economy. The government aims for a budget surplus of about 1% annually and frequently has much more than 1%, which is then directed to the ESSF (Davis 2007: 3). Fiscal prudence paid off for Chile in 2008 during the global economic crisis. Copper prices had been continuously rising between 2006 and 2008 and there was renewed political and societal pressure to spend the monies in the ESSF on social projects. Nonetheless, then-President Michelle Bachelet resisted such demands and continued to save money in the funds, enabling the reserve balance to grow. When the 2008 crisis hit, Chile was able to use its RSF to promote a huge stimulus package (the world's fifth largest as a percentage of GDP) and had money to spare afterwards. This stimulus package was able to steady and stabilize the Chilean economy while many other countries around the world floundered—including the United States (Johnson 2011: 28).

As a result, President Bachelet enjoyed approval ratings exceeding 80%, even at the time she left office in 2010[37]. The rules and management of the ESSF and PRF have not been altered or "watered down" to increase government spending. The *Concertación* administration has valued saving rents rather than spending them. Thus, the Chilean RSF was able to do exactly what it was intended to do: stabilize the economy during a time of crisis by acting as a "rainy day" fund. Chile is now much less susceptible to the economic volatility and other negative consequences of resource commodity dependence.

[37] Chilean presidents cannot run for re-election; most likely a stipulation enacted after Pinchot's seventeen year dictatorship.

Conclusion

"…and the seven years of famine began, just as Joseph had said. There was famine in all other lands, but in the whole land of Egypt there was food. When the famine had spread over the country, Joseph opened the storehouses and sold grain to the Egyptians…" Genesis 41:54—41:56

The first documented RSF was established in 1956 yet the notion of storing and saving excess resources at the government level has been in in place since Biblical times as exemplified by the above excerpt from the Book of Genesis. The brief version of the story is that God warned Joseph of a future famine and Joseph then advised the Pharaoh to begin saving grain in order to prepare for the famine. Grain, as part of the agriculture sector, is presented here as a commodity just like copper and oil. The production of grain was highly dependent on the weather and other variables that made the amount of grain available to the public highly volatile. Here, we see a parallel to the dependency that countries have on the international market price of resources such as copper and oil. The market demand and price for their resources, like the weather, is something beyond their control. However, countries do have the ability to save their excess revenues received during boom periods to be financially secure during a bust period—or in agriculture terms, a famine. Furthermore, they have the ability to do so at the highest government level, be it by the Pharaoh or a presidential administration. While the Bible has been interpreted in various ways for a multitude of purposes, a valuable lesson learned here is fiscal prudence and savings is one of the most sensible and viable solutions to the resource dependency.

In recent years, world commerce has become highly globalized. As such, many countries around the world depend on exports for a large portion of their national income. However, some countries' dependency on exports is extreme, especially those that rely on natural resource commodities. Countries that rely on resource commodities for a significant portion of their national income consequently rely on the global demand and market prices for their resource. While early economists thought natural resources would be an unalloyed source of wealth, research and evidence show otherwise. Due to the volatility of global prices and the sole focus on the resource extraction industry, scholars have come to the general conclusion that countries rich with natural resources are often plagued by a series of defective social, political and economic characteristics.

Countries that have a large abundance of natural resources tend to have easy access to high levels of wealth underground. However, it has been puzzling as to how and why countries that are bestowed with so much wealth tend to have authoritarian regimes, high inequality in society and poor education and health systems. Moreover, while governments receive high revenue inflows from resource commodity exports they do not invest in research and technology developments for other sectors of the economy; consequently other industries such as manufacturing and agriculture are ignored. Furthermore, although resource wealth is readily accessible, governments that depend on resource wealth are often impose harsh austerity reforms. These paradoxes all add up to "the resource curse" which impedes equitable and sustainable development.

There are several "symptoms" that comprise the resource curse; however, the central problem of the resource is the unpredictable but ever-present boom-bust cycle. Many countries that are excessively dependent on resource exports have fallen victim to the boom and bust cycle of the resource curse. This problematic cycle is associated with three other derived and serious issues such as the pathologies of a monoeconomy, inflexible state and economic institutions, and severe regime shifts from democracy to semi-authoritarian rule all which create a host of budget and management problems (Bannon and Collier 2003; Ross 2003).

