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Fiscal Federalism in Mexico: Distortions and Structural Traps

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The decentralization process in Mexico has shown significant progress by trying to empower local and state governments. However, the Mexican case makes clear that the transfer of greater powers to subnational governments does not necessarily mean an increase in their institutional capacities. Thus, due to the lack of institutional capacities at the subnational level, the prevailing arrangement of fiscal federalism in Mexico has generated vertical imbalances that result in “structural traps”. As a consequence, the current framework fails to guarantee the three basic premises that should be fulfilled by today’s intergovernmental fiscal arrangements: fiscal responsibility, compensatory duties and accountability. This article (1) explores the current state of fiscal federalism in Mexico, (2) makes a comparison with OECD countries to show how levels of government interact in both, federal and unitary regimes and (3) makes an assessment of the institutional capacities of subnational governments in Mexico.

Keywords: Fiscal federalism, decentralization policies, intergovernmental relations, local finance
JEL classification: H71, H77

El proceso de descentralización en México ha mostrado avances significativos al otorgar más facultades a los estados y municipios. Sin embargo, el caso mexicano demuestra que la transferencia de más atribuciones no significa necesariamente una mejora en las capacidades institucionales de los gobiernos subnacionales. En ese sentido, la configuración actual del federalismo fiscal mexicano cuenta con trampas estructurales generadas por importantes desequilibrios verticales, lo que le ha impedido garantizar las tres premisas básicas en...

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Introduction

In today’s world, nations interested in growth, social development, competitiveness and effective deployment of welfare policies need to establish mechanisms for collaboration and coordination between tiers of government. There are many collaboration mechanisms already in existence, including European multi-level government systems, which promote maximum collaboration between governments as a means to provide public services in the timeliest manner. There is little room for doubt that in the current context, no strong nation can exist without strong subnational governments.

Federal systems have certain advantages. Each level of government enjoys relative autonomy, allowing for a much more dynamic entrepreneurial capacity, while opportunities abound for interaction with other government levels. Such a system lays a foundation for competition and cooperation, thus enjoying the benefits associated with both. Within these cooperation and coordination schemes lies the fiscal system, understood as the definition of powers and responsibilities between levels of government in order to collect taxes and manage public spending. When analyzing the fiscal system at the local level, one must make reference to decentralization in general with special attention to fiscal decentralization. Decentralization is defined as the transfer of powers and responsibilities from the central government to the subnational governments so as to empower them to manage and make administrative decisions about issues in their own regions.

Currently, this transfer of powers occurs in Mexico without an optimal, versatile framework thus impeding an more effective distribution of fiscal responsibilities. None of the current schemes has been able to guarantee a basic set of key premises, such as fiscal responsibility, compensatory duties and accountability guidelines. First, these three premises highlight
the need to find a balance between spending capacity and tax collection obligations that will result in the creation of positive incentives for all levels of government to be *fiscally responsible*\(^2\). Second, they establish guidelines for federal transfers to subnational governments. These transfers seek to *balance* the activities carried out by each level of government through a combination of earmarked and general funds. Finally, the promotion of accountability and evaluation frameworks is fundamental in order to shed light on the effectiveness and quality of public spending.

The aim of this article is to present the current state of fiscal federalism in Mexico. Throughout the text, I am going to make clear that the Mexican federal system lacks the necessary structure to take full advantage of fiscal decentralization. Rather, the federal system’s current framework is moving the country in the wrong direction. Instead of cultivating an environment of collaboration, balance, responsibility and accountability, the current system rewards fiscal laziness, horizontal and vertical imbalance and spending practices that are anything but transparent. Such failures, derived from structural traps, are complemented by the inability of subnational governments, due to a lack of institutional and administrative capacity, to meet the tax obligations defined by the current legal framework.

The article is divided into four parts. The first one traces the evolution of fiscal federalism in Mexico by outlining the key changes that paved the way for the current situation. Next, in order to present a clearer perspective of Mexico’s position on the global stage of fiscal decentralization, the following section contains a comparative analysis of member states of the Organization for Economic Co-operation and Development (OECD) and other Latin American nations with federal systems. The third part outlines the challenges that impede subnational governments from becoming important bastions of fiscal decentralization. The fourth and final section of the article addresses the principal effects of distortions of fiscal federalism in Mexico and concludes with a reflection upon the fiscal decentralization perspective in general.

