

CHAPTER 1

DECENTRALIZATION, POVERTY, AND DEVELOPMENT IN MEXICO

This report, the third in a series on poverty in Mexico, examines the relationship between decentralization and the provision of key social and productive services—education, health, social infrastructure, and rural development—viewing the overall performance of these services over the past decade as potential contributors to poverty reduction. While it is not possible to identify the effect that the decentralization of these programs has had on poverty reduction, the report does discuss trends in the performance of these programs, which should affect poverty, and the strengths and weaknesses of the decentralization process with regard to accountability, incentives for performance, and allocation of effective authority.

The first-phase report dealt with the overall conditions and influences on poverty, including an evaluation of the CONTIGO strategy. It found that Mexico has achieved major progress in some non-monetary dimensions of well-being, but much weaker progress on others, such as the income of the poor. Despite the recent gains, particularly for the extreme poor, poverty remains a challenge. CONTIGO provides a sound conceptual framework for the government's poverty reduction strategy. There have been notable successes in specific programs as well, especially *Oportunidades*. But many challenges remain for implementing the principles of the CONTIGO framework across government programs. The quality of services is a major problem in many sectors. Social policies for meeting the basic needs of the extreme poor are well developed, but policies for promoting their income growth are not. A broader agenda for the moderate poor is pending. Most of the extreme and moderate poor fall outside the formal social protection system and face significant risks, for example, from health crises, unemployment, or lack of income in old age. And a wide range of institutional issues have yet to be tackled, such as strengthening accountability, especially under decentralized structures.

The second-phase report dealt with the determinants of rural and urban incomes and management of household risks. The poor are very heterogeneous, and, among other dimensions of poverty, geographic location matters in the design of appropriate poverty alleviation interventions. The urban poor are limited to low-quality jobs marked by low productivity and limited social protection. To continue supporting the rural poor to move out of poverty, it is important to increase agricultural productivity, especially for small- and medium-size farmers. In addition, Mexico's health system does a poor job of addressing the risks facing the poor.

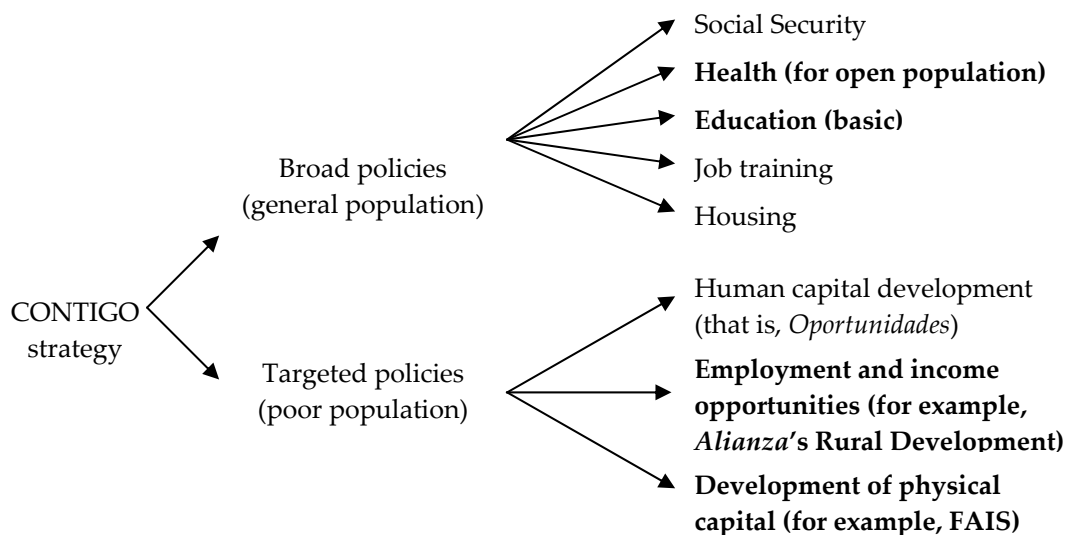
To follow up on the results of the previous reports, this report focuses on the delivery of public services and on center-local relations in this area. It does so for two reasons. First, both social and economic services shape the opportunities of poor people. Social services contribute to human capital formation and risk management, while economic services shape access to markets. The government provides an important subset of these services, and achieving better access and better quality of services is a major goal of public action. Second, a large and rising proportion of government services are being delivered, to varying degrees, under decentralized auspices. This is the result of Mexico's particular pattern of decentralization, especially in the past decade or so.

Which services matter most? The report selects areas of particular importance to the poor in the domain of social services (education and health) and economic services (local infrastructure and services related to rural development and agriculture). The report does not address the provision of preventative communal public health or other municipal services in large cities, since those are rarely financed with earmarked federal resources, or the provision of a social safety net, since the federal government operates the main program in this area—*Oportunidades*. This chapter provides an overview of the sectors and programs analyzed in this report. Also, this chapter discusses the framework and history of decentralization of these programs.

I. SERVICE AREAS IN THIS REPORT

The government strategy for poverty reduction, CONTIGO, includes two types of interventions: broad based and targeted (see Figure 1.1). Broad-based social expenditures are not specifically targeted to the poor, but the CONTIGO framework recognizes that they provide opportunities for the poor. Within broad-based interventions, the government distinguishes the areas of social security, health care, education, job training, and housing.

