



## Research Note

### Extractive Industries, Revenue Allocation and Local Politics

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#### How do we explain the choice of regimes adopted to distribute revenues from extractive industries?

The success of a developmental strategy based on the extraction of non-renewable resources is rooted in the share of revenues captured by the state and the modalities that governments adopt to use and distribute those revenues. In this paper, the authors provide a political economy approach to understanding reform processes around the distribution of revenues from extractive industries (EIs). They undertook a comparative analysis of Bolivia, Colombia, Ecuador and Peru examining the political bargains that led to the distributional regimes adopted. In so doing, they answer the following questions:

- How do central governments share the revenues from extractive industries with different levels of subnational government?
- How do governments distribute EI revenues across extractive and non-extractive territories at subnational level?
- Which are the mechanisms and rules adopted by governments to allocate these resources?
- And what is the bargaining potential of subnational territories to demand a more proportionate share of revenues?

#### Same reform objective, very different outcomes

The significant increase in commodity prices and the subsequent windfall of revenues and investment accruing from the extractive industries sector has triggered an intense political debate about decentralization and distribution of revenues in resource-rich countries. Within this context, all four case study countries initiated reform processes in which the national governments attempted to strengthen control over the allocation and use of EI revenues. However, these reforms produced policy outcomes that differ significantly in terms of the levels and models of fiscal decentralization as well as their redistributive effects. Ecuador and Colombia recentralized the management of revenues in the hands of the executive at the expense of subnational governments, while Peru and Bolivia in fact ended up increasing the devolution of revenues to the regions. As regards redistributive effects, Peru and Ecuador maintained devolution formulae that benefit extractive territories only, whereas Bolivia and Colombia adopted more redistributive formulae to share the wealth from extractive industries with non-producing territories.

#### Strong subnational actors politically aligned with the national government contribute to a more efficient distribution of revenues

The research reveals that the varying distribution modalities of natural resource revenues adopted in the four case studies resulted from two political dimensions: the degree of bargaining power of sub-national actors and the linkage between national and subnational political actors. Local actors with strong bargaining power tend to obtain greater revenue sharing gains. However,

the political alignment between national and local political elites will tend to produce, other things being equal, a better redistribution of revenues across producing and non-producing regions. This is supported by the empirical findings from the case studies, which suggest that countries tend to favour greater decentralization of revenues where subnational actors have traditionally bargained for strong decentralization reforms in the past (Peru and Bolivia). In those cases transfers tend to

be distributed more equally (across producing and non-producing districts) when there is greater alignment between central and subnational actors (Bolivia). Conversely, national governments tend to centralize revenues where subnational actors are politically weak or clearly subordinated to the national elite (Colombia and Ecuador). In those cases also, transfers are more equally distributed when there is greater alignment between central and subnational levels (Colombia).

### Combining fixed devolution rules with equalizing criteria

In the case studies covered, distributive regimes that have worked best to promote sustainable development objectives combined fixed devolution with some equalizing criteria according to subnational needs (poverty levels, local extractive capacity, basic infrastructure, and so on). The case of Bolivia presents an interesting combination of these attributes. Here, the government adopted a distribution formula that promotes a good degree of devolution of revenues to subnational actors and territories in tandem with a fairer distribution of resources across producing and non-producing districts. There is no single agent or territory that receives a greater share than others, nor is there scope for discretionary allocation of revenues without the active participation of the local government. The bargaining power of subnational governments in Bolivia has produced, in principle, a *de facto* system of checks and balances that oversees the performance and execution of central government programmes.

### Changing institutional arrangements and political balances

The design and implementation of redistributive formulae tends to follow path dependent trajectories: once a structure of transfers is in place, it is fairly difficult to change or revert them without upsetting existing political balances or institutional arrangements. In the cases of Peru and Ecuador, the instruments to promote devolution of revenues were adopted before the commodities boom and the presence of large windfall revenues helped to reinforce the existing distribution of power between central and subnational governments. Looking towards the future, in Ecuador it will be difficult to include the transfer of oil revenues in the allocation of fiscal transfers to subnational governments, while in Peru it will be difficult to promote a fairer redistribution of revenues between producing and non-producing localities. This should be a warning for policy makers who view EI reforms as a quick fix for appeasing local tensions and opposition to extraction, as temporary solutions could lead to increased conflicts and negative developmental results in the longer term.

*The paper on which this Research Note is based is available at [www.unrisd.org/arellano-acosta](http://www.unrisd.org/arellano-acosta)*

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