\(^2\) Specific literature on the subject indicates two types of fiscal imbalance. Vertical imbalance refers to the centralization among levels of government (federal, state and municipal). Horizontal imbalance refers to bias in delegation of responsibilities among government actors at the same level (state-state, municipal-municipal). Further analysis on this subject can be found by consulting Bird and Vaillancourt (2006).
1. The Evolution and Challenges of Fiscal Federalism in Mexico

In the 1980’s, Mexican municipalities were plagued by conditions of weakness, dependency and poverty. These conditions were brought on by the heavy hoarding of resources at the federal level and by an intense centralization of political power. Such situation undoubtedly minimized the capacities of subnational governments to achieve economical, social and political development. This increasingly unsustainable scenario led to the first decentralization policies in 1983, during the term of Miguel de la Madrid (1982-1988). These initiatives are considered as the reforms that set the standard for significant change in intergovernmental relations in Mexico. As stated by Beltrán and Portilla (1986), the reforms were intended to strengthen federalism, reinvigorate municipalities and promote regional development. The reforms’ central themes included granting municipalities three powers: (i) provision of public services, specifically water, sewage, public lighting, sanitation, retail and wholesale public markets, cemeteries, streets, parks and gardens, public safety and transit; (ii) collection of property taxes and; (iii) the authority to define, approve and manage land use and development plans.

The modifications made to Article 115 of the Constitution undoubtedly empowered municipal governments and, in theory, increased local governments’ control over their own affairs. However, as numerous studies have analyzed in great detail (Cabrero, 1998; Rodríguez, 1997), the reforms ended up having a limited impact, as many of the problems they were enacted to resolve are still prevalent today. One of the clearest examples of this is that of property tax collection. Although the power to collect taxes was one of the central components of the 1983 initiatives (to be explained in greater detail), a large portion of municipal governments do not have the human or technical resources to undertake such a task, and in many cases not enough or poorly updated property data to do so.³

In the end, the intended policies were unable to revert the centralization of the public administration and any change in intergovernmental relations was less significant than expected.

³ It is noteworthy that total property tax collection in Mexico is very low. In fact, when compared to countries with similar levels of development, it’s one of the lowest in Latin America. From 2005 to 2007, Chile’s collection rate was 0.59% of GNP, Argentina’s 0.44%, Brazil’s 0.44%, Bolivia’s 0.62%, Uruguay’s 0.71% (2000-2004), and México’s barely 0.18% (Sepúlveda and Martínez-Vázquez, 2011).
Subsequent efforts were then made to promote fiscal decentralization in Mexico yet again. The National Fiscal Coordination System (SNCF) was created in 1980 to define and regulate the country’s intergovernmental fiscal relations. According to Hernández (1997), the SNCF was founded to prevent duplicate collection of taxes and to determine federal funding based on states’ levels of economic development. Hence, the following key steps were taken (Sour, 2004): in 1986 the power to collect property taxes was transferred to the municipalities; in 1988 the states took charge of collecting value-added taxes; in 1991 a size-based criteria was implemented for the purpose of distributing federal funds (non-earmarked federal transfers) to the states; in 1996, federal budget Item 26 sought to end poverty; and in 1998, budget Item 26 became budget Item 33, a combined federal allocation to states and municipalities (funds designated by the federal government and regulated by the states for education, health, basic infrastructure, public safety, food and social assistance).

In 1999 a new reform to Article 115 of the Constitution was enacted. The amended article granted greater decision-making power to the municipalities by enabling them to request state governments to transfer control over certain services within the municipality. Before this reform, state governments had the discretionary power to determine which municipalities would receive such transfers. Since the reform, local governments have benefited from a greater legal recourse as well. Even though the state governments hold the decision-making process regarding service delivery at the local level, the municipalities reserve the right to appeal to the Supreme Court regarding state decisions that affect such issue.