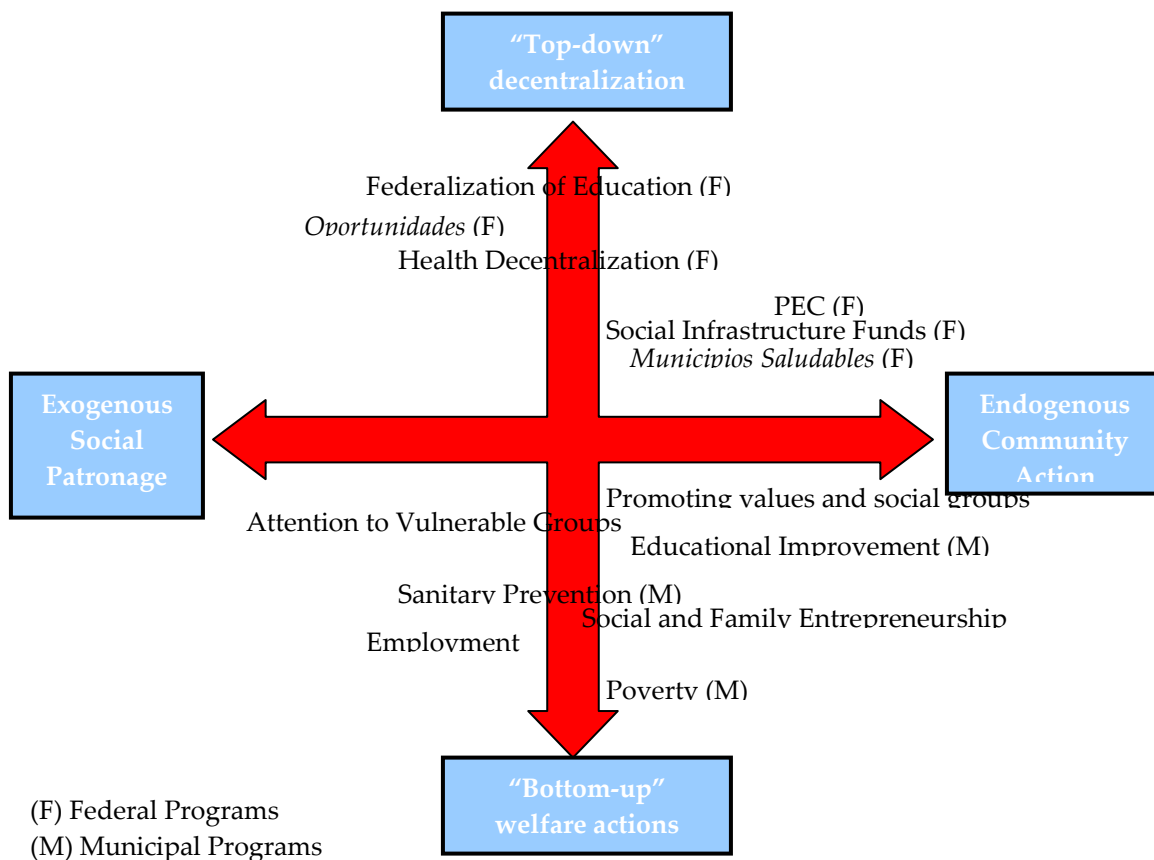
Figure 1.1. CONTIGO Poverty Reduction Strategy



Recognizing that broad-based interventions alone do not suffice to help the poor emerge from poverty, the Government of Mexico has also implemented three groups of targeted interventions specifically designed for the poor. The first group promotes investments in the human capital of the poor, with a focus on education, health, and nutrition. The second aims to improve employment opportunities for the poor. The third targets poor areas in order to provide them with better services and physical capital.

One can see these programs of federal origin in a broader context by considering also the programs that individual states and municipalities create. Figure 1.2 shows them arrayed by the originating level of government and also by whether the benefits go more to individuals or to communities.

Figure 1.2. Map of Decentralization and Social Programs



Source: Cabrero Mendoza 2003.

Basic Education

Around 92 percent of students in basic education attend public schools, so it is not a targeted program. Nonetheless, the majority of these students come from poor families, and the basic education program is the largest federal spending program. Although the biggest gaps in educational coverage for the poor are at upper-secondary and university levels, improving the quality of primary education and access to lower-secondary education remain priorities, both for their own sake and to provide a foundation for the poor to move up the educational ladder (World Bank, 2004a). The *Fondo de Aportaciones para la Educación Básica* (FAEB, Basic Education Fund) of *Ramo*¹ 33 transfers to states the resources to pay teacher salaries, through an agreement reached in 1993. As an earmarked expenditure, this absorbs more than one-third of all resources transferred to the state governments.

Federal programs that supplement the basic education program include *Oportunidades*, *Consejo Nacional de Fomento Educativo* (CONAFE), and the *Programa*

¹ The *Ramos* are the budgetary codes.

