

# On the political economy of resource rents distribution

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# Summary

The overarching objective of this thesis is to analyse the impact of institutional change on the political incentives driving resource distribution and on the subsequent fiscal responses of subnational governments. Through this analysis, this thesis aims to advance the understanding of fiscal federalism and its implications for development.

Despite the extensive research on fiscal federalism, further exploration is needed to better comprehend its intricate dynamics and evolution in the face of ongoing formal and informal changes, particularly in decentralised countries striving for development.

The existing literature has largely overlooked the profound influence, unintended consequences, and underlying incentives arising from institutional design in resource distribution and its ongoing adaptation. These factors significantly shape the political and fiscal responses of subnational actors, ultimately determining the outcomes of decentralisation and carrying significant implications for societal performance and overall development.

Consequently, policy design in decentralised and developing contexts no longer entails a simple trade-off between the central government's coordination capacity and decentralisation's adaptability to local circumstances. Rather, it requires addressing and overcoming the inefficiencies caused by utility-maximising agents embedded within the government structure. This thesis sheds light on the complexity involved in managing fiscal federalism and emphasises the importance of careful policy design as a tool that can either lead to improvements or pose further challenges for budget management and resource distribution.

Furthermore, by focusing on the distribution of natural resource rents, this thesis offers insights into the origins and underlying mechanisms that enable or prevent the occurrence of a resource curse at the subnational level, with potential repercussions at the national level.

The thesis comprises five chapters. Chapter 1 serves as the introduction, offering the motivation for the research and outlining the research questions that guide the core chapters. It also provides an overview of the research setting and methodology, which ends with the presenting of an outline of the thesis's structure.

Chapter 2 examines the impact of the regulatory framework design in mitigating the influence of political party alignment on resource distribution across jurisdictions. It reveals the strategic use of policy redesign to enhance the relevance of party alignment with the central government, resulting in preferential resource

distribution to politically aligned subnational governments as political objectives are prioritised over efficiency. This chapter contributes to the fiscal federalism literature by emphasising the significance of inter-governmental transfer policy design in ensuring proper fiscal decentralisation. The chapter calls for institutional design that aims for unbiased transfer distribution, striking a balance between the potential impact of political alignment on resource distribution and the need to mitigate the adverse effects of the resource curse through a fair and equitable distribution of resource rents.

Chapter 3 examines whether resource rents fuel political budget cycles (PBCs) at the subnational level. It finds that resource rents do drive PBCs by increasing investment in health and education at the subnational level. However, by fostering human capital investment the adverse effects of the resource curse can potentially be mitigated. Additionally, this chapter finds that institutional changes have the potential to limit the impact of PBCs and reduce the reliance of human capital investment on resource rents. While these institutional changes encourage responsible fiscal behavior and mitigate the magnitude of PBCs, they may also restrict human capital investment with long-term developmental consequences. The chapter contributes to the field of fiscal federalism studies by analysing the implications of inter-governmental redistribution on public investment in the presence of resource rents, as well as by exploring the relationship between PBCs and resource rents at the subnational level.

Chapter 4 investigates whether administrative efficiency is crucial for subnational governments to mitigate the substitution effect between royalty revenue and taxes, which contributes to the resource curse phenomenon. It finds that the ability of subnational governments to adjust their fiscal effort in response to changes in revenue relies on their administrative efficiency. The chapter contributes to the field of fiscal federalism studies by challenging the assumption that all subnational governments can increase the revenue they generate on their own at will and, by emphasising the pivotal role of administrative efficiency to explain the extent to which subnational jurisdictions are subject to a ‘natural resource curse’.

Chapter 5 concludes the thesis by discussing main findings, policy implications, limitations, and avenues for further research.