In sum, Mexico has experienced in the last three decades greater state and municipal government participation in the design and implementation of public policy. The formation of the SNCF at the end of the 1970s and the wave of constitutional reforms in the 1980s and 1990s granted

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4 The concept of fiscal decentralization refers to the transfer of funds from the federal to the subnational level with the goal of improving welfare and development levels in the country through capacity building in local governments. According to studies conducted on the topic, such an approach has advantages and disadvantages. Among the advantages is economic efficiency, as transaction costs drop due to inclusion of the population and government. This facilitates faster identification of community needs and more effective public expenditure (Tiebout, 1956; Oates, 1993). On the other hand, some argue that a potential risk of fiscal decentralization is macroeconomic instability and regional imbalance (Prud’homme, 1995). Furthermore, lack of capacities at the local level can lead to fiscal imbalance (Stein, 1998).
Mexican states and municipalities unprecedented powers and responsibilities. This period marks a major transition from a de jure to a de facto, more dynamic federalism, in which subnational governments have become defining actors of local and national policy, as well as agents of strategic change and promoters of development and well being.

This wave of decentralization is reflected in the spending trends among the levels of government. At the beginning of the 1980s, the Federation centralized nearly 85% of public spending while the states and municipalities spent a residual percentage (14.2% and 1.8 percent respectively). However, for the last decade the clear trend in spending is towards decentralization (Figure 1). Compared to other federal countries, Mexico is very close to the average distribution of spending between federation, states and municipalities, resembling strongly consolidated federal systems such as Germany and Canada. This resemblance will be re-visited later in this article.

An expenditure-revenue analysis points out very contrasting aspects. According to the Ministry of Finance’s (Secretaría de Hacienda y Crédito Público- SHCP) figures from the year 2010, Mexico’s federal government collected 94% of all tax revenues, while the states and municipalities together collected only 6% (Figure 2). This trend has not changed and as indicated in Figure 2, the revenue of subnational governments has remained stagnant. In the case of state governments, it has decreased over the last 20 years. Hence there is a formally established federalism that has only permeated in expenditures. As we will see further on, Mexico is an atypical case, in the sense that it acts as a federal nation in the context of expenditure but as a unitary nation in the context of revenue.

2. Mexican fiscal federalism on a comparative basis
In order to have a better understanding on the current state of fiscal decentralization in Mexico, it is useful to compare it to other countries, particularly to the OECD members. Such a comparison is interesting because the OECD is comprised of nations with federal and unitary systems. In that sense, the fact that the OCED member states have certain degree of heterogeneity allows for a comparison with diverse contexts. First, as demonstrated in Figure 3, the Mexican federal system is consistent in the allocation of expenditures at the federal and at the subnational level, given that the proportions are very similar among the two. ^What

^For this analysis the federal government was compared to the states and municipalities together as one.
these figures show us is that in Mexico the intergovernmental distribution of expenditures includes a greater proportion of expenditures for states and municipalities (48.21%) compared to certain countries with consolidated federalist governments, such as Germany or the United States.

Figure 1. Allocation of expenditures by level of government, 1998-2010

![Graph showing allocation of expenditures by level of government from 1998 to 2010.]

Source: Compiled by author using data from INEGI and SHCP.

Figure 2. Generation of revenue by level of government, 1998-2010.

![Graph showing generation of revenue by level of government from 1998 to 2010.]

Source: Compiled by author using data from INEGI and SHCP.
Figure 3. Government level expenditures as a percentage of the national total in OECD Member countries

Source: Compiled by the author, using data from the OECD, 2009. Data is from the year 2009, except for countries marked with an asterisk, for which the data is from the year 2008. The OECD data does not include information from Australia, Chile, Japan or Turkey, and so those countries are omitted from this analysis.

An analysis of revenue reveals a very different situation. Figure 4 shows us that the Mexican federal system is more representative of countries with unitary tendencies, such as the United Kingdom, Greece and France, rather than countries with consolidated federalisms such as Canada and Switzerland. In Mexico there is a difference of 81% between the revenues generated by the federal government and those generated by the states and municipalities. In 2009 the central government contributed with more than 90% of the revenues at the national level while the states and municipalities together did not reach 10%. This leaves Mexico far from Canada and Switzerland where subnational governments contribute nearly with 55% and 50% respectively.

The data in Figure 5 displays how Mexico’s revenue-expenditure relationship surpasses the OECD average. The comparison demonstrates that the subnational governments of the OECD Member countries contribute on average with 21% of the total revenues. There are cases such as the United States or Germany, where there is a proportional relationship between revenues and expenditures—or even where the revenue of local
Figure 4. Government level revenues as a percentage of the national total

![Graph showing government level revenues as a percentage of the national total.](image)

Source: Compiled by author using data from the OECD, 2009. Data is from the year 2009, except for countries marked with an asterisk, for which the data is from the year 2008. The OECD data does not include information from Australia, Chile, Japan or Turkey resulting in those countries being omitted from this analysis.