Escuelas de Calidad (PEC, Program of Quality Schools). *Oportunidades* provides a subsidy directly to poor households on condition that the children attend schools. PEC was started on a pilot basis, bringing funds directly from the federal government to schools. Three parties are required to participate: (a) the administrators of the individual school must develop and implement a five-year school improvement plan, (b) the state must match the federal contribution at a ratio of 1:2, and (c) the school community must make a financial contribution (which can come from a variety of sources, including parents, municipalities, and the private sector) and participate in the planning process. Communities voluntarily self-select for the program. CONAFE supports about 25 percent of schools—those in marginalized rural areas—in the development of curricula, didactic materials, and textbooks in an indigenous language and in Spanish to facilitate bilingual education.

Health Care for the Population without Social Security Coverage

Despite progress in health, half the population remains uninsured and a tenth is without access to health care. For the rural poor, the priority is to provide access to a basic package of preventive and curative health care. Extreme poverty brings with it a high level of mortality and morbidity. Moreover, when families without social security coverage face a severe health shock, they incur catastrophic health costs, which cause them to become poor. Whereas only 2.7 percent of the insured suffered excessive health shocks² in 2004, 5.6 percent of the uninsured did. The second most important fund in *Ramo 33* is the *Fondo de Aportaciones para los Servicios de Salud* (FASSA) or Health Services Fund. FASSA was established in 1997 to finance states, which became responsible for paying the salaries of health workers who attend the population without social security coverage.

The public programs that go mostly to the population without social security coverage (mainly the poor) include the Ministry of Health (SSA), *Instituto Mexicano de Seguro Social* (IMSS)-*Oportunidades*, and *Seguro Popular*. The Ministry of Health has an extensive geographic coverage—more than 12,000 health clinics in the 32 states. IMSS-*Oportunidades* provides health services in marginalized rural and urban communities, using facilities and personnel arranged by IMSS but not part of the mainstream IMSS system. *Seguro Popular* purchases services from SSA and IMSS-*Oportunidades*. *Seguro Popular* aims to improve equity both at the state and at the household levels. At the state level, it seeks to achieve equality in public health spending per capita across states (as well as across public health insurance schemes). At the household level, it aims to achieve full coverage of the population without social security coverage, minimizing vulnerability to catastrophic or impoverishing health expenditures and, more generally, ensuring equality of basic health opportunities. The program intends to reach these

² Excessive health expenditures include catastrophic (over 30 percent of household disposable income) and impoverishing (those that are not catastrophic yet, but cause a family to fall below the poverty line) health expenditures.

objectives by 2010. Evaluation of the program's impact is under way. However, preliminary results indicate that *Seguro Popular's* targeting could be substantially improved, for example, by following closely the targeting of *Oportunidades*.

Social Infrastructure in Marginal Municipalities

In Mexico, there are large differences in standards of living among states as well as among municipalities within states. These differences could be due to differences in the characteristics of the households living in various areas, such as level of education and occupation, but they could also be due to characteristics of the areas themselves, such as infrastructure. More precisely, the characteristics of an area can have both direct geographic effects (significant geographic determinants of income or consumption that are observed even after controlling for a wide range of household characteristics that may be due to climate, access to markets, demand for labor, or industry concentration) and indirect geographic effects (which may affect household endowments, such as availability of schools or opportunities) on the well-being of its inhabitants. According to previous research, there are indeed both direct and indirect geographic effects on standards of living at the state level in Mexico. The geographic effects are relatively stable over time and coherent with observed migration. This provides some rationale for investing in the physical capital and social infrastructure of poor areas, since area characteristics do matter for poverty reduction.

The modalities of providing and funding social infrastructure vary widely in Mexico. During the early 1990s, investments in social infrastructure were driven by the *Programa Nacional de Solidaridad* (PRONASOL), which was devoted largely to basic social infrastructural investment. One of the program's most remarkable elements was its demand-driven mechanism, using the organized participation of local communities, which bypassed municipal and state governments.

PRONASOL was discontinued following accusations of intensive political misuse. In 1996 and 1997, a public formula was used for the first time to distribute social infrastructure investments through a fund named *Fondo de Desarrollo Social Municipal*, which was later institutionalized under the Fiscal Coordination Law of 1998 and renamed the *Fondo de Aportaciones para la Infraestructura Social* (FAIS) or Social Infrastructure Fund.

FAIS, the third largest fund in *Ramo 33*, uses a transparent poverty-weighted formula to distribute resources for investment capital to states and municipalities. The amount was initially decided annually in the budget process, but starting in 1998 the Fiscal Coordination Law specifies that FAIS should be 2.5 percent of the projected *recaudación federal participable*. The money goes initially to the state treasuries, but with strict conditions to pass along 87.8 percent to municipalities, under the title *Fondo para la Infraestructura Municipal* (FISM), with the rest remaining at the state level under the title *Fondo para la Infraestructura Social Estatal* (FISE). The distribution across states and to the

municipalities within states is set by formulas in the federal law. FISE has no earmarking (it has to be used for regional or intermunicipal projects), and FISM can be used in any of the following areas: water, sewerage and sanitation, municipal urbanization, rural electrification, basic health infrastructure, basic education infrastructure, housing improvement, rural roads, and rural productive infrastructure. There is no tight monitoring of these funds, and most municipalities also put funds from other sources into these areas.

