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The Paradox of Renter's Insurance: Resource Stabilization Funds in Venezuela and Chile

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The Paradox of Renter's Insurance: Resource Stabilization Funds in Venezuela and Chile

by

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Dedication

For Linda Johnson and Leanne Hebl

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Abstract

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This report, rooted in the conflict over the control of natural resource wealth, departs from the widely-accepted findings of two disparate literatures. First, while recent analyses correctly conclude that natural resources rents play a contingent role in development, this study deviates from the conventional wisdom attributing the variation of the resource curse to formal institutions. Secondly, as opposed to the recent wave of "political insurance" arguments that ascribe the creation of reforms to weak incumbents attempting to tie the hands of their successors, I argue that actors pursue similar institutional reforms for economic and political reasons. I build on these literatures by examining the commitment to a specific government institution—stabilization funds, which manage the fluctuations of natural resource rents and stop natural resource wealth from being a curse—across three natural resource-rich Latin American countries: Chile, Mexico and Venezuela. Paradoxically, because successful stabilization funds provide greater political benefits when rents are saved, I argue that these institutions only tie the hands of political successors from using rents for political purposes when they are created for economic purposes.

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Introduction

Under what circumstances do weak incumbents initiate reforms in order to limit the ability of their successors to govern in an unconstrained manner? When and in what circumstances do such reforms work? How does the conflict over the political control of natural resource wealth shape what is know as the resource curse? What explains the ability of some countries to not be cursed by natural resource wealth?

This manuscript will address these questions by examining why governments create specific institutions—which I call resource stabilization funds—that are designed to help insulate countries from the wild fluctuations of natural resource prices. As will be explained below, while these institutions have the potential to positively impact the economies of natural resource-rich countries, they can also serve as mechanisms to constrain the use of natural resource revenues for political purposes. I pit my own explanation for why these institutions are created and the reasons for the success of these institutions against the logic of political insurance, which have recently become popular explanations for the creation of institutions across different issue areas of comparative politics.

Political insurance arguments, in their most general form, suggest that embattled incumbents create certain institutions or reforms in order to tie the hands of their successors, such that these successors cannot govern unencumbered. The evidence from this manuscript suggests that these attempts to tie successor's hands based on political calculations are unlikely to succeed. In contrast, I argue that reforms and institutions can tie the hands of successor governments, but only when they are created for positive purposes. I present evidence based on field research in Venezuela and Chile, two natural resource-rich countries that have had contrasting experiences with the management of their natural resource revenues despite a similar institution—a resource stabilization fund.

In Venezuela, I attribute the failure of this institution to the fact that its creators wanted to limit the availability of politically-beneficial oil revenues to incoming president Hugo Chávez. In Chile, I argue that the success of the resource stabilization fund was due to the fact that it was created for purely economic purposes, long before a successor government came to power.

By focusing on countries rich in natural resources, I am also able to speak to the resource curse literature, which has made remarkable strides as of late. While I agree with the recent wave of resource curse literature suggesting that natural resource wealth is a contingent curse (or blessing) (Dunning 2009; Smith 2008), my argument explaining the variation among rentier states focuses on the management of rents as opposed to formal institutions, upon which much of the recent literature focuses. I argue that the conditions under which Chile's stabilization fund was created—and not necessarily the institution itself—has helped the country escape the negative effects of natural resources. In contrast, as a result of the reasons for its creation, the resource stabilization fund in Venezuela has not been successful, leaving the country vulnerable to the symptoms of the resource curse. As a result, the findings of this manuscript suggest that institutional design is a worse predictor of institutional success than the conditions under which institutions are created.

This Master's Report will unfold as follows. I first explain and critique the logic of political insurance arguments. Second, I lay out my own argument based upon this critique. Third, I discuss the resource curse literature and how resource stabilization funds can play a positive role in minimizing the curse. Fourth, I present case studies of Venezuela and Chile to back up my arguments. I conclude with a discussion of the implications of the evidence for political science scholarship.

The Logic of Political Insurance

Institutions often structure gains and incentives such that certain groups benefit while other actors lose out (Przeworski 2004). Similarly, certain reforms, especially economic reforms, often create different winners and losers within a country (Schamis 1999; Hellman 1998). As a result, there is an important political component behind the creation of institutions and reforms.

A wave of recent literature, rooted in the idea of political insurance, has directly addressed the very political nature of institutional creation and reform implementation. While varying between issue areas, the basic premise of these arguments is that weak and endangered incumbents, foreseeing that they are soon going to be kicked out of office, undertake reforms or create institutions in order to constrain their political opponents. These incumbents, who understand the political benefits of governing in an unfettered manner, want to constrain their successors by minimizing the ability of their rivals to extend their tenure by manipulating certain levers of government. In short, weak incumbents create institutions or reforms to tie the hands of their opponents, even if it means that the incumbents temporarily tie their own hands by subjecting themselves to the constraints intended for their successors.

While getting its start in the American Politics literature on bureaucratic drift (Moe 1991; see Boylan 2001 and Figueiredo 2002 for a review of these original arguments), scholars of comparative politics have frequently applied these political insurance arguments in diverse issue areas such as Central Bank Independence (Boylan 2001), the endogenous restriction of natural resource revenues (Dunning 2010), as well as the creation of certain judicial reforms (Ginsburg 2003; Finkel 2005, 2008).

The current wave of political insurance literature is a reaction to more functionalist arguments (e.g. Maxfield 1997), which removed politics from the creation of institutions that clearly benefitted the interests of certain domestic actors to the detriment of others. The application of political insurance arguments to comparative politics, and especially in developing and transitioning countries, was a welcome realization that political actors had much to gain and lose in high stakes political contests that were taking place under conditions of uncertainty and high fluidity. Institutions were not benign innovations; rather, incumbents were controlling what they could, often at the expense of their successors.

Unfortunately, the intuitiveness of these political insurance arguments has largely meant that their often-tenuous logic has been taken for granted. There are several problems with these arguments. First, the timing of institutional creation does not make sense in much of the political insurance literature. We should expect that incumbents will only insulate their preferred policies at the last possible second, so they can enjoy the benefits of governing unfettered as long as possible. Yet, in the empirical application of many political insurance arguments, incumbents undertake reforms years before their term is set to expire.[1] However, if incumbents are worried about their political successors using certain tricks to increase their political standing, why would the incumbent not try to rebuild her own political support by employing these same tricks in the time she has remaining? To give up control over valuable political resources with plenty of time remaining in her term suggests that the ability to manipulate the levers of government is not so politically valuable after all; therefore she would not have to be worried about insuring her preferred outcomes in order to constrain the actions of her successors.

Second, political insurance arguments often assume that institutions and policies created by weak incumbents will be automatically successful in tying the hands of their rivals; these arguments are biased toward institutional success. The recent wave of political insurance arguments is applied to developing countries that are often institutionally weak and in the midst of political and economic transitions, which often makes countries susceptible to uncertainty (O'Donnell and Schmitter 1986). Under circumstances of uncertainty and fluidity, assuming that an institution will automatically take root and successfully tie the hands of political successors is a stretch (Levitsky and Murillo 2009). In a related manner, instances of political insurance are unlikely to tie the hands of successors since the logic of these arguments assumes that the incumbents who enact insurance policies are weak. New incumbents should thus face little public

[1] For example, Dunning (2010) suggests that because the Caldera administration in Venezuela came into office in a position of weakness, it undertook reforms minimize the amount of oil rents flowing to the government almost immediately, several years before its mandate was set to expire.

opprobrium or audience costs if they ignore or repeal the policies of a discredited predecessor. As a result, we should be suspicious that successors will be truly constrained by the attempts of their predecessors to tie their hands.