When demand and price are exceptionally high and revenue inflow is readily available this is known as a "boom" period. Governments tend to overspend and undersave during boom periods, leaving them with little revenue to function during the "bust" period that generally follows. Accordingly, the boom-bust cycle leads to an undiversified or *monoeconomy*—an economy that consists of only one sector. Boom periods encourage governments and industries to shift domestic labor and material supplies toward the extraction industry, inhibiting other sectors from developing and contributing to the national economy. Subsequently, the dependence on resource revenue often creates a void in the country's institutional structures, leading to fixed and inflexible economic infrastructure. Everything revolves around the resource sector, the monoeconomy. Thus, governments that are structured around resource exports are more prone to corruption, weakened accountability and heightened rent-seeking. This becomes especially clear when the loss of revenues leads to painfully enforced austerity policies with effects distributed amongst the society unequally, hurting the poor more than the wealthy. The boom-bust cycle and its derived evils only stunt the future economic stability and political consistency of developing nations.

In comparison, while literature abounds regarding resource wealth and the resource curse, there has been a dearth of literature and research on possible solutions to ameliorating the negative consequences of the resource curse. Several countries around the world have begun implementing savings funds known as resource stabilization funds (RSFs). These are essentially "rainy day" funds created by the government to store excess revenue and rents during boom periods in order to offset a dramatic drop in revenue during a bust. These funds primarily attempt to stop the serious failure of governments to save resource revenue income during boom periods by redirecting a percentage of profits into a special government account that is separate from the fiscal budget. Because only a fraction of resources rents are supposed to enter the budget, the government is forced to plan expenditures as if they were not in a resource boom period and limit spending.

Although the first RSF was officially established in 1956, the notion of storing and saving excess resources at the government level has been in in place since Biblical times as exemplified by the quote prefacing this conclusion chapter. The “resource curse” has long affected established communities whether they are dependent on agriculture (grain), oil, or copper. This paper has examined the political aspects of the more modern RSFs that have been set up in the Latin American countries of Chile, Venezuela, and Ecuador. While each country’s development of their resource stabilization funds is distinctive, Chile, Venezuela and Ecuador do share features that make them appropriate research comparison studies: all three countries are dependent on natural resources for a significant portion of their national income (Chile: copper; Ecuador and Venezuela: oil); as individual nations their development revolves around the resource industry; each has a state-owned enterprise, nationalized by the government, which is charge of the majority of the resource extraction and sales; and they all experienced relentless political and economic instability as they each have oscillated between democracy and quasi-authoritarian regimes. Yet these countries differ in the establishment and regulation of their RSFs that allows for research and cross-comparisons. This paper has investigated and attempted to answer questions regarding utilization, distribution, transparency, and fiscal management of the RSFs in each country. Moreover, the selected case studies do provide significant economic and anecdotal evidence that the success and permanence of an RSF depends upon the domestic political conditions. However, through this exploration of several diverse resource stabilization funds, serious problems and issues regarding the utilization, distribution, transparency, and fiscal management have been brought to light and the remainder of the conclusion chapter offers suggestions to improve the longevity and success of a very viable cure to the resource curse.

Overlooked Variables: Political Environment, Rationale, and Policymakers

While the institutional strengths and weaknesses of the resource stabilization fund are important in determining its success, other variables such as the political conditions under which these funds are established, the rationale behind their creation, and policymaker's actual compliance with the rules and regulations of the fund are essential to the permanence of the RSF. Although an RSF is designed to counteract an economic issue, it is also very much interconnected with the political conditions of a country as well. After all, it is the policymakers who decided when to create one, who will manage it, the legal procedures regarding spending and saving rules, and what the money will actually be used for. Thus, an RSF can be become a highly politicized economic reform.