Figure 5. Subnational revenue-expenditure proportions for Argentina, Brazil, Mexico and OECD countries.

![Bar chart showing subnational revenue-expenditure proportions.](image)

Source: Compiled by author using data from the OECD and Martínez-Vázquez (2010, 248)
governments is greater than that of the national government, as in the United States. Mexico has the greatest revenue-expenditure gap among the OECD. To provide the context of federal systems in Latin America, Brazil and Argentina were included in this comparison. Both countries have a more balanced revenue-expenditure relationship than Mexico. In the case of Argentina, subnational government expenditures represent 42% of the national total, and in terms of revenue they contribute with 45%. Brazil’s situation is similar, where subnational expenditures comprise 55% of the total and revenues, 46%.

Finally, this comparative analysis shows another important component of fiscal federalism: the levels of tax collection (Figure 6). In unitary regimes the proportion of collections tends to be unequal, with a larger part coming from the central government. The aforementioned case presents itself upon comparison of the levels of fiscal revenues among OECD countries with unitary traditions and those with a federal system. After comparing Mexico’s rates, it’s evident that the intergovernmental relationship in the context of tax collections does not correspond to that of the OECD countries with federal systems. These countries have, on average, a collection rate of 67% at the federal level and 33% at the subnational level. The collection gap is wider among unitary governments with their central governmental collecting an average of 85% and subnational governments only 15%. In Mexico the gap is even wider than that of unitary governments, with the federal level generating 97% of the tax revenues and the states and municipalities just 3%.

This analysis can be interpreted quite clearly. Compared to other systems, both federal and unitary, we find severe imbalances in the relationship between the government revenues/expenditures at the central and subnational government levels in Mexico. This imbalances deviate from the typical federal systems approach and have more in common with unitary governments. Expenditure data reveals a different phenomenon, since the Mexican fiscal federalism figures are similar to those of countries with highly decentralized federal systems. As discussed below, the implications of these distortions are diverse, all due to the current institutional framework. This derived in part by the decentralization process in the early eighties, which, far from promoting the autonomy and strength of subnational governments, has created a situation of contrasts and imbalances with state and local governments which in turn appear to have accepted a subordinate role to the federal government as passive recipients of central resources.
3. Fiscal imbalances: main implications
What causes the expenditure/revenue contradiction? A first look suggests that earmarked federal transfers are gradually becoming an “addiction” to which subnational governments are getting used to depriving both their financial autonomy and their tax collection efforts. The state and municipal expenditure autonomy in Mexico is almost non-existent. States have 10% of expenditure autonomy and municipalities account for 27%. As seen in the previous section, while it is true that there is no international example that reaches a perfect balance on the level of revenue-expenditure, the logic of fiscal responsibility is to encourage subnational governments to generate significant levels of income in order to cover a good part of their expenditures.

Mexico’s situation brings to light two important facts: on the one hand, it would appear that there is a growing “fiscal laziness” in all of the states and municipalities, whose authorities choose not to assume the costs associated with direct collection and in return receive guaranteed federal funds; on the other hand there is a growing decline in subnational autonomy due to an increase in earmarked federal funds, which diminishes the implementation of policies endogenous to the subnational level.
But “fiscal laziness” and resource dependency are not the only factors causing this disequilibrium. The institutional capacities of subnational governments in Mexico play a significant role. In order to operate more efficiently –by taking advantage of the transfer of resources and responsibilities–, subnational governments must possess the necessary administrative and institutional capacities that will enable them to carry out the duties and powers that they are given. Several factors have been identified that will lead to the full development of the aforementioned capacities (Cabrero, 2004).

The first one refers to the horizontal exchange of information, meaning the observation of best practices and crossed learning through local government associations or intergovernmental fiscal commissions that aim to enhance the fiscal management. The second refers to the democratic intensity of local public action or the level of citizen’s involvement in the decision-making processes within local governments and the level of governmental accountability towards the citizenship. The third is the budgetary institutions’ regulatory framework, their degrees of accuracy and efficiency. The fourth includes the emerging organizational structures, meaning the impulse to achieve a clearer and more efficient organizational design. Finally, the fifth factor comprises the qualifications and professional profiles of state and local authorities. The following two sections present an analysis of such state and municipal governments’ capacities.