Finally, the definitions and measures of important variables triggering instances of policy insurance are often either weak or non-existent.[2] For example, while a weak incumbent is required under the logic of political insurance, some authors have not developed clear variables or measures for their readers to indicate when an incumbent is truly weak (Finkel 2005; Ginsburg 2003). Such an omission makes falsification difficult and relies on post hoc justification (e.g. an incumbent was weak because political insurance occurred). Moreover, while Dunning (2010) does develop a measure for executive weakness, his measure is static and based entirely on the conditions under which incumbents are elected, neglecting the fact that the political standing of incumbents can vacillate wildly during a tenure.[3] Furthermore, it is not only the weak political standing of the incumbents that is responsible for instances of political insurance: the nature of the opposition also matters. Without a clear threat from a political rival, there are no hands to tie. Among the recent examples of political insurance arguments, only Boylan (2001) incorporates the opposition. However, her variable is based upon differences of political ideology between the incumbent and the opposition,

[2] Boylan (2001), who took great pains to suggest that political insurance occurs under conditions of a threat which is both intense and imminent, is a rare exception to this criticism. Yet even her typology focuses more on the nature of the opposition than the nature of the incumbents themselves.

[3] The case of Michelle Bachelet in Chile is instructive regarding the ever-changing political fortunes of incumbents. After winning a majority after the second round of the 2006 election, her approval rating plunged because of the controversial changes to the Santiago Transportation System, only to dramatically rebound by the time she left office. Source: Centro de Estudios Públicos: Estudio Nacional de Opinión Pública N 55, Junio 2007 and Estudio Nacional de Opinión Pública N 61, Octubre 2009, http://www.cepchile.cl/bannerscep/bdatos_encuestas_cep/base_datos.php. Last accessed November 9, 2010.

neglecting the fact that political rivals need not have vastly different ideological platforms in order for each to be concerned about the other reaping the political benefits of holding the reins of government.[4] As a result, in order to identify actual cases of political insurance, we require indicators of greater precision regarding the political standing of incumbents and the strength of the opposition.

Based on the above criticisms, I argue that we should be suspicious of some—but certainly not all—instances of political insurance. Furthermore, even in the rare cases of political insurance, we should be equally skeptical that these institutions will successfully constrain successors. Under what conditions does political insurance occur? Moreover, when do reforms actually tie the hands of political successors? I develop an argument to address these questions in the section that follows.

Political Insurance vs. Economically-Oriented Institutional Creation

In contrast to the logic of the political insurance literature which suggests that politically-motivated institutions successfully constrain political rivals, I argue that institutions and reforms only tie the hands of successors when they are created for economic, and not political, purposes.[5]

I agree with de Figueiredo's (2002) assessment that instances of political insulation are quite rare. As a result, it is essential to establish the conditions under which political insurance occurs, which has been taken for granted in some of the recent political insurance literature (e.g. Ginsburg 2003; Finkel 2005).

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[4] An example here is the two main political parties of Venezuela until the 1990s, AD and COPEI, who were very competitive with one another despite similar policies. The perquisite of being in office was an opportunity to control oil revenues and to enjoy its spoils, not to enact certain ideologically-oriented policies.

[5] I use the terms "reforms" and "institutions" interchangeably in this section.

Following the criticisms of political insurance arguments above, I argue that a first condition of political insurance is that an incumbent is at the end of her tenure. If an election is not immanent, an incumbent can still improve her political standing. Under the logic of political insurance arguments, an incumbent constrains herself in order to tie the hands of successors. Yet if there is still ample time left for an incumbent to regain her political luster, it would not make sense for the incumbent to tie her own hands and jeopardize her chances of resurgence. Thus, it is only logical that political insurance happens only when there is very little time remaining in an incumbent's term.

Similarly, a second condition for cases of political insurance is that the incumbent be unelectable and/or completely discredited. Along with being at the end of her mandate, an incumbent would only tie her own hands and give up the advantages of governing in an unfettered manner when there is no chance that she, or her political affiliates, can remain in power. For political insurance to make sense, an incumbent needs to be in a position whereby she cannot extend her tenure by exploiting the benefits she wants to deny her successor, which will only occur when the incumbent has no chance of maintaining power.

In addition to a very weak incumbent at the end of her term, considerations of political insurance must also include the opposition. Specifically, the threat emanating from the opposition needs to be strong and coherent. While Boylan's (2001) framework for political insurance correctly includes the proximity of the oppositional threat, it is also necessary to consider the viability and strength of the incumbent's political rivals. Even when elections are looming, a weak opposition consisting of several disparate factions does not represent nearly the threat that a single challenger with popular support does. Without a clear threat from a strong and unified opposition, the embattled incumbent might be able to overcome her weakness and remain in office. In short, for political insurance to work, an incumbent needs someone's hands to tie.

Finally, institutions or reforms created for the purposes of political insurance should include specific provisions aimed at constraining the executive. Since the whole point of an incumbent insulating her preferred policies is tying the hands of her successors, the text of the reform or rules of the institution should clearly attempt to minimize executive discretion.

While these conditions help to identify cases of political insurance, left unanswered is whether attempts to tie successor's hands will be successful. I argue that the seeds of an institution's demise are sewn when they are created for purposes of political insurance; that is, we should not expect reforms to work when their creation corresponds to the above conditions.

The fact that actual cases of political insurance are undertaken by a very weak incumbent with precious little time left in her term has important implications for the functionality of the institution. First, since actual instances of political insurance occur just before government turnover, the institutions created do not provide any benefits to the successor government. While most instances of political insulation involve the creation of a reform that seems benign on paper (e.g. a resource stabilization fund can bring macroeconomic stability and minimize an economy's vulnerability to wild fluctuations of natural resource prices), the positive benefits of these institutions often accrue over the medium or long term, thereby denying the successor the short term benefits enjoyed by the former incumbent. As a result, it is often in the interests of the successor to ignore or change the previous incumbent's reform so she can enjoy the political benefits of governing in an unconstrained manner.

Similarly, since institutions structure benefits such that there are winners and losers, newly-created institutions and reforms can provide new benefits to or can empower new individuals or groups.[6] However, when institutions are created under the conditions of political insurance, these nascent reforms are unlikely to have started providing benefits to these other actors, thereby removing a potential veto point to an executive stripping back the reforms (Tsebelis 1995).

Third, the conditions under which instances of political insurance occur also facilitate the successor in being able to ignore or change the previous incumbent's reforms. Since an incumbent will only insulate her preferred policies when she is unelectable and discredited, the reforms she enacts should have limited credibility in the eyes of the electorate. As a result, it should be relatively easy for the successor to repeal or ignore the institution, since the audience costs will be minimal.