Decentralized Rural Development

To overcome poverty, the rural poor need more than transfers like those from *Oportunidades* or private remittances; they also need sustainable income and employment opportunities. Many federal programs are oriented to this. Indeed, the federal government spends an enormous amount in rural areas. In the 2005 expenditure budget, MxP\$ 147 billion were allocated to rural areas under the many programs included in the *Programa Especial Concurrente*. Of this total, MxP\$ 48 billion are classified as production support. Hence, an estimate of around US\$ 4.5 billion goes annually to support production in rural areas.

Alianza para el Campo is the major farm modernization program in Mexico. It is targeted to poor producers and is the only production-oriented rural program that has been partly decentralized to the municipal level. It has been operating since 1996 at an annual cost of more than US\$1 billion and represents 17 percent of the *Secretaría de Agricultura, Ganadería, Desarrollo Rural, Pesca y Alimentación* (SAGARPA) budget. It is a demand-driven program for investment support, including three major subprograms: *Fomento Agrícola*, *Fomento Ganadero*, and *Desarrollo Rural* (agricultural, livestock, and rural development, respectively). All farmers and farm associations are eligible for this program, which subsidizes variable percentages (often 50 percent) of productive investments in approved projects.

Alianza's Rural Development Program consists of three programs. The first is the *Programa de Apoyo a los Proyectos de Inversión* (PAPIR), an investment fund that supports income- and employment-generation investments by small producers and other rural dwellers. PAPIR provides subsidies to low-income rural residents to improve their farms or carry out other productive investments. Until 2005 there were two modalities: (1) support for productive projects, which is restricted to producer groups of six or more members, and (2) support for individual producers. A maximum of 30 percent of PAPIR resources in each state could be allocated to individual producers. In the case of groups, the subsidy for ordinary beneficiaries ranges between 50 and 70 percent, decreasing with the amount of subsidy, and between 50 and 90 percent for priority groups.³ For individual producers, it ranged between 50 and 53 percent. Since 2005 only groups, not

³ The priority groups are youth, women, indigenous peoples, elderly producers, and the handicapped.

individuals, are eligible for support. In 2005 PAPIR accounted for 72 percent of the MxP\$ 2.2 billion of federal funds allocated to the Rural Development Program.

The other parts of the Rural Development Program are the *Programa de Desarrollo de Capacidades* (PRODESCA) and the *Programa de Fortalecimiento de Empresas y Organizaciones Rurales* (PROFEMOR). PRODESCA provides training and technical assistance to help producer groups formulate and implement projects financed by PAPIR. PROFEMOR supports producer organizations and provides technical support to the rural development councils through *coordinadores técnicos* (technical coordinators).

II. INTERNATIONAL EXPERIENCE WITH DECENTRALIZATION OF SERVICES: FROM GRAND HOPES TO COMPLEX REALITIES

Decentralization is an ongoing fact of life in Mexico, driven by political as much as by economic reasons. Decentralization became popular in the development community in the 1980s and 1990s. It was often viewed as a solution to the inefficient and inequitable provision of services. To understand the particular features of Mexico's process, this section outlines two of the main arguments for decentralization in the development literature and experience and then relates these to the more complex experience in practice. We highlight two broad categories, both because advocates of decentralization consider them to be important and because they provide a useful intellectual basis for the analysis in this report.

Public Finance and the Optimal Location of Service Delivery

The first category of issues flows from general concerns about the underlying production functions for delivery. Where preferences or conditions vary across geographic jurisdictions, local service delivery has a potential advantage to the extent that local organizations have better information and can adapt the mix or design of services to local conditions. However, this local advantage has to be set against the possible advantages of delivery by higher levels of government to the extent that there are economies of scale in production or management, there are spillovers in costs or benefits, and provision has the feature of a public good.

Other than of a clearly economy-wide nature—macroeconomic policy and national defense, for example—most public services are at least partially suited to local delivery. In education, curriculum design and testing are public goods and should be primarily national concerns. In contrast, school management requires good local knowledge and should be run locally. In health, treatment norms are public goods, and immunization has externalities; both are typically run nationally. Health centers, in contrast, can be run locally. In infrastructure, a country's arterial transport network has both major spillovers and economies of production and should be under central management. Having common engineering standards for the whole country makes sense and is generally defined nationally. In contrast, lower levels of government are

typically best at running local urban and rural roads. In agriculture, pricing policy is intrinsically national, as is most, though not all, research, whereas water management is a local concern, and extension services may work best locally.

There is a tendency to consider whether a whole sector is or should be decentralized, when the more important question is how central and local public action can best complement each other and how the division of labor should be defined in organizational terms. The optimal level of decentralization need not correspond to the core public organizational structure. In education, the most local unit for management is the school, not the municipality. In river basin development, it is typically a geographic region that encompasses more than one municipality and often crosses state lines. This needs to be taken into account in designing management structures.

Finally, there can be differences in the capacity or responsiveness of different levels of government. Local government may have potentially more information on local preferences and conditions, but weaker capacity to use this information. This takes us to the second consideration.

Agency and Accountability

The second category of issues is the extent to which different levels of government respond to local or national concerns. Government action is embedded within a polity and is a form of “agency” problem (see Bardhan and Mookherjee 2005 for a recent review of the relevant literature). Governments hold power and take action formally on behalf of the citizenry, whether in authoritarian or democratic settings. But for a variety of reasons, governments may be imperfect agents of the wishes of citizens; in other words, they may be incompletely accountable to all citizens. They may lack information, they may reflect the interests of some groups more than others (as is classically the case in unequal, stratified societies), or officeholders may pursue their own interests. Decentralization can make a difference in how governments respond to these influences and thus in how they behave.