3.1. INSTITUTIONAL CAPACITIES OF STATE GOVERNMENTS

State governments used to work as administrative structures controlled at the federal level. The central government found some comfort in maintaining the state governments with underdeveloped administrative capacities and dependent on the federal level. That is, there were no incentives to promote institutional development beyond the minimum necessary administrative capacities required to carry out the tasks mandated by the central authorities. Since the aforementioned reforms to the national political scenario, in which the states no longer serve as mere administrative units, there has been a transformation in the horizontal exchange of information among the various state governments. The National Governors’ Conference (CONAGO) is an example of this. However the CONAGO, composed of all the states’ governors, acts more as a coalition to demand greater fiscal transfers from the Federal Government than as a space to exchange information and/or best practices. This is just one example, that although there have been changes in the role of state gov-
ernments in Mexico, the norm remains one of financial dependence on the federal government, depriving local governments of their autonomy.

Undoubtedly, the democratic transformations that resulted from a situation of divided government, coupled with growing citizen participation, had increased states’ commitment to greater accountability and transparency. However, there is a long road ahead as state governments have broad discretion of how to manage information regarding budget allocations. As a result of the accountability process, which is still in development, the results of state strengthening are very uneven among that level of government. Several studies have proved that there are only a few state governments genuinely interested in being held accountable (Hernandez, 1997; Cabrero and Carrera, 2001; Rios Cazares and Cejudo, 2010). Hernandez (1997) shows that only a small number of institutions make an effort to go public with their financial records. Only 85% of states clarify their financial information as either revenue or expenditure and an even smaller percentage, 54%, publish such information publicly. Cabrero and Carrera (2001) establish that only one state (of the three analyzed in their study) made revenue and expenditure reports a central theme in local newspapers and public forums. Rios Cazares and Cejudo (2010) point out that in the states, the Ministry of Finance is ranked the second-most reluctant agency to provide information. They note the existence of an extreme case where the comptroller, that is, the body responsible for internal control of the local public administration, is subject to the decisions of the Ministry of Finance of the state government (Rios Cazares and Cejudo, 2010). This shows that an important part of the local public finance accountability system is in danger of being captured by those responsible for managing resources.

The regulatory framework of state fiscal institutions is a fundamental element for public finance management. As long as regulations are precise and clear, they will, in effect, determine the rigor and efficiency of financial activity. According to the aforementioned study (Cabrero and Carrera, 2001), none of the states had developed all the fiscal compliance related codes. Furthermore, the study makes evident the asymmetries in institutional development, given that there was a 50% difference between the states with the highest rate of compliance, 90%, and the states with the lowest rate of compliance, 40%.

In order to undertake financial activity, states have different organizational structures and staff distributions. This is a significant indicator of
the importance that each department has in the organizational system as a whole (Child, 1973; Pugh, 1968). Cabrero and Carrera (2001) found a common thread in the criteria that determine the organizational structures and distribution of staff in states’ public finance departments. Priority was given to revenue, expenditure, accounting and budgeting and less attention was paid to the areas of auditing and fiscal inspection. In regard to the professional profiles of the officials comprising these organizational structures, the study found that states with better financial performance tend to promote continuing education and training.

It seems to be clear that the strengthening of institutional capacities is an important factor to improve financial performance of both state and municipal governments (as will be seen below). The pace and extent of fiscal decentralization towards the states should include an assessment of their administrative and institutional potential. A fiscal decentralization process running at different speeds would allow each state to receive new roles and responsibilities at their own pace and according to their potential.

3.2. Institutional capacities of municipal governments

Because of its privileged position for understanding the demands and needs of society, it is assumed that municipalities should be the level of government in charge of providing citizens with the necessary conditions to maximize their welfare. As previously mentioned, the municipalities must have the necessary institutional and administrative capacities to do so. In order to have a better understanding of the current situation of fiscal federalism in the municipal context and to shed light on the institutional and administrative capacities at this level of government, information is presented about levels of association, profiles of municipal officials, attitude towards public finance inside the municipal governments and the ways in which revenue is generated and allocated at the municipal level. Unlike the states, information for the municipalities in all of these areas is available for as recently as 2009, courtesy of the 2009 National Survey of Government, Public Safety and Municipal Justice (hereafter referred to as “the 2009 survey”) conducted by INEGI.