This paper has tried to illustrate the necessity of having a stable political environment in order to have a successful and permanent stabilization or savings fund. Stating a country needs stable political conditions is obviously easier said than done. However, this is the ultimate solution in order for economic solutions to the resource curse to be put in place as it is the core problem of RSFs. We saw how Ecuador and Venezuela's RSFs all fail, largely due to the conditions surrounding their establishment and the oscillations of presidential administrations. Each president has the capability to alter the fund or create a new one. This was even more drastic in Venezuela, where Chávez essentially took over the newly created RSF for his own political advantage to create several social welfare projects. This of course does not mean that a dictatorship is necessary to establish a fund either, as was seen in Chile. Although Pinochet's authoritarian regime did provide a stable environment by force, we also saw how the RSF remained successful during the transition to a democracy. The democratic *Concertación* coalition has remained victoriously steady and in power since 1990 in Chile, demonstrating that stability can occur in a democracy as well. Perhaps most importantly is that the long-term goals of political and economic stability need to be put ahead of short-term gains for individual politicians. This would certainly encourage creating reforms and institutions that are designed to prosper and withstand time.

Consequently, political motives and rationale to establish a fund will only hinder its success. An RSF needs to be established as part of a long-term macroeconomic plan and with several other accompanying economic reforms. It cannot be a one-time deal. Furthermore, its primary objective should not be to constrain an incoming president's access to excess resource revenues as did Venezuelan policymakers. Stabilization and savings mechanisms established for true economic insurance and under economic-minded policies are far more likely to minimize the incentives and opportunities of successive administrations to manipulate or completely ignore legal procedures. Such rationale will only create a vicious cycle of unstable politics and weak stabilization funds—each clearly doing very little to help bolster and insure a country, especially during a crisis. Potential future studies of RSFs may investigate why this seems to occur more frequently in "developing" countries in comparison with more "developed" countries. How did so-called "developed" countries adjust their political policies during a time of crisis? What was the rationale for their establishment of an RSF? Or perhaps more importantly, why is it that RSFs seem to appear more frequently in "developing" countries?

Finally, future policymakers will not adhere to policies due to the influence of international actors (like the IMF or World Bank), out of concern for the electorate, or because of an ideological attachment to them (Johnson 2011). Rather, we have seen through the three case studies presented in this paper that politicians will act according to rules and regulations (or not) when it serves their best interest. This applies to RSFs as well as other institutions. Such variables, although not economic in nature, should not be overlooked in potential future studies of the viability of resource stabilization funds.

Room for Improvement

While RSFs have become popular in Latin America, exemplified in Ecuador, Chile, and Venezuela, they have also been very deceptive. Stabilization funds have rarely been able to fulfill the high expectations of addressing the volatility of global prices by saving a part of the bonanza profits for an economic crisis. This is best seen in Ecuador: in the four years after their first RSF was created, the government created five different funds! One of those was eventually eliminated for political, nationalist reasons. The core problem, political instability, has led to several derivative problems that should be addressed as well. One of the most common reasons for their failure is the complexity of the rules and regulations of the funds in combination with vague definitions and guidelines for when governments can use the money (Cueva 2008). Ecuador's existing legal rules for the utilization, earmarking, and saving of oil revenues is highly complex with different types of earmarking and loose definitions and constraints of when the government can actually use the money. Having so many interconnected funds only makes the RSF system more complicated and less transparent. This lack of transparency and enforceable rules enables politicians to use their discretion in the usage of the funds. This makes it very difficult to conduct an open discussion of spending priorities for the public and where excess oil revenues should be channeled to best benefit the citizens and the country.

In addition, there are also issues pertaining to budgetary transparency. Ecuador's budgetary process is constantly subject to lobbying from politically powerful groups that want to obtain funding beyond their allotted amount. Beneficiaries are always after the potential earmarks distributed from the FEP fund. Thus, an ever-growing share of the budget is going toward current spending and capital expenditures that are becoming predetermined by law, even though an RSF is supposed to be a mechanism predetermined by law to save money. Ecuador's RSFs are becoming more and more a part of the government's yearly budget instead of reserve funds for emergency situations. Consequently this results in excess or inadequate financing for specific purposes, depending on the circumstances. A common trend seen in Ecuador and Venezuela is that there is a pro-cyclical tendency for fiscal policy where during a boom period there is political pressure to spend money or beneficiaries demand to receive the large amounts of excess money (Giugale et al 2008). However, when an economic crisis occurs, there is also an increased demand for the government to financially prop up the country. Yet with no money in their savings fund, this is virtually impossible. Ecuadorian and Venezuelan governments constantly face cash management challenges due to their budgetary process.

