

On the political economy of resource rents distribution

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Impact Statement

This thesis enhances the understanding of fiscal federalism dynamics, including the conditions under which fiscal federalism functions effectively and its implications for societal performance and development. In terms of the scientific impact, the research analyses the impact of institutional changes on revenue distribution and the subsequent responses of utility-maximising political agents within government structures. It examines how these responses influence political alignment effects, investment in human capital, and fiscal effort at the subnational level. By uncovering the complex and heterogeneous responses of these agents to incentives resulting from ongoing institutional changes, the present research reveals why welfare-enhancing and efficiency-oriented fiscal federalism strategies may not always yield the anticipated outcomes. This contributes to a better understanding of the actual results achievable through fiscal federalism interventions, particularly in relation to resource distribution.

Regarding the potential policy impact, the findings of this research address key policy challenges encountered by governments in resource management, such as achieving efficient resource allocation, unbiased transfer distribution, responsible fiscal management, and eventually long-term development. By emphasising the importance of institutional design, the findings of this research underscore specific policy guidelines. Policies should strike a balance between granting excessive decision-making power to the central government, which can lead to political interference in resource distribution, and implementing rigid rules that benefit a select few, resulting in resource misallocation and misuse. Instead of recentralising resources, policies should prioritise sustainable investment in critical sectors such as education, emphasising efficient resource use while discouraging subnational governments' resource dependency. Preserving subnational autonomy is crucial in policy design; doing so entails respecting prior competency agreements and considering the heterogeneity among subnational governments in effectively responding to the challenges posed by institutional redesign. Targeted policy interventions can mitigate the negative consequences of resource dependency and

promote autonomous and responsible fiscal management at the subnational level by increasing administrative efficiency where it is below par. This will empower and equip subnational jurisdictions to adeptly navigate resource fluctuations and counteract tax-grant substitution, strengthening those jurisdictions' fiscal resilience. Overcoming these policy-related challenges is essential for subsequently addressing economic and societal issues at both the subnational and national levels, thus creating an enabling environment for development to thrive.

The findings from this research should enhance the management of fiscal federalism by providing guidelines for the designing of regulatory frameworks that promote efficient distribution of inter-governmental revenue and ensure responsible fiscal autonomy at the subnational level. These guidelines are invaluable for policymakers, government officials, and public administrators involved in policy decisions, institutional reforms, inter-governmental fiscal transfers, and natural resource rents distribution. They aim to inform and support the opportune formulation and implementation of policies that ensure unbiased and equitable resource distribution, enhance limited resources utilisation, foster sustainable investment, and achieve welfare objectives and long-term development while preventing irresponsible fiscal management and negative socio-economic consequences for nations and regions.

The research results of this thesis can be translated into academic publications that disseminate knowledge and lead to further research on the responses of dynamic fiscal federalism to institutional reforms and their subsequent impacts on political budget cycles, fiscal management, and the resource curse at the subnational level.

Chapter 2 brings to the forefront of the fiscal decentralisation discourse the pivotal role of the regulatory framework of inter-governmental transfers. It underscores how framework design significantly impacts effective revenue decentralisation, especially resource rents, thus clarifying empirical disparities and outcomes in the literature. Essentially, the chapter highlights intentional policy design by the central government, wherein party alignment shapes resource distribution among subnational governments. The findings stress the importance of balanced framework design to achieve unbiased transfer distribution, thus averting inequality and inefficiencies caused by strict rules and alignment-driven inefficiencies caused by universal access rules influenced by the central government. Leveraging institutional change, the findings unveil mechanisms behind the resource curse, highlighting how biased resource rent distribution perpetuates the curse by straying from efficiency-based criteria. The chapter is expected to be submitted to a journal specialising in public administration and development in October.

Chapter 3 reveals that subnational investment in health and education relies on resource rents, which also drive political budget cycles (PBCs) at this level. In essence, fiscal transfers funded by royalties become a mechanism for spreading PBCs and the resource curse. Interestingly, by fostering human capital investment beyond election years, PBCs may counteract the curse. The chapter also unveils how institutional changes might curtail PBC effects and reduce reliance on resource rents as a source for human capital investment, thereby enhancing fiscal stability. However, constraining public investment could hinder human capital accumulation, hampering long-term development. Chapter 3 was presented at the 62nd European Regional Science Association Congress, signifying its potential academic and policy impact. Given its focus on prevalent regional developmental concerns, the congress offered the paper an ideal platform for adding to knowledge exchange among academia and policymakers. Furthermore, the chapter is under review at *Resources Policy*, aligning seamlessly with the ongoing discourse concerning sustainable resource exploitation¹.

Chapter 4 exposes the central importance of administrative efficiency—the ability to convert inputs into policy outcomes—in shaping subnational governments’ fiscal efforts. Fundamentally, subnational governments’ ability to counter the substitution effect between tax and royalty revenue hinges on those governments’ administrative efficiency, challenging the notion that local government capacity to easily raise tax revenue is inherent. This chapter emphasises the role of institutional quality in understanding the occurrence and extent of the natural resource curse among subnational governments. Chapter 4 has been revised and accepted for publication in *Local Government Studies*, as it delves into the crucial local characteristics needed to overcome the potential misuse of resource windfalls and achieve subnational autonomy.

Through its three chapters, this thesis offers significant outputs and makes substantial contributions to the intellectual discourse and knowledge creation in diverse yet interconnected domains: public administration, resource rent management, and local government development, all within the realm of fiscal federalism. Moreover, the results presented in the thesis provide the valuable policy guidelines already stated to further enhance its impact, because they can inform the design of inter-governmental transfer policies, resource revenue allocation, and fiscal management strategies. Additionally, the research can inform the development of training programs and capacity-building initiatives for public administrators

¹ The authors would like to thank the anonymous referees from *Regional Studies* for providing their constructive comments to improve the quality of the paper.

engaged in fiscal federalism at both the national and subnational levels, especially in developing countries.

The innovative nature of this research lies in its use of empirical analysis, theoretical contributions, and policy implications that expand the existing knowledge base in the field of fiscal federalism studies. By analysing the impact of institutional changes on established relationships between variables and clarifying the conditions under which those relationships occur, the research addresses gaps in the fiscal federalism literature. It does so by delving into the subnational fiscal responses of political agents to institutional changes in revenue availability. These responses encompass changes in investment decisions, revenue collection and political interference by upper levels of government, all of which manage to traverse subnational governments' autonomy. Furthermore, the results uncover political determinants of resource rents distribution and shed light on the development of the resource curse, which originates from inefficient resource allocation and distribution at the local level and extends to the national level. Overall, these findings offer novel and valuable insights into the intricate dynamics of fiscal federalism, enhancing the understanding of how political factors, resource revenue distribution, and policy design interact to shape fiscal federalism outcomes in developing countries.