When a national government devolves financing and service delivery responsibilities, it can do so with the requirement and expectation of accountability either back up to the national level or downward to the local citizens. Both strategies have demonstrated successes internationally. As Box 1.1 indicates, Germany follows more a strategy of upward accountability with many administrative controls, while Canada has sought to create more accountability at the local level. Both strategies work best when there is good administrative capacity, and both Canada and Germany are ahead of Mexico in that regard. The Canadian model has less complexity, requires less in terms of obedience to authority, and allows for utilizing the administrative capacity that may be strong in some places; thus it may be more suited to Mexico.

Box 1.1. Decentralization and Accountability for Results in Canada and Germany

The constitutions of all federations allocate powers either for self-rule or shared rule, with the degree and type of decentralization varying widely. In Australia, Canada and the United States, subnational governments have substantial legislative authority, especially on matters of expenditure. Germany, in contrast, follows a model of administrative federalism, where virtually all legislative power rests with the center, and the *laender* have almost all responsibility for implementation and administration.

In the Canadian federation, provinces have the authority and responsibility for most of both expenditure and revenue. They levy their own personal and corporate income taxes and their own sales taxes, and they control the natural resources within their borders. With most provinces raising most of their own revenue, both fiscal and political electoral pressures give incentives for officials to assure the quality and efficacy of services.

In Germany, the federal legislation sets the standards for decentralized services, and most of the revenue to pay for them comes from taxes set nationally but collected locally. Equalization formulas for redistributing tax revenue per capita dilute the incentives for local tax effort. Nonetheless, the culture of bureaucratic competence and compliance with rules, as well as the political accountability of local officials for implementing the programs, makes the production of services generally efficient and effective enough to meet federal standards.

In both countries, the formal accountability is chiefly through the long route of government, with Canada having more of the shorter long route going through local governments. Neither country seems to have a lot of formal programs to create the short route to accountability, but the general vigor of civil society in both countries assures that some of this accountability takes place.

Sources: Giugale and Webb 2000; Webb and Zapata 2006.

Citizens may influence the performance of local government through two processes, following Hirschman's classic approach: through "exit" (linked to the mobility of investment and population or labor) and through "voice" (the direct expression of citizen influence on government within a jurisdiction).

The "exit" route works through the mobility of capital or citizens: the possibility of attracting more capital or workers can induce local governments to offer better services—in local infrastructure, government processing of regulations, and schooling, for example. The threat of losing mobile capital and more educated workers is, conversely, an incentive for local governments to maintain or improve the quality of services. Thus Nuevo León may seek to provide better services than Estado de México in order to attract more foreign and local investment. This is the essence of the idea that federalism may promote a virtuous cycle of competition, applied, for example, as an interpretation of China's successful development in the 1980s and 1990s (Qian and

Weingast 1997). More recently, there are reports of intense competition among Indian cities in their effort to provide a better business environment for the informatics- and software-related industries. This interjurisdictional competition can also take a less benign form for economic development when it involves tax incentives, as in the “fiscal wars” waged by Brazilian states seeking to attract foreign direct investment (Tendler 2000). Mexico has largely avoided such competition by discouraging local taxes since the mid-twentieth century (Díaz Cayeros and McLure, 2000).

“Voice” can work through a variety of mechanisms, including elections that vote a party out of office, exposés and critiques in the media, citizen complaints, participation in parent schooling committees, street protests, and even, in a few extreme cases, lynching of the mayor.⁴ Advocates of decentralization argue that local government is closer to the people and so is responsive to their interests and needs, including those of poor people within their jurisdiction. This is linked to the desirability of fostering greater participation, both in formal local democratic processes and in the interaction between social mobilization and the design and implementation of more open government policy. In the past 15 years, Mexico has greatly increased the competitiveness of elections and the possibility of party change at all levels of government. This has directly increased voice and amplified the effect of other modes of voice.

