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Natural Resource Funds (NRFs), or natural?resource sovereign wealth funds, are special?purpose investment funds that have become increasingly important tools for public asset and fiscal management in resource?dependent countries worldwide.

Publication Date:
Tuesday, 17 of February 2026

Approach

Natural Resource Funds (NRFs), or sovereign wealth funds financed by natural resources, are special?purpose investment instruments that have become increasingly relevant as tools for fiscal management and public asset administration in resource?dependent countries around the world. They are generally used for fiscal and macroeconomic stabilization, as well as for saving and investment, with implications for public wealth, economic growth, and development (Schwartz and Beuermann, 2021).

Despite their widespread presence in natural?resource?rich countries, identifying the causal effect of NRFs on fiscal indicators has proven challenging due to self?selection issues and the absence of suitable comparison groups. This study overcomes these challenges and analyzes the effect of royalties and the smoothing mechanism of Colombia's Savings and Stabilization Fund (FAEP) on the public finances of municipal governments between 2000 and 2010.

In Colombia, the FAEP was created with the purpose of mitigating the impact of oil revenue volatility on national and subnational spending. Although the mechanism applied to departments and municipalities (in addition to the national level), the present study focuses exclusively on municipalities. Importantly, eligibility for the FAEP was not limited to oil?producing municipalities: it also included non?producing municipalities classified as export ports for oil. Likewise, not all oil?producing municipalities were included in the FAEP, and municipalities receiving revenue from non?oil resources were also excluded. This configuration created a natural experiment in which some municipalities receiving royalties were incorporated into the FAEP while other municipalities, also receiving royalties, were not.

Contribution

This study contributes to the literature in several ways. First, it evaluates the impact of the FAEP on municipalities that were required to comply with the same rules governing NRFs as established by law. This allows for the identification of a clearly defined treatment, rather than comparing heterogeneous NRFs with different saving rules.

Second, by including relatively comparable municipalities with and without FAEP participation, identification is based on variation between treated and untreated municipalities, rather than before?and?after variation within municipalities.

Third, municipalities did not self?select into the FAEP, as participation was mandated by national legislation, thereby reducing the risk of selection bias.

Results

We find that windfall revenues from natural resources increased spending on gross fixed capital formation (GFCF); however, this effect was neutralized when municipalities participated in the FAEP. We do not identify an effect of windfall natural resource revenues or FAEP participation on operating expenditures or tax revenues. Finally, although capital expenditures other than GFCF were positively

affected by royalty revenues, we do not find evidence of an effect of FAEP participation on this category of capital spending.