For all of these reasons, political insurance is unlikely to tie the hands of successors, contrary to the assumptions of much of the extant political insurance literature. In contrast, I argue that reforms undertaken for positive purposes have a much better opportunity to survive and to constrain political successors. Yet we must first discuss how we can differentiate instances of positively-motivated reforms from those

[6] For example, the creation of a resource stabilization fund can help to stabilize the exchange rate (Balassa 1988), making exporting more viable and increasing the economic and political clout of this group.

created for political purposes before commencing a discussion of why such reforms have a greater potential for success.

First, reforms that have positive aims are likely to be undertaken when problems of the current system are exposed and, as a result, demands for broad-based change are articulated. This reduces the barriers to implementing reforms aimed at positive change for two reasons. On the one hand, such a crisis can often marginalize the actors with entrenched interests in maintaining the current system, who typically fight to protect their specific benefits (Pierson 1994). On the other hand, the public might see themselves in the domain of losses during these times of economic duress (Weyland 2002), making them more inclined to accept reforms.

Second, I argue that institutions created for positive purposes will be created in close proximity to and alongside other complementary reforms. Since the previous condition suggested that positive-minded reform occurs once problems with the existing system rear their head, a one-off reform will likely have little impact on deep seated and complex problems. Instead, when institutions are created for positive purposes, we are likely to see a package of complementary reforms aimed at achieving broad goals (e.g. macroeconomic stability) as opposed to a narrow goal (e.g. saving natural resource revenues for a rainy day).

Third, the timing of creation is also important. Opposite the logic of politically-motivated institutional creation where incumbents enact reforms at the last second, incumbents enact reforms for positive ends while there is still plenty time remaining in their mandate. Reforms that attempt to achieve positive goals do not often bear fruit in the short term; in fact, many economic reforms impose short term costs while the benefits only accrue in the medium-to-long term. As a result, the incumbent would want to be in a position to enjoy these medium-term benefits, and would only enact such reforms if there was still sufficient time in her term to reap these benefits.

These conditions under which economically-oriented reforms take place contribute to the ability of these reforms to successfully tie the hands of successors. First of all, the institutions themselves have a greater opportunity to develop institutional strength if they are not created immediately before government turnover (Levitsky and Murillo 2009). When an institution is functioning regularly for a period between its creation and government turnover, the institution itself might become more resistant to change. Over time, the institution becomes more regularized and process-oriented allowing it to take on a life of its own, making adherence to its rules something of a procedural norm (Barnett and Finnemore 2005).

Second, respecting the institution can be beneficial to new governments after transitions, as it sends positive economic signals aimed to foreign investors who might be hesitant to invest when a new and unknown government comes to power—especially in times of uncertainty (Maxfield 1997). Furthermore, it assuages foreign investors who have already investments in the country, making capital flight less likely. Not only can adhering to the institution thus provide a government with greater income from taxation, but these foreign investors can also act as something of a veto point, making it more difficult for a government to dramatically change course if they wanted.

Third, and in a similar manner, economically-oriented reforms often create new domestic actors with a vested interest in the maintenance of the system, who can also act as a veto point against institutional change. While the crisis to which the reforms responded decimated the power of those with vested interests in the previous system, actors with vested interests in the new system will rise and become more empowered the longer the new institution functions, making it politically difficult to scale back the predecessor's reforms.

While this combination of actors with interests in maintaining the institution makes scaling back the reforms more difficult, the conditions of economically-oriented institutional creation also provide direct benefits to the successor government itself. First of all, there are political benefits to be had for maintaining economic stability, especially in countries where wild economic fluctuations made economic instability the norm (Engel and Meller 1993; see Ocampo 2005 for a broad view of the importance of macroeconomic stability). Jobs are often more plentiful and stable, spending on public sector projects and social benefits is more consistent, and investments are generally less risky. The greater economic stability the successor government can provide, the greater are its chances of reelection. The potential to increase political standing via adherence to economic reforms means that there are fewer incentives for the government itself to break institutional rules for short term benefits.

This combination of external and internal utility minimizes the opportunities to defect and diminishes the benefits from reneging on the reforms enacted by the previous incumbent. The result is that the successor is constrained from breaking the institutional rules for short term gain. This leads to the paradoxical conclusion that institutions can only tie the hands of successors when the initial reason for enacting that institution was not for constraining rivals, but rather for positive, economic reasons. When created for political purposes, successors have few incentives to abide by the previous incumbent's reforms and generally have little difficulty ignoring or changing these reforms. As a result, the successor gets to enjoy the political benefits from which their predecessor sought to limit access. When created for positive purposes, however, successors actually gain more from abiding by the institution than from the political benefits gained through ignoring or changing the institution. Political insurance is only possible where it was not intended.

Because successful cases of political insurance depend upon the conditions under which reforms were created, the "parchment rules" (Carey 2000) of the institution are often of little consequence. This argument suggests, as the evidence below bears out, that a formal institution that is very strong on paper will actually be less successful than a weak formal institution when the former is created for political purposes and the latter is created for positive purposes. This mirrors the conclusions reached by Levitsky and Murillo (2009) that institutional strength should not simply be though of as a function of the formal characteristics of institutions.

I apply this distinction between politically- and economically-motivated reforms to natural resource-rich countries. Historically, countries that are awash in natural resources typically exhibit suboptimal economic performance, which I argue is due to the poor management of natural resource rents. A main hurdle to the proper management of natural resource revenues is that the often-massive flow of rents provides incumbents with a source of political advantage over rivals, which often leads incumbents to wantonly spend these riches. An incumbent, facing electoral defeat, might want to deny her successors access to these politically-valuable rents. However, it is precisely this pattern of reckless spending that creates the economic imbalances, which a reform-minded incumbent might seek to alter. As a result, there are both economic and political reasons to constrain the amount of rents available for current spending. In what follows, I first examine what scholars call the resource curse and then a main institutional avenue through which countries attempt to minimize the effects of this curse.

The Resource Curse and Resource Stabilization Funds as a Solution

The literature on the natural resource curse, the rentier state, and Dutch Disease[7] has recently made remarkable strides by relying on more nuanced and contingent explanations to understand the relationship that natural resource wealth plays in political and economic development (or lack thereof).

The original strand of resource curse literature sought to link natural resource wealth to state weakness, mainly in the Middle East and developing countries (Mahdavy 1970: Beblawi 1990; Gelb and Associates 1988; see especially Ross 1999 for a comprehensive review of this literature).This attempt to attribute suboptimal outcomes to the abundance of rents flowing to the state was a reaction to the sanguine arguments of the 1950s, which suggested that developing countries rich in natural resources were at an

[7] While all three of these traditions have their own logic, I lump them together as they represent the main contributions of how states that are rich in natural resources differ from countries without abundant natural resources

advantage vis-à-vis their natural resource-poor peers (Viner 1952; North 1955). The resulting conclusion was the existence of a “paradox of plenty”: instead of helping countries develop, natural resource wealth produced authoritarian governments, decayed state institutions, and weak economic growth (Karl 1997).

In the 1990s and early 2000s, scholars, aided by more robust statistical techniques, seemed to deepen the links between rents and suboptimal economic and political outcomes (Sachs and Werner 1995, 1997; Ross 2001). Nevertheless, the blanket statement that natural resource wealth automatically yielded economic and political instability chafed against empirical realities (Robinson et al. 2006): countries with stable economies such as Chile and Botswana received large rents from copper and diamonds, respectively, while scholars traced democracy in Venezuela to the presence of oil wealth (Karl 1987; Dunning 2008).