Multiple Relationships of Accountability

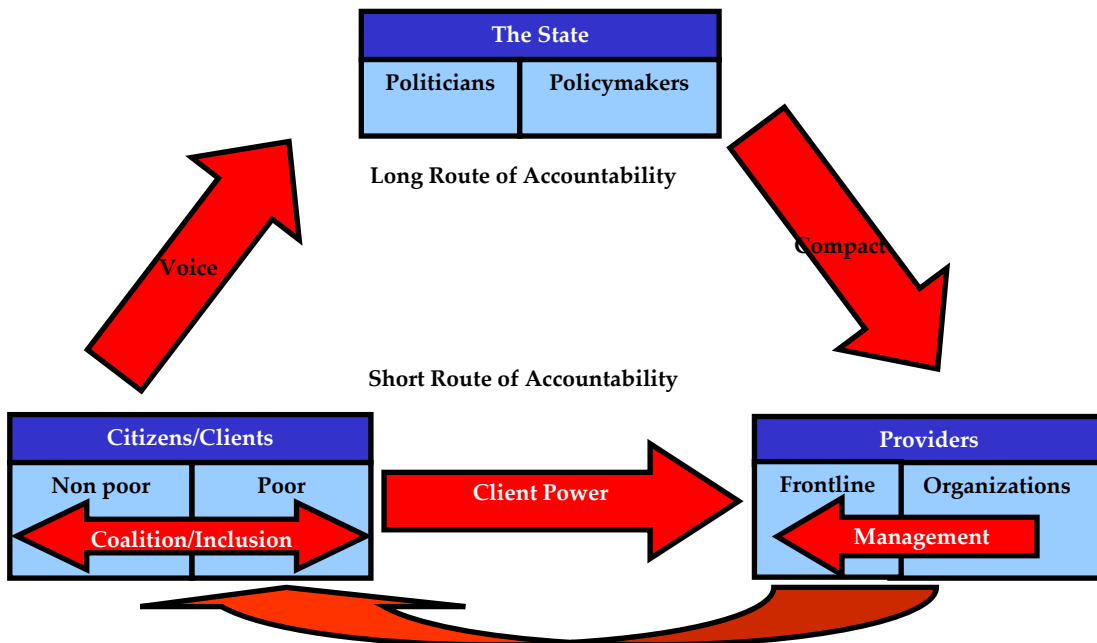
It is useful to analyze the effects of decentralization in terms of the relationships of “accountability” among different levels of government and citizens and within the national and local context. This can be done through a network of relationships of accountability (see Figure 1.3 for a stylized framework). The central idea is that the nature, extent, and quality of service delivery to a particular group of citizens are mediated by relationships of accountability. In this aggregate picture, there are four such relationships:

- *Between citizens and policymakers (“voice”).* Policymakers decide policies, while citizens, to varying degrees, influence them through a variety of political channels.
- *Between policymakers and provider organizations (“compact”).* Policymakers do not themselves deliver services, but they have contractual relationships with providers, including, perhaps, the executing parts of a ministry, a parastatal, or a regulated private company.
- *Between the managers of the provider organization and frontline workers (“management”).* While this relation occurs within an organization—from the

⁴ Grindle (2005) opens her study of Mexican municipal development with a number of anecdotes in this vein. The lynching occurred in Ilave, Peru, in April 2004. See also the film “La Ley de Herodes” for a fictional account of the cycle of mayoral action and eventual citizen revolt in the heyday of the *Partido Revolucionario Institucional* (PRI) in Mexico.

- Ministry of Education to teachers, for example—a set of factors influences the translation of managerial decisions and the behavior of teachers, nurses, or extension agents.
- *Between clients and frontline workers (“client power”).* The actual transaction occurs between “street-level bureaucrats” and citizens, who are themselves a heterogeneous group. This is an interaction between people—in the classroom, clinic, farm, town hall—and the power, or lack of it, of the client can influence the behavior of the worker.

Figure 1.3. Accountability Relationships among Citizens, Policymakers, and Providers of Services



Source: World Bank 2004b.

As highlighted in Figure 1.3, the client-power relationship can be termed the “short” route to accountability, as exemplified by the effects of direct community participation or parent councils. The route via citizen voice, policymakers, and provider behavior can be termed the “long” route. While these work in different ways, they are often complementary, rather than substitutes.

The compact relationship is not only concerned with accountability for performance, but also with the degree of autonomy and authority that governments (especially in a multilevel situation like Mexico’s) have to manage the providers.

How does this prism help to interpret the mixed experience of decentralization? It shows that service delivery is far from a technocratic activity; rather service delivery is embedded in a set of social relationships, embodied in formal and informal institutions, and these relationships are both reflected in and influenced by action at the central and

local level. Where policymakers respond to narrow elites, the design of policy will be biased against poorer groups, and implementation will be responsive to such elites. More broadly, in many Latin American countries, including Mexico, government action has historically been embedded within structures of corporatism and clientelism. The design of government policy and the behavior of service providers have aimed largely to protect the jobs of and the services to members within corporate structures and to provide the discretionary patronage associated with powers of office.

Chapter 4 customizes the 2004 World Development Report (WDR) framework to reflect the multiple levels of government and other players, but even this cannot capture all the important institutional dimensions. For instance, the local governments need to develop and retain competent personnel. There has been a major increase in the number and complexity of federal programs that rely on local governments to deliver, which reflect a need to consolidate federal programs and streamline regulations, so that local government can more readily access them. Also there is a need to create effective linkages among federal programs and between them and the locally run programs.

Mixed Experiences in Decentralization

While enthusiasm for decentralization has been high in many quarters, experiences have been mixed. There have been impressive successes—for example, the oft-cited cases of Porto Alegre, Brazil, and Bogotá, Colombia—but there have also been many cases in which decentralization has entailed poor performance by local government or had no apparent impact.

Decentralization clearly is not itself the solution for service delivery, whether for the poor or for the non-poor. Nevertheless, it may be a desirable and effective instrument of policy. How it works will depend on both its context and design and, in particular, how the relationships described above interact.