Furthermore, the fiscal management system in place for both Ecuador and Venezuela are very weak. In Venezuela, the political rationale for establishing an RSF created a very decentralized and unfocused management system. Once Chávez became the president he was able to manipulate the fund's rules and the Central Bank even illegally approved some of his expenditures because there was absolutely no opposition to stop him. In Ecuador, the sheer number of funds creates a convoluted management system with different funds being managed by different branches of government or organizations such as the Ministry of Finance or the Central Bank. This limits the ability to track spending trends and budget implementation. Moreover, there is weak leadership within the relevant responsible authorities which exacerbates weak definitions of utilization and creates poor spending priorities. This leads to some institutions have excess money for expenditures and others (such as the Treasury) facing constant shortfalls of money which requires costly borrowing and financing.

RSF Recommendations

These weaknesses inherent in the foundation of RSF could be ameliorated by introducing a more efficient, centralized, and transparent system initiated by policymakers. Of course, this is much easier suggested than done as disorderly and unstable politics creates these institutional problems. First, the number of funds should be limited to one or two at the most. Ecuador's four RSFs are rather excessive and the complexity makes the funds almost useless. A model to follow might be Chile's where they have created two funds: one for more social and welfare expenditures and one strictly for stabilization and debt-management purposes (Cueva: 2008). This leads to a second recommendation of creating clear, decisive, and unambiguous rules regarding the usage of the money in the funds. Words like "emergency" should be clearly defined so that the government cannot creatively concoct a reason as to how a current situation might be labeled as an emergency, allowing them to use the funds. These rules should also apply to budgetary implementation in order to be consistent and encourage accountability between the government budget and the RSF.

Second, the funds should be controlled by a nonpartisan organization such as the Central Bank and would do well to have investment and policy advisors and a committee of legislators much like Chile does. Having one entity manage the funds ensures that the funds are being channeled through one avenue and would make it easier to account for the revenues. In Venezuela, billions of dollars have "vanished" because there is no oversight regarding Chávez's usage of the excess oil revenues coming into Venezuela. Furthermore, having a nonpartisan authority in charge of managing the funds would help deter political pressures to spend the money reserve. Ideally, this would help stop the earmarking process seen in Ecuador that completely destroys the original purpose of the fund as earmarking enables the funds to be spent on current expenditures instead of saving them for future ones.

Finally, creating a more transparent system, such as Chile's, by making information about the fund and its monthly expenditures easily accessible via a website to the public would further increase good oversight and also allow citizens to contribute to a discussion regarding public spending priorities. Some alternatives to improve transparency could include a greater role for societal organizations in the budgetary process (this is seen in Brazil where the community meets to discuss the town budget); including the costs of government provided subsidies in the general budget as this is an extra incurred cost; and making public large investment projects that are financed from oil revenues. This would not only help transparency goals but also encourage discussion about the utilization of the monies and help direct them to the best usage—other than savings. RSFs could also be subject to transparency indices, as Chile's RSFs are, which would promote better accessibility and accountability procedures.

One Final Thought…

"…Then a new king, to whom Joseph meant nothing, came to power in Egypt. "Look," he said to his people, "the Israelites have become far too numerous for us. Come, we must deal shrewdly with them or they will become even more numerous and, if war breaks out, will join our enemies, fight against us and leave the country…" Exodus 1:8

In Egypt, when a new Pharaoh came to power he knew nothing of the productive savings Joseph had done for the Egyptians and how he had essentially saved their lives during the famine. The new Pharaoh saw Joseph as a threat and thus, proceeded to enslave the Israelites, Joseph's people. Here, in a way, we see how political changes can completely destroy a nation's economic well-being and stabilization mechanisms and how the lower class will bear the brunt of the burden. Today, it is essential for countries that are dependent on resources to remember their bust periods, their economic crises, and listen to the policymakers who may speak out against bonanza social spending instead of brushing them aside during boom periods. If the domestic political conditions are stable enough, saving and stabilization funds could be a powerful antidote to the resource curse.

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