

The Effects of Natural Resource Revenues on Municipal Finance

In contrast to theoretical predictions, a large empirical literature suggests that local jurisdictions use exogenous revenues such as resource rents or transfers largely to increase local spending. This paper provides novel evidence for a setting with strong participatory institutions, distinguishing it from previous studies on the so-called flypaper effect. Using panel data for municipalities in Switzerland, we investigate how the revenues from hydropower plants affect local fiscal policy. For identification, we rely on variation in exogenous determined hydropower potential as well as federal and cantonal rules. We find evidence of reduced local tax rates as a result of higher hydropower revenues. The results indicate that instruments of direct democracy may counteract the flypaper effect by allowing the public to participate in policy-making.