III. MEXICO'S HISTORICAL PROCESS OF DECENTRALIZATION

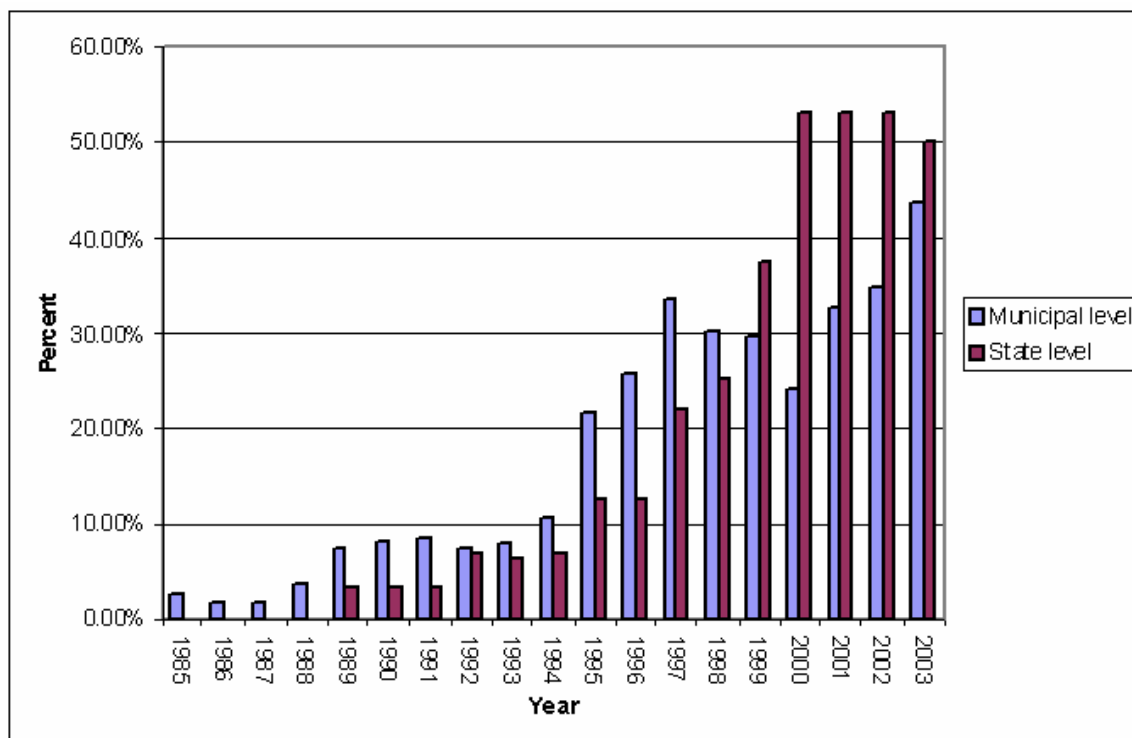
Mexico has a long-standing formal commitment to decentralization, embodied in the 1917 Constitution's explicit endorsement of "free municipalities"—or *municipios libres*—and its federal character. Despite this formal commitment, for much of the 20th century Mexico was highly centralized, both in political and administrative terms. Political centralization was part and parcel of the dominance of the *Partido Revolucionario Institucional* (PRI), which effectively had exclusive power at all levels of government from the end of the 1920s until the early 1980s and held power at the national, federal level until 2000. The PRI was a hierarchical party, tightly allied to a range of vertical, corporatist structures for organizing society, notably among worker groups. Administrative centralization was reflected in the concentration of power in the national executive branch of government—in particular, the presidency—with very limited devolution of tax and spending authority to state and municipal levels.

The PRI's control of all government structures for many decades reinforced this centralizing tendency. An example of this is the PRI's management of subnational offices. While elections were held at state and municipal levels, the PRI managed both the choice of candidates and, to a large degree, the electoral process itself in the beginning of the 1970s. Ironically, the no-reelection rule (three-year terms for mayors and six-year terms for state governors) only served to increase the PRI's hierarchical power. This rule was originally conceived as a democratizing move, but in practice it made politicians dependent on the party rather than their electorates: the PRI managed candidacies and appointments as part of an overall strategy of vertical control.

Just as centralization reflected the intertwining of political and administrative structures, so decentralization of service delivery was a product of two interrelated processes: the gradual transition from an authoritarian to a democratic polity and a series of specific decisions on taxes, sectoral spending, and associated laws and regulations.

Democratization started at the local level, as manifested by real competition between political parties. Whereas the presidency remained in PRI hands until 2000, a sprinkling of municipalities and states were controlled by other parties beginning in the late 1980s. By 1997, more than 30 percent of municipalities and more than 20 percent of states were run by either the *Partido Acción Nacional* (PAN) or the *Partido de la Revolución Democrática* (PRD), and by 2003, these proportions had risen to more than 40 and 50 percent, respectively (see Figure 1.4)

Figure 1.4. Percent of Municipalities and States Governed by Parties Other than the PRI, 1985-2003



Source: Grindle 2005.

The mid-term elections of July 1997 also saw the PRI lose its majority in the lower house of the national Congress. The shift in power from the executive to the legislative branch continued in 2000. This is relevant because regional interests, as well as some important corporate interests (the teachers union and farmers groups), wield significant influence within the Congress.

Administrative decentralization started before the democratization process. For the purposes of this study, the main events were as follows.