Local government’s interaction with other actors is essential to understand its functionality. An increase in shared needs has forced local authorities to search for opportunities for collaboration outside of their borders. New urban planning models entail multiple political entities and, as a consequence, the conformation of metropolitan areas (Choi
and Brower, 2006). This incorporates sets of organizational structures with a multi-sectorial focus that includes a wide spectrum of themes such as land use, urban development and recreation. In the case of Mexico, there is a collaborative dynamic in the delivery of public services.

Of all the municipalities in Mexico, the 2009 Survey shows that only 37% reported some type of association (900 out of 2,456). Urban municipalities report higher levels of association but the rural ones are lagging behind with less than 45% reporting association. When this data is analyzed according to poverty levels, an inverse relationship is revealed, given that those with higher levels of poverty are the least likely to forge partnerships with other municipalities. By contrast, the ones with lower levels of poverty tend to favor municipal partnerships. In addition, they perceive municipal associations as “good.” Overall, the information indicates that municipal association is an emerging theme, given that only one third of local governments participate in these so-called collaborative networks.

Municipal association occurs only in the area of basic service delivery, and has yet to tackle more ambitious aspects of intergovernmental relations, such as collaborative tax collection. Although only one third of municipal governments have reported some kind of association, one must recognize that the trend as of 2000 has risen (527 municipalities reported associations in 2000 and 900 in 2009). This may be due in part to some federal programs that reward participation in municipal associations by giving more resources, thus promoting the development of joint strategies for the development of infrastructure, delivery of services and regional development, among others.

The officials’ professional profiles can be defined by their professional experience and academic preparation. Regarding the former, it is necessary to take into account the record of the last job held by the officials in charge of local finance. According to data from the 2009 Survey, the scene is as follows. Before taking office, 24% of the people in these finance-related positions reported their previous job as that of an independent contractor and 17% reported having previously worked in the municipal administration. The situation becomes more problematic when the previous experience of finance officials is broken down by municipality type. As seen in Figure 7, compared to urban municipalities, there is a greater number of people in rural municipalities who come from the private sector and/or whose position in the municipality’s finance office is their first job.
As for finance officials’ educational levels, information from the 2009 Survey shows that in at least half of the municipalities (56%), the official has a bachelor’s degree, 13% of the officials finished primary school, 11% finished secondary school, 10% finished high school, 6% finished some kind of technical school and 3% finished graduate school. On the other hand, 0.3% has only preschool or no schooling at all, and another 0.3% holds a PhD (Figure 8). In most cases, the finance official has staff members who at least finished high school (65%). The cases in which staff has only basic training, such as primary, secondary, or technical school, comprise 24% of the total, while graduate students are very scarce (3%), and those who do not have any education are even rarer (0.3%). The data is similar to that of professional experience where municipalities are categorized by their size. The instances of primary, secondary and high school education are more concentrated in rural areas and, at the other end of the spectrum, graduate-level education is more common in urban municipalities.
As mentioned previously, another criterion for understanding the current state of municipalities’ administrative capacities is their regulatory framework and the activities carried out by the administration with regard to local finance. Understanding the regulatory framework helps to grasp the relevance of this issue for the local government. One indicator of said importance is the number of committees dedicated to public finance. According to the 2009 Survey, half of Mexican municipalities have at least one committee dedicated to finance. Overall, these finance committees represent only 8% of the total number of municipal committees. Of the municipalities that do have committees, just 38% presented initiatives and only 45% have actual action plans.

Local government expenditure is a critical activity of a municipal treasury. One of the risks associated with fiscal decentralization processes is that increased revenue flows for local governments do not necessarily translate into rationally allocated expenditures, but rather generate various distortions. This is more likely to happen when the resources coming into the municipal level are primarily from transfers from another level of government rather than generated by their own fiscal efforts (Tanzi, 1995; Cabrero, 1996). The information provided by the 2009 Survey regarding municipal revenue distribution confirms the tendency of local governments towards these distortions. More than two-thirds of their expendi-
ture is originated by federal transfers, indicating a lack of autonomy in the management of such resources. Consequently, resource allocation may not necessarily address the major problems of the municipality.