Reacting to this disconnect, scholars have recently moved toward the conclusion that natural resources play a contingent role in political and economic development; that is, while natural resources certainly have the potential to produce suboptimal outcomes, rents alone are not a determinant of durable authoritarianism and economic underachievement (Dunning 2009; Smith 2008; Kurtz 2009). A recurring theme of this second wave of resource curse literature is that the contingent nature of rents depends on institutions. A main debate of these arguments is whether private or public institutions—very generally defined—account for the ability of some countries to escape the symptoms of the resource curse (Kolstad 2007; Mehlum et al 2006). Yet, these recent studies are biased toward looking at formal institutions instead of the underlying reasons accounting for institutional strength or weakness (Levitsky and Murillo 2009) that condition the success or failure of these institutions.

This recent wave of arguments suggesting that the resource curse is contingent chafes against several recent studies that suggest the causal effect played by natural resource wealth is overblown (Haber and Menaldo 2008; Herb 2005; Hertog 2010). Nevertheless, I follow Gelb and Associates (1988) and argue that natural resource-rich countries do indeed face unique challenges that their resource-poor counterparts do not.[8] The main problem faced by countries that receive large amounts of rents is the variability of this income source, which can inhibit long-term growth. For example, in 2008, oil prices climbed to a high of $145/barrel in July only to drop precipitously to $34/barrel 6 months later. For a country like Venezuela, a $1 increase (decrease) in the price per barrel of oil can increase (decrease) government revenue by almost $86 million in a single month.[9] This potential for wild price fluctuations of a country's main export, and the corresponding effect on public finances, exposes the economy to extreme vulnerability. While resource booms leave natural resource-exporting countries flush with cash, resource busts result in the need to dramatically cut social spending and halt public works projects that are in progress, which elicits further destabilizing economic effects (Engel and Meller 1993): Hausmann et al. (1993) suggest that these negative shocks prove very difficult from which to bounce back while North et al. (2009) argue that

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[8] My discussion of the challenges faced by natural resource-rich countries revolves around the economic side of the resource curse, which is often referred to as the economic resource curse. I am agnostic as to whether natural resource wealth has an effect on regime outcomes, and the remainder of this manuscript will not address this "political resource curse."

[9] Authors calculations using BP's Statistical Review of World Energy 2010, accessed October 16, 2010. This vulnerability holds for exporters of other natural resources as well: a $0.01 increase in the price of copper yields the Chilean government an additional $120 million in annual revenue (Ruiz-Dana 2007).

counties subject to highly volatile growth rates remain relegated to weaker and less productive social orders.

I argue that the observed variation of the economic resource curse if a function of the (in)ability to manage natural resource revenues. I thus agree with the recent wave of resource curse literature suggesting that natural resource wealth is a contingent curse, but instead of focusing on the role of formal institutions, I center my explanation in the ways in which countries manage their rents: countries that can shield themselves from the instability of resource prices will be economically better off than those that cannot.

Resource Stabilization Funds

The principal means by which countries can minimize their vulnerability to resource busts is through special government institutions called Resource Stabilization Funds (RSFs). RSFs attempt to rectify the failure of countries to save resource income during the boom years by channeling revenues into an account separate from the fiscal budget, which provides revenues the government can draw upon when resource prices fall (Davis et al., 2003).[10]

Generally, RSFs have rules that set a reference price for the natural resource. When the actual price of the resource matches the reference price, no deposits are made into the RSF. However, when actual prices are above the reference price, a percentage of the excess revenues are deposited in the fund, not to be used as current spending by the

[10] Davis et al. (2003) note that these funds can take three different forms: Stabilization Funds, Savings Funds, and Financing Funds. While there are differences in the specific details between each type, following Humphreys and Sandbu (2007), I do not differentiate between the three since the underlying goal—removing excess rents from a country's current budget—is largely the same for each type of fund.

government. When resource prices are lower than the base price, the country can draw on the revenues from the RSF in order to cover the shortfall.[11]

There are many economic benefits of RSFs. First, resource-rich countries often spend beyond their means during boom times, as many leaders believe resource prices will stay high long into the future (Mitra 1994). Inevitably, resource prices tumble, sending the economy into a downward spiral and compromising future growth. RSFs combat this problem on two fronts. On the one hand, since only a fraction of the resource revenues enters the budget, governments must plan their expenditures as if they were not in a resource boom, minimizing over-spending. On the other hand, RSF holdings increase during boom times, which can later be used to smooth out shortages of government income during busts, yielding financial consistency.

Furthermore, a well-managed RSF can produce broader macroeconomic stability for a country. Dutch Disease, a plague often associated with resource-rich economies, spawns from the fact that non-resource-related economic activity is rendered less profitable and tends to atrophy while the natural resource sector become more and more the center of economic activity (Humphreys, Sachs, and Stiglitz 2007; Collier 2007). Further compounding this problem is that resource-based economies are often subject to high exchange rates, which makes the non-resource export industry less viable (Balassa 1988). As export diversity wanes, natural resource dependence increases, along with vulnerability to negative shocks. Yet the creation of a RSF can solve these problems. Since excess revenues do not enter the budget, a successful RSF will force a government

[11] For more detailed information, see Basch and Engel (1993) for an example of the deposit and withdrawal rules as applied to the Chilean Copper Stabilization Fund.

to invest less in its own economy, maintaining the stability of exchange rates, thereby increasing the potential profitability of non-resource-based economic sectors. As these newly empowered economic actors gain economic clout, they can transform their economic prowess into political power (Moravcsik 1997), making it more difficult for the government to reverse course on its commitment to control the spending of rents.

Removing excess rents from the budget and into a RSF allows countries to become less reliant on resource rents, which should foster countercyclical fiscal policy and minimize the negative impact of resource price busts (Engel and Valdés 2000). In short, these funds act as an insurance policy against the uncertainties and dangers of relying heavily on an unpredictable source of income.

Yet while RSFs may seem quite benign, they do reduce the amount of rents that the government can use for current spending. Since natural resource revenues are often fungible with political power, incumbents who control natural resources revenues can be in a position to extend their tenure (Fearon and Laitin 2003). A successful RSF minimizes the discretion that an executive has over the use of natural resource rents. An embattled incumbent, whose tenure is at its end, might wish to deny her successor unfettered access to politically-valuable rents by creating a RSF. Thus, while RSFs can play a positive economic role, they can serve political ends as well. These diverging political and economic motivations for RSF creation provide an opportunity to test the argument advanced above.

What follows is an analysis of two Latin American countries rich in natural resources—Chile and Venezuela—that have had dramatically different experiences with their RSFs. In Venezuela, I argue that the RSF was created for political purposes, which, in accordance with my argument, has resulted in a weak RSF despite its strong rules. Conversely, the Chilean RSF was created for positive economic purposes, resulting in a strong RSF that tied the hands of successor governments despite its weak rules and minimized the country's vulnerability to the resource curse.

Resource Stabilization Funds in Venezuela and Chile

I apply my argument for the differences in outcomes due to politically-motivated and positively-motivated institutional creation to Venezuela and Chile. Both countries are rich in valuable natural resources, oil for Venezuela and copper for Chile; resources that are equally susceptible price fluctuations.[12] While oil has recently been more important to the economy of Venezuela than copper has been for Chile, it was not until copper prices fell during the oil booms of the 1970s (which coincided with a drop in copper prices) that this difference became noteworthy. In 1970 for example, 91% of Venezuela's merchandise exports came from oil while over 88% of Chile's merchandise exports were from copper.[13] In each country, rents flow directly to the central government, as a state enterprise—PDVSA in Venezuela and CODELCO in Chile—are responsible for the bulk of resource extraction and sales.

The data in these case studies are primarily derived from field research in each country, which consisted of in-depth and open-ended interviews with important economic policymakers as well as examinations of primary and secondary documentation. The

[12] According to United Nations UNCTAD data, the correlation between the monthly price of oil/barrel and copper/lb. between 1980 and 2010 is .84. Furthermore, between 1980 and 2009, copper had a greater Price Instability Index than oil. Source: http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx, last accessed November 19, 2010.

[13] Source: World Bank World Development Indicators Online, last accessed November 1, 2010.

upshot of these case studies is that while the oil stabilization fund of Venezuela has largely failed to control spending of natural resource revenues leaving Venezuela mired in the grip of the resource curse, in Chile, by contrast, the copper stabilization fund has succeeded admirably in reducing spending of copper rents and minimizing its vulnerability to negative price shocks. I attribute this divergence not to the RSFs themselves, but rather to the diverging conditions under which each country created its RSF.

Venezuela and the Macroeconomic Stabilization Fund

I argue that the creation of the Venezuelan Macroeconomic Stabilization Fund[14] (MSF) is a clear example of political insurance, adhering very closely to the argument specified above for identifying instances of political insulation. As will be discussed in detail below, this institution did not tie the hands of Hugo Chávez, the Venezuelan President who assumed office a month after the creation of the MSF, nor did it have a positive economic impact on Venezuela's economy. Instead, Chávez easily changed the rules of the fund multiple times, giving him ever greater discretion over the use of oil rents.

Ever since the oil booms and busts starting in the 1970s it has been well known within Venezuela that the economy was heavily dependent upon volatile oil revenues, which engendered broader macroeconomic stability (Maza Zavala 1994). Nevertheless, until the creation of the MSF in 1998, it proved too difficult to reform Venezuelan public

[14] While I refer to the Venezuelan oil stabilization fund as the Macroeconomic Stabilization Fund, the original stabilization fund created in 1998 was called the *Fondo de Inversión para la Estabilización Macroeconómica*, which was replaced with the *Fondo de Estabilización Macroeconómica* in 2003.

finances in a way that reduced the country's dependence on oil. In fact, previous attempts at economic reforms, initiated in times of low oil prices, were scuttled when oil prices rose; reform and austerity were able to be avoided when increasing oil rents provided an opportunity to delay change (Nóbrega 1995; Nóbrega and Ortega 1996; Weyland 2002). For example, the ambitious economic reform plan known as the *Gran Viraje*, or Great Turnaround, initiated during the second presidency of Carlos Andrés Pérez in 1989, had an oil stabilization fund as part of the desired battery of reforms (CORDIPLAN 1989). However, even though internal economic planning documents stipulated that an oil stabilization fund would be operational in 1992 (CORDIPLAN 1990), the fund was never created as the boom in oil prices in late 1990 led the government to scale back its reforms (Nóbrega and Ortega 1996). Thus, even though policymakers knew Venezuela's oil dependence yielded economic instability (Hausmann et al. 1993), the optimal solution, a RSF, proved too difficult to create at this juncture.

Yet several years later, Venezuela would finally create a RSF. This begs the question of what had fundamentally changed in Venezuela in order to facilitate the creation of the MSF. Given the previous failed attempt to create an oil stabilization fund and the history of bailouts stemming from injections of oil rents during booms—where rents temporarily gave incumbents a new lease on their political life—I argue that conditions under which the MSF was created are conspicuously political.

The administration of Rafael Caldera, much like his predecessor Pérez, initiated a round of economic reforms, called the *Agenda Venezuela*, or Venezuelan Agenda, that were eventually scaled back during the oil boom of 1996-1997. During this period, it was the Venezuelan Central Bank and not the executive branch that made progress on an oil stabilization fund law (author interview with Luis Rivero). As the price of oil was high, there seemed to be little interest from within the Caldera government to reform public finances in a way that minimized the role of rents. For example, Teodoro Petkoff, the Economic Planning Ministers during the Caldera government, did not recall a conference in 1997 hosted by the Venezuelan Central Bank in Caracas that brought in renowned international and domestic experts to discuss the issues surrounding the creation of an oil stabilization fund in Venezuela (author interview with Teodoro Petkoff).

While the Central Bank was working through 13 different variations of an oil stabilization fund law (Rivero 2001), the Caldera administration was limping toward the end of its mandate with little popular support. While the hegemony of Venezuela's once strong two-party system began to erode as early as 1989, the writing was on the wall pronounced the traditional parties—*AD* and *COPEI*—all but dead in 1998. Political outsiders rejecting the labels of these traditional parties led in the polls in the lead-up to the 1998 presidential election. Moreover, no one affiliated with the Caldera government was a serious contender in these elections as the lone constant of pre-election polls was the inability of the traditional parties to attract support. In December 1997, a former beauty queen was leading, but her standing in the polls slipped throughout 1998. Yet, as 1998 unfolded a clear threat from the opposition presented itself: "Taking over the lead, [Hugo] Chávez began his dramatic ascent, registering 30 percent in polls taken in May and reaching 39 percent by August 1998" (McCoy 1999: 66). The "dramatic rise" of Chávez "made many people nervous" because of his status as a political outsider and the populist rhetoric he was espousing (McCoy 1999: 67). After being off the radar screen of the Caldera administration for many years, the MSF law became a national priority as the December 1998 election date neared and the threat from the opposition became clearer.

After wide congressional approval, the "long-awaited" stabilization fund was finally passed into law on November 4, 1998, a mere month before the presidential elections would bring populist outsider Hugo Chávez to power. Chávez won the election in a landslide, where he garnered the highest percentage of the vote in Venezuela's democratic history. The timing of MSF creation was such that the outgoing Caldera administration was not going to even be in power when the law took effect. Thus, the Caldera administration was able to write the rules of the stabilization fund that his successor would (theoretically) be responsible for following.

The MSF law, passed just before the election, placed constraints on the newly-elected president, further lending support to the argument that the 1998 MSF law was a form of political insurance for the outgoing Caldera administration. A previous draft of the oil stabilization fund law released more than 21 months before the 1998 election—before a clear threat from the opposition took shape—suffered from "grave design flaws" by providing too much discretion to the executive (Gomes Lozano 1997: 9). These "flaws" were rectified in the final version of the law, which eliminated a source of potential executive manipulation of the oil stabilization fund. While the final design was perhaps more rational, it succeeded in removing a possible pathway to executive interference that was deemed appropriate less than 2 years prior.

While the reform did place constraints on the executive, notably absent were complementary reforms aimed at shielding the economy from the vulnerability of oil, making economic policies more countercyclical, or increasing the viability of the non-oil export sector. No other policies or laws aimed at altering the state's fiscal relationship with oil rents were being considered or were in the legislative process at the time when the MSF was created (author interview with Teodoro Petkoff). In short, the MSF was a one-off reform.