Figure 9. Municipal revenue allocation 1998-2008

In order to generate revenue, property tax collection is, in theory, one of the most important resources available to municipalities in countries around the world. Mexico’s municipalities were granted with this faculty through changes to Article 115 of the Constitution in 1983. It was mentioned in the second part of this article that the level of property tax collection in our country is alarmingly low compared to other countries with similar degrees of development. Hence it is so very important to understand how the failures in a tax collection system can explain the lack of a major source of revenue and how improving that function can be a key fiscal stepping stone for local governments toward more autonomy in fiscal management.

In Mexico there are at least two options for the collection of property taxes. The first is directly through the municipality and the second is through the state government. The 2009 Survey data shows that in most cases (83%), property taxes are collected directly by the municipality. 12% of municipalities collect property taxes through an agreement with the state and 5% collect through other options. The efficiency of property tax
collection also has a lot to do with the cadastre system. The 2009 survey data reveals that 36% of municipalities had updated their cadastre within a year, 5% within two years, 3% within three years and 30% within over four years. For 25% of municipalities, the cadastre update is a permanent and constant undertaking. Thus, only a quarter of the municipal land registries are systematically updated, while the remaining 75% do not have up-to-date records, with the obvious consequence of low tax collection rates (Figure 10). In addition to the low update rates, the obsolete methods with which the cadastres are updated are problematic. As the 2009 Survey indicates, nearly 70% of the municipalities opt for slow and costly procedures that increase the likelihood of erroneous registries, such as paper records (43%) and on-site inspections (26%).

Figure 10. Most recent update of land registry

Source: Compiled by author using the 2009 Survey

In order to improve the efficiency of property tax collection it is not enough to have the cadastre updated or the use of modern means to do so. Updating cadastral values is necessary to increase revenues. Forty-four percent of municipalities updated their property values 1 year ago, 6% two years ago, 4% three years ago, 28% over three years ago, and 18% of the municipalities constantly update their cadastral values. The data shows, that only a small part of municipalities (18%) have up-to-date cadastral values while the remaining 82% work with outdated values. This makes tax collection a difficult task and limits the amount of potential revenues.
The data presented throughout this article sheds light on the reasons behind the inefficiency in the collection of property taxes for a large part of the country’s municipalities: administrative lags, regulatory neglect, obsolete systems, and a lack of human, financial and technical resources to properly operate the cadastre system and cadastral values.

It is clear that local governments’ ability to collect taxes is not the only area where unpreparedness is an issue. Throughout this article we have indicated that there is a precarious level of professional development among the officials in charge of treasury and finance. Moreover, the level of attention given by local and state governments to the issue of public finance is equally minimal.

The purpose of this section has been to identify the gaps in subnational governments’ administrative and institutional capacities. Through the analysis of the data just presented, it seems that is in the municipalities where the effects of a homogeneous process of decentralization in a heterogeneous reality produces the most worrisome effects of the current configuration of Mexican fiscal federalism and where more improvement efforts are needed. Thus, in addition to the structural flaws in the distribution of fiscal authority, we should also include the diminished capacity of state and local governments to manage their financial issues. The following section relates the effects of the contradictions that come with fiscal decentralization in Mexico.

**Final thoughts: The impact of Mexican fiscal federalism’s distortions**

After highlighting the administrative and institutional weaknesses of local governments and their revenue-expenditure imbalances it is possible to demonstrate the strong dependence of subnational authorities on federal transfers. Decentralization focused only on expenditures is mere fictitious decentralization, in that it limits subnational governments’ actions and acts as a regulatory mechanism that controls the autonomy of states and municipalities.

Such revenue distortion in Mexico creates vertical imbalances that constitute a trap of fiscal federalism. These imbalances, fail to create the right incentives, which means that it does not allows complying the precept that each level of government should generate the revenue that it expends. This results in the exercise of “fiscal populism” by local governments that spend irresponsibly because they do not have the right incentives to generate their own resources (Musgrave and Musgrave, 1984; Bird, 1993, Tanzi 1995).
The significant increase in municipal revenues is due to the considerable real growth of federal funding, not to the capacity building of local governments in the area of tax collection. We have already noted their many shortcomings in this area. Instead, subnational governments have begun to yield some responsibilities related to the design and implementation of local action plans and recognize themselves as managers of centrally defined mandates.