We can thus see that the Venezuelan creation of the MSF closely followed the indicators for political insurance stipulated above. Not only was the reform undertaken by an executive whose political allies had no chance of winning the 1998 election, but the creation of the stabilization fund occurred mere weeks before the next president was set to be elected. Pre-election polls strongly suggested that Hugo Chávez was sure to be elected president, constituting a viable oppositional threat. Moreover, this reform imposed greater restrictions on executive discretion over the use of rents and the management of the MSF. Finally, far from being part of a broader package of countercyclical economic reforms aimed at rationalizing public finances or minimizing Venezuela's dependence on natural resources,[15] the MSF was a one-off reform.

I argue that it was the political nature of MSF creation that led to a very weak stabilization fund. From the start, the MSF was subject to political manipulation and failed to tie the hands of Hugo Chávez. Upon assuming office, Hugo Chávez changed the

[15] Interestingly, counter to the experience of Chile where policymakers believed the copper stabilization fund achieved multiple economic goals over the medium- and long-term, former Venezuelan Economic Planning Minister Teodoro Petkoff rejected the idea that an oil stabilization had any purpose beyond providing a buffer against the short term fluctuations of oil prices (author interviews with Manuel Marfán and Teodoro Petkoff).

MSF law as "one of his first economic decisions" (Analítica Mensual 1999). Although the creators did believe the new institution would be successful in achieving its goals (author interviews with Martiza Izaguirre, Teodoro Petkoff, and Luis Rivero), there is good reason to believe that the MSF was dead on arrival, undermined by the conditions under which it was created.

Chávez came to power just as oil prices started an upward march, leaving a large potential stock of rents at his disposal. While this increased the gains to be had from scaling back or ignoring the MSF, the fund itself did not provide any incentives for Chávez to adhere to the rules. First of all, Chávez's dismantling of the stabilization fund was facilitated by the fact that it was not created in tandem with other complementary reforms. Since the MSF was not a load bearing pillar of a broader set of economic policies, the parameters of the stabilization fund could be manipulated without the rest of the economic system collapsing.

Secondly, the timing of MSF creation and the fact that the stabilization fund was not created alongside reforms intended to increase the viability of the non-oil export sector facilitated Chávez's ability to easily weaken the rules of the stabilization fund. One the one hand, because the institution had only been created mere months before its rules were changed, non-oil exporters had yet to benefit from the stabilization fund's potential ability to control the exchange rate and make the price of their goods more competitive in foreign markets. On the other hand, because the MSF was a one-off reform, there were no complementary reforms that provided incentives to non-oil exporters, such as subsidies. In short, there were no external barriers to institutional change since potential stakeholders of the reform had not yet benefitted from the institution and were thus in no position to apply political pressure to protect their benefits.

An analysis of the changes to the MSF institutional rules allowed Chávez greater executive discretion over the management of the fund; that is, the rules of the fund became weaker, giving Chávez more direct control over the depository of oil rents.[16] The first change to the rules of the fund stipulated that 40% of any withdrawal from the MSF be directed toward Chávez's recently-created, Fondo Único Social, or Single Social Fund. The Fondo Único Social, created in 1999, was "an institution run by the military that disbursed billions of dollars of oil monies" for social development projects (Edwards 2010: 197). This change led Chávez to enjoy much greater current spending of oil revenues. For example, in the 2000 budget, of the 241 billion *Bolívares* allotted to the FUS, more than 230 billion came from the MSF, which would not have been possible without his change to the MSF law.[17]

Chávez would go on to change the original MSF four more times in the ensuing four years, with a common thread being the "delay" of deposits into the fund. The change to the MSF rules in 2002 said there would be no deposits during 2003. This came on the heels of the change in October 2001, stipulating there would be no deposits into the fund in the final quarter of 2001 or during all of 2002. Furthermore the change to the rules in 2001 lowered the percentage of oil revenues directed toward the fund, from 50% of all oil

[16] For example, an article was added giving the executive a 5-year window for discretionary withdrawals of MSF revenues. These withdrawals needed little more than the consent of the Finance Committee of the Chamber of Deputies.
[17] Source: Ley de Presupuesto para el Ejercicio Fiscal 2000, http://201.249.236.149:7777/onapre/Ley_2000/Ley_de_Presupuesto_2000.pdf, accessed Oct 27, 2010.

earnings down to 6%.[18] Finally, the January 2003 change to the MSF removed—for 5 years—the article of the original law stipulating that a maximum of 2/3 of the fund's total revenue could be withdrawn annually, allowing unlimited spending from the fund. The cumulative effect of these changes was that Chávez would enjoy more oil revenues for current spending while having greater discretion over the use of these rents.

Beyond the weakening of the MSF caused by Chávez's numerous law changes, there is also evidence that Chávez and the Central Bank did not comply with the institutional rules of the MSF law. For example, the once-autonomous congressional economic oversight committee noted that there were irregularities with the deposits to the fund between the final financial quarter of 2000 to the third quarter of 2001 (Oficina de Asesoría Económica y Financiera 2002b). Furthermore this same oversight committee noted that the Venezuelan Central Bank's approvals of Chávez's request for funds from the MSF were "illegal" (Oficina de Asesoría Económica y Financiera 2002a: 17).

Because the law was created by a discredited executive whose political allies were swept from power, there was no one holding Chávez's feet to the fire with regard to the stabilization fund. Moreover, the fact that Chávez won the election by the largest margin in Venezuela's democratic history meant that he had a mandate that was difficult for the opposition to counter. In short, just as the MSF provided no incentives for Chávez to adhere to the original rules, neither did the opposition have the ability to enforce Chávez's compliance with the institution.

[18] The percentage of oil revenues directed to the MSF would then increase at 1% annually for the next 5 years.

Not surprisingly, the creators of the institution now see the MSF as a failure (author interviews with Maritza Izaguirre and Teodoro Petkoff), and a senior Venezuelan Central Bank advisor says that, though still on the books, the MSF "doesn't exist anymore." In the decade between Chávez's initial election and the height of the oil boom in 2008, the MSF did not help Venezuela reduce its dependence on oil rents nor did it spur non-oil exports. In fact, the percentage of total exports from oil increased dramatically while the non-oil exports decreased.[19] This had the effect of making the Venezuelan economy much more dependent on oil rents, thereby deepening its susceptibility to the symptoms of the resource curse.

In the end, the attempt to tie the hands of Hugo Chávez failed and the status quo in Venezuela prevailed. The Venezuelan economy's dependence on rents was maintained (if not deepened) while Chávez was able to do what every Venezuelan President had done since the 1970s: he spent the vast sums of oil wealth as they poured in, saving none for a rainy day. The net result is that Venezuela's economy is still largely cursed by oil, despite a formal institution intended as a cure. The Venezuelan case demonstrates the difficulty that political insurance arguments face: principally that the conditions under which attempts to tie successors' hands occur allow these successors to ignore or change the constraints placed upon them.

Chile and the Copper Stabilization Fund

I argue first, in contrast to Venezuela, that the Chilean Copper Stabilization Fund (CSF) was created for positive purposes, and second, that the conditions under which the

[19] Source: World Bank World Development Indicators Online, accessed November 3, 2010.

CSF was created allowed the institution to tie the hands of successor governments from using copper revenues for political purposes. As a result, Chile is now less susceptible to the potential negative effects of natural resource wealth (Mulder 2006).

Similar to how the Venezuelan economy was historically addicted to oil revenues, the Chilean economy demonstrated a history of dependence upon copper rents (Marfán and Bosworth 1994). From the 1950s to the 1970s, between 50-60% of total export revenues were attributable to copper. Furthermore, even before nationalization, copper revenues often accounted for upwards of 10% of GDP (Ffrench-Davis 1974). In another similarity to Venezuela, the Chilean dependence on a single export product caused economic weakness: Ffrench-Davis (1974) noted that the characteristics of the international market for copper prices “constituted the principal cause of instability” for Chile’s economy (26). For example, in 1984, the Chilean Treasury Ministry noted that “every 1-cent change in the price of copper leads to a $26 million change in income for the country,” subjecting public finances to great uncertainty (Ministerio de Hacienda 1984: 2).

While the military regime of Pinochet started initiating neoliberal economic reforms in the 1970s, they did not diminish either Chile’s dependence on copper revenues or the importance of copper rents for the health of the economy.[20] The problems and complications resulting from this dependence came to a head in 1982, when “the price of copper [had] fallen to its lowest level, in real terms, in the last several decades”

[20] Ironically, military funding became dependent on copper revenues during the Pinochet government when the 1958 copper law was amended such that the military received 10% of the sales of the state copper company, CODELCO.

(Ministerio de Hacienda 1984: 2). As a result of the corresponding massive drop in government revenue, Chile experienced an acute economic contraction, which many blamed directly on the precipitous drop in copper prices (Ministerio de Hacienda 1984; Fermandois et al 2009; World Bank 1990).

This instability of copper prices, coupled with an acute banking crisis, led policymakers to seek out an alternative economic course. While many economic analysts had called for greater export diversification in Chile prior to the mid-1980s (see Agosin and Bravo Ortega 2007), it was not until the start of the "pragmatic" neoliberal reforms enacted during the tenure of Finance Minister Hernan Büchi, that Chile began to minimize its dependence on copper revenues by aggressively promoting non-copper exports (Silva 1996). Due to the extent of the crisis and the international financial conditions at the time, Chile was unable to accomplish a radical reorientation of their economy—thereby reducing the prominence of copper rents—without the assistance of multilateral financial institutions, most notably the World Bank. In 1985, while Pinochet still had more than three years left in his 8-year term granted to him by the 1980 plebiscite, Chile negotiated a subsequently signed a Structural Adjustment Loan (SAL) with the World Bank. One of the conditions of this loan was the creation of a resource stabilization fund for copper, which would become the CSF.

The main goal of the SAL was to "develop non-copper exports and efficient import substitution" (World Bank 1990: xiv). Far from being a simple depository in which to store excess copper revenues for a rainy day, the CSF was envisioned to play a central role in the development of the non-copper export economy. "An essential feature" of the SAL "would be a Copper Stabilization Fund (CSF) to resist the exchange rate appreciation (depreciation) and demand pressures that arise when volatile copper prices jump (decline)" (World Bank 1990: 6-7). Not only would the CSF minimize the short-term problems of copper price fluctuations, but it would also aid medium-to-long-term macroeconomic stability.

The World Bank (1990) argued that the failure of previous attempts to emerge from the deep economic crisis of the early 1980s was due to the exclusive short-term focus of the corrective efforts. Alternatively, the 1985 SAL was intended to "instill a medium-term dimension and approach in economic policy" with a "permanent emphasis on export promotion," while knowing that "successive short-term policies would have doomed the adjustment effort to failure" (World Bank, 1990: ix). In order for the SAL and the CSF to be successful, "It was realized that a longer period for adjustment—say three to five years—was necessary" (World Bank 1990: 30). Stability and growth were the goals, but they were not expected to occur overnight. The implementation of the SAL was the culmination of a desire to reorient the economy away from a dependence on copper revenues. The Copper Stabilization Fund, which was to be a main pillar of these ambitious reforms, was formally created at the end of 1985, just as copper prices started an ascent.

The creation of the CSF mirrors the conditions for economically-motivated reform stipulated above. First of all, it was created when Pinochet still had plenty of time left in office before the 1988 plebiscite. The pragmatic neoliberal reforms enacted in the mid-1980s were not intended to bear fruit immediately. By enacting the reforms with several years left in his term, Pinochet was putting himself in a position to gain politically from the medium-term benefits produced by these policies. Second, the impetus for the creation of the CSF and the other complementary economic policies was the result of economic challenges as opposed to political ones. Copper prices dropped precipitously in the early 1980s to a two-decade low. This price drop led to a very deep recession that exposed the need to change the relationship of state finances vis-à-vis copper revenues by minimizing dependence on such a volatile source of revenues. Finally, far from being a one-off reform, the CSF was part of a battery of reforms intended to minimize Chile's economic dependence on copper by moving to a revenue source that was less prone to wild price shocks.

It is worth noting that the indicators for politically-motivated institutional creation were absent at the time the CSF was created. For example, there was no real threat emanating from the opposition; no need to tie anyone's hands. Even though the opposition started becoming slightly more cohesive in the mid-1980s when the CSF was created, the opposition still consisted of numerous, disparate factions, with many former leftist political elites still living abroad in exile (Silva 1996). Moreover, the reforms did not tie the hands of the executive. As we will see below, both the Pinochet regime and the successor government, the *Concertación*, could have changed the rules of the fund by decree, without consent from Congress.

The CSF started accumulating revenues in 1987, and even more so in 1988 during a boom in copper prices. Instead of channeling these revenues through the budget for current spending, the Pinochet government used the stored copper revenues to pay down the enormous public debt (Arellano 2005). Furthermore, the CSF revenues were used to directly bolster the non-copper export sector in 1989 when the government aided Chilean grape exporters hurt by the cyanide scare and the resulting temporarily ban on Chilean grape exports to the United States. This period allowed the institution to start developing standard operating procedures, thereby helping it become institutionalized before the transition to a different government. However, the real test for the strength of the institution was whether it would be able to survive after a change in the power structure under which the institution was created (Levitsky and Murillo 2009).

The historic plebiscite of 1988 denied Pinochet another automatic presidential term and led to new elections in 1989, where the center-left coalition, known as the *Concertación*, emerged victorious. After 17 years of repressive military rule, many on the left wanted the new *Concertación* administration to immediately increase social spending and enact patronage-oriented policies in order to reverse the years of economic hardship that Chile's poorest citizens had endured under Pinochet's neoliberal reforms (author interviews with Joaquín Vial and José Pablo Arellano). However, Chilean economic policymakers saw the problems that neighboring countries had recently faced when transitioning to democracy under conditions of economic uncertainty. The experience of these neighboring governments, most notably Argentina and Brazil, suggested that newly-democratic governments needed economic stability in order to remain politically viable. The *Concertación* economic policymakers thus argued that economic prudence, and not an immediate return to high social spending, was the only path toward political sustainability: these economic policymakers understood the need to address social issues, but the simultaneous goals of sustained political viability and helping the poor were believed to only be achieved through good management of the economy (author interviews with Joaquín Vial and José Pablo Arellano).