As mentioned above, one of the principal risks associated with fiscal decentralization is regional imbalance. In Mexico, the discrepancies among governments pertaining to the same level are abysmal. In other words, there is also dire horizontal imbalance. The municipal level is where the situation is even more troubling as a consequence of the profound disparities in population and social and economic issues. The twenty most populous municipalities, which comprise 1% of all municipalities, receive one-sixth of all federal transfers and represent nearly one-third of the total revenue generated by all municipalities. The next 300 most populated municipalities (approximately 12%) receive nearly half of all federal funding allocated for local governments and collect slightly more than half of the total revenue generated by all municipalities. Obviously, the more than 2,100 remaining municipalities – generally cities with fewer than 15,000 inhabitants or rural communities - receive only 40% of the remaining federal funds and their collections represent only 14% of total municipal revenue.

Another consequence of the distortions created by the current institutional framework is that fiscal policy is negotiated and drafted by only a few select stakeholders. At one end, the Secretary of Finance (with some participation on the part of the Secretary of Education, Secretary of Social Development and Secretary of Health) regulates intergovernmental transfers. At the other end, governors have become key players with tremendous lobbying ability. They pursue resources through traditional channels or through special transfers (as in the case of oil surpluses). Finally, there is one more group of players with the ability to maneuver and negotiate: the 20 largest municipalities. The sheer amount of resources they generate enables them to maintain relative autonomy from state control.

There are more weaknesses on the subnational scene including monitoring, accountability and evaluation mechanisms. While transparency and accountability should and could create opportunities to assess the impact of resource allocation, they tend to become simple procedures carried out to meet legal obligations.
In the introductory section, three basic premises were presented as common features among the different models of fiscal federalism. The Mexican tax system has created an incentive system with outcomes that adversely affect these premises. Instead of promoting balance and intergovernmental fiscal responsibility, the tax system rewards subnational “fiscal laziness” and dependence. Instead of using federal transfers as an effective compensatory mechanism, they are wielded as instruments of centralized control and influence over public policy. Finally, instead of establishing objective frameworks for monitoring, evaluation and auditing, a system has been created in which state legislatures intimidate other political players. Needless to say, the aim of such activities is not to promote increased citizen participation.

Clearly, the current distribution of fiscal authority in Mexico leaves no doubt that the structural weaknesses hinder any attempt to strengthen the capacities of subnational governments. Although the reforms that began in the early eighties sought to strengthen and improve the conditions at the subnational level, the structural traps created by institutional frameworks resulted in the complete opposite. As a result, significant distortions that are not necessarily congruent with fiscal federalism arose. The contradiction is rooted in the fact that Mexico spends like a highly decentralized nation and, as presented in the second section generates revenues like a highly centralized country.

Why has such a dynamic prevailed? One might get the impression that there is an implicit agreement and complicity among actors seeking to maintain positions of power. It appears that Mexico’s dominant intergovernmental fiscal arrangement is sustained by a “state of shared convenience.” It is a tacit agreement in which the federal government assumes the cost of fiscal imbalances in exchange for keeping some level of control over subnational governments as a means of leverage for negotiations and agreements. States assume the cost of surrendering their fiscal autonomy, and any policy autonomy that would have come of it, in exchange for maximizing public spending and minimizing the political capital lost by taxing the population. Furthermore, the flow of resources regarding the oil surplus act as an anticipated pay-off in exchange for the deferment of any major fiscal federalism reform. Finally, the municipal level also surrenders elements of their autonomy in exchange for a steady flow of federal resources.

In the end, citizens are the big losers when it comes to these imbalances. Without a clear definition of powers, the responsibility is diluted
and there are no coordinated tools that allow the integration of strategies meant to solve public problems. Mexico is still far from having in place the necessary arrangements that would allow for an effective multi-level government.

Today’s most successful federal systems are those that, by seeking the greatest possible fiscal balance, have clarified the tax and treasury responsibilities among the various levels of government. They promote a mystique of intergovernmental collaboration and facilitate a balanced dialogue between federal and subnational governments. In the meantime, Mexico must embark on a profound reflection of the subject in order to break down the “shared convenience” dynamic that appears to explain the current state of affairs. The present situation will only increasingly threaten the development, competitiveness and even the democratic governance of the entire country.
Bibliography