One important way that the Concertación was able to maintain their fiscal discipline—and benefit politically from their economic prudence—was through the CSF. The copper fund was outside the budget, meaning its revenues were "unseen" to those who wanted to spend and known only by those who preferred to save (author interview with José Pable Arellano). The extra-budgetary position of the CSF greatly minimized pressures to spend from those within the coalition and helped economic policymakers continue the transition to an economy dominated by non-copper exports that was less susceptible to negative shocks in copper prices (author interview with Manuel Marfán).

Ironically, it was the lack of transparency—the fact that the fund's revenues were largely outside the public's view—that helped the Chilean economic policymakers maintain the CSF's viability. Had CSF revenues been included directly in the budget, it would have been much more difficult for the Concertación to maintain its economic prudence with respect to how it managed copper revenues (author interview with Manuel Marfán). Furthermore, there were not regular reports on the transfers to and from the stabilization fund. This stands in stark contrast to the arguments by Davis et al. (2001), who argue that transparency is a necessary condition for successful stabilization funds. Moreover, the *Concertación* administrations could have altered the rules of the stabilization fund at their discretion and without the approval of Congress; that is, had they wanted, they could have given themselves greater access to the fund's revenues. The lack of transparency combined with the weak nature of the CSF's rules suggests that formal characteristics of institutions are less important for institutional success than a desire to comply.

Had the Concertación not inherited this already-functioning institution, it would have been very difficult to "hide" copper revenues in order to reduce pressures to spend and maintain economic prudence in order to enhance their political standing. The Budget Director during the first *Concertación* administration, José Pablo Arellano, noted that the *Concertación* actually enhanced the functioning of the CSF compared to the Pinochet years (author interview with José Pablo Arellano). The coalition worked through, and indeed strengthened, the institution created by its predecessor in order to achieve its own economic—and political—goals.

In short, upon assuming the presidency after 17 years of dictatorship, the *Concertación* faced many competing priorities. The coalition faced pressures to spend, they had money stored in the CSF ready to spend, and they had the discretion to change the CSF rules if they had wanted to spend. Yet the *Concertación's* goals required that the coalition maintain its political standing. Understanding that its future electability was tightly linked to its ability to manage the economy well, the *Concertación* was able to use the CSF to minimize spending pressures and to maintain macroeconomic stability. Thus, the CSF helped the *Concertación* lengthen its time horizons and achieve their political goals by providing them the opportunity to gain greater continuous benefits across the medium and long term than the short term benefits that would have been gained by using the copper revenues for current spending.

The upshot of the Concertación being able to minimize pressures to immediately spend copper revenues had important impacts for the rest of the economy and for the economic platform started by the SAL. While the Pinochet regime did enact laws that made the country more appealing to international investors, it was not until the Concertación came into office that Chile experienced a boom in FDI. The desire to send positive economic signals to potential investors was a priority for the *Concertación* (author interviews with Joaquín Vial and Manuel Marfán). The success of these signals to investors—and the subsequent ability to sustain this investment—were contingent upon maintaining macroeconomic stability, which was one of the main purposes of the CSF. The success of these efforts are evident: FDI to Chile increased dramatically during the *Concertación's* watch, expanding almost fourfold to record levels—from US $2.7 billion to 9.8 billion—between 1993 and 1999 (O'Brien 2002; Ffrench-Davis 2002).

Another benefit of the CSF, which its creators intended, was that it helped keep the exchange rate stable, increasing the viability of the non-copper exports. As suggested above, one problem that natural resource-rich countries face is that wanton spending of unpredictable rents often begets wild fluctuations of the exchange rate. During booms, the exchange rate has the tendency to appreciate, making the products of non-resource exporters more expensive abroad, often hurting the profitability of this sector and further concentrating investment in the natural resource sector. By virtue of the Concertación's ability to abstain from using copper revenues for current spending, non-copper exporters were able to enjoy the macroeconomic stability provided by the CSF. Even though copper exports expanded rapidly during the *Concertación's* first decade in power, non-copper exports grew even more quickly, eclipsing copper rents as the country's main source of export revenues (Ffrench-Davis 2002).

The CSF has helped to minimize the country's dependence on copper rents and has provided a platform to expand non-copper exports, leading to the rise of new domestic and international economic actors who benefit from the current system. The logic of collective action (Olson 1982) would suggest that the increase in the number and power of the non-governmental stakeholders in Chile's new non-copper dominated economic model would make it more difficult for the *Concertación* to jeopardize macroeconomic stability by raiding the CSF in order to spend a greater proportion of its copper revenues. Yet, as explained above, it is not only external pressure that is causing the *Concertación* to adhere to the CSF: the political benefits enjoyed by the coalition ensure internal compliance with the institution.

The evidence presented above suggests that the conditions under which the CSF was created, and specifically that it was created for economic purposes, made the institution successful in constraining the Concertación from spending copper revenues for short-term political purposes. The upshot of the Concertación's prudent management of the CSF is that the country is less economically volatile and is much less prone to the negative effects of the resource curse than before (Perry 2007; Marfán and Bosworth 1994; Mulder 2006; Larraín and Parro 2008).

Conclusion

The findings of this Master's Report have several implications for current research in comparative politics. First, while political insurance arguments have an important role to play in the explanations of institutional creation, they are subject to caution on two fronts. First of all, there needs to be a greater clarity of the conditions under which political insurance occurs. More precise variables are required in order to truly differentiate instances of political insurance from other reasons for institutional creation. This manuscript has identified certain conditions that should accompany both politically- and economically-motivated institutional reforms. However, more work should be done to develop definitive measures of important variables, such as executive weakness and the strength of the opposition.

A second problem with political insurance arguments is their bias toward institutional success. Political insurance arguments often take for granted that institutions created under precarious conditions will succeed and tie the hands of successors. I have argued that the conditions under which political insurance occurs sets the stage for the failure of these institutions. Reconciling the performance of institutions with the conditions under which they are created will be a difficult task for the next wave of researchers applying political insurance arguments.

This Report also adds an important dimension to the literature on the natural resource curse. The evidence in this article corroborates the recent wave of resource curse literature suggesting that natural resources are a contingent curse, and can occasionally be a blessing. However, it also suggests that formal institutions have less of a role to play in "curing" the resource curse than the current literature suggests. While a formal institution—the resource stabilization fund—helped Chile minimize its dependence on copper rents, Venezuela was not as lucky. However, the success of the formal institution in Chile (and the failure of the formal institution in Venezuela) had less to do with the institution itself, and more to do with the conditions under which the institution was created. Thus, it is possible that the formal institutions themselves are epiphenomenal to other variables, requiring researchers in the resource curse tradition to dig deeper to find the true causes of variation among natural resource-rich countries.

Finally, this manuscript speaks to the problems of attributing institutional success to formal institutions. The resource stabilization fund law in Venezuela was initially much stronger and much more explicit than that of Chile. The *Concertación* in Chile could have changed the rules of the copper stabilization fund at any time without congressional approval. Despite a strong institution in Venezuela and a weak institution in Chile, the RSF was broken in Venezuela but remained intact in Chile. Considering that the experience with the resource stabilization fund was much more favorable in Chile than Venezuela, the formal design of the institution proved a poor predictor of institutional success. Researchers should thus heed the advice of Levitsky and Murillo (2009) by focusing less on the formal structure of institutions and more on variables that impact institutional strength.

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