The 1978 Fiscal Coordination Law set the legal framework for center-local relations. Its central feature was that states and municipalities would forgo collecting a set of federal taxes, levies, and contributions in return for receiving an agreed share of total revenues. The shares of the *participaciones* are legally owned by the states and municipalities. They are calculated under transparent formulas and passed on to lower levels of government in the federal budget under *Ramo 28*. They constitute the major source of non-earmarked funds for almost all state and municipal governments, accounting for around a third of total revenues at both levels.⁵

⁵ Only Nayarit and the Distrito Federal have comparable levels of own revenues.

Lower levels of government also receive resources from individual federal ministries and agencies under specific *convenios*. These are specific agreements involving the transfer of resources to states for defined uses (at times with a requirement to pass portions on to municipalities). Unlike *participaciones*, they are federal resources and subject to supervision, audit, and sanction by federal authorities. They have the advantages and disadvantages of falling under the discretionary power of federal bodies: this gives them considerable flexibility as a tool for sharing program management and providing incentives for lower levels of government. But they lack the transparency and clarity of formula-driven allocations and provide opportunities for rent seeking and influence peddling, enabling lower levels of government to seek additional revenues from higher levels of government rather than encouraging them to generate funds locally. *Convenios* are used in a variety of areas and are still relevant to many areas of spending today, including all decentralized spending under agriculture, for example, but they constitute only about 3 percent of the federal budget.

Beginning in the early 1990s, there was growing recognition of the inefficiencies of a service delivery system dominated by federal spending. Changes were initially made in a number of sector-specific areas. The three most important (and relevant to this study) were the following:

- The PRONASOL program, introduced in 1989 by President Salinas de Gortari for the delivery of social and economic infrastructure, was a federal program under the Ministry of Social Development that encouraged local participation while largely bypassing local government structures.
- The 1992 *Acuerdo Nacional para la Modernización de la Educación Básica*, signed by the Ministry of Public Education (SEP, *Secretaría de Educación Pública*), the national teachers union, and the state governments, involved the transfer of financial resources for running basic schooling.
- The 1996 *Acuerdo Nacional para la Descentralización de Salud*, signed by the Ministry of Health, the health sector unions, and the state governments, involved the transfer of financial resources for running the government-managed part of the health system.

These programs were incomplete as they responded to partial objectives. And in the case of PRONASOL, there was a significant backlash, owing to its blatant political misuse.⁶ Indeed in 1996, under President Zedillo, a new formula was introduced under which two-thirds of PRONASOL's budget was distributed to lower levels of government. The PRI's loss of dominance in the lower house of Congress in 1997 and rising demands, especially from non-PRI governors, for greater transparency and less

⁶ While statistically it shows up as a tool for support of the PRI (Díaz Cayeros and Silva 2004), Salinas used PRONASOL as a way to build a system of personal loyalties to himself, outside of and counterbalancing traditional PRI structures.

discretion in center-local budgetary relations laid the basis for a more comprehensive change.

The December 1997 reform of the LCF introduced a new instrument: sector-specific transfers to subnational governments, or *aportaciones*, to be passed from the federal budget under a new budgetary code, *Ramo 33*. These transfers are intermediate in character between *participaciones* and *convenios*. Like *participaciones*, they are assigned by predictable rules or even transparent formulas, which provide state and municipal governments with a stable and certain amount of resources. But like *convenios*, they are earmarked for specific sectoral uses, initially under five headings:

- FAEB, which subsumed the 1992 agreement on basic education
- FASSA, which subsumed the 1993 agreement on the government segment of the health system
- FAIS, the successor program to PRONASOL for the provision of local social and economic infrastructure
- *Fondo de Aportaciones Múltiples* (FAM), which subsumed two federal programs for school feeding and school construction
- *Fondo de Aportaciones para la Educación Técnica y de Adultos* (FAETA), which took over federal programs in technical and adult education.

Smaller programs were added later. This report focuses on the first three, which account for the bulk of resources transferred to state and local governments under *Ramo 33* and whose clients mostly are in the poorer deciles of the income distribution.⁷ It assesses the overall design of decentralization for four broad service categories—education, health, local infrastructure, and rural development (outside of *Ramo 33*)—that together involve financing from a variety of sources: *participaciones*, *convenios*, *aportaciones*, and own funding from local resource mobilization.

⁷ The two main categories of transfers to the states are *participaciones* and *aportaciones*. *Participaciones* were originally state and municipality revenues whose collection was delegated to the federal level in the Fiscal Pact for tax efficiency reasons. Most of these transfers are distributed under *Ramo 28*. *Aportaciones* were conceived as federal money earmarked to pay for (formerly) federal commitments and transferred to the states and municipalities together with those commitments (for example, education and health). These funds, formerly under *Ramo 26*, now go out under *Ramo 33*. Since 1998, Congress has been incorporating in the budget the *Programa de Apoyo para el Fortalecimiento de las Entidades Federativas* (PAFEF) without any clear mechanism in the allocation of these resources across states. The initial purpose of PAFEF was to strengthen the education infrastructure in those states in which the state governments were not allocating enough resources. Therefore, these resources were earmarked for education infrastructure if the states did not allocate adequate resources for this; otherwise, they could use it for other type of infrastructure. In 2000, the rules changed so that a state could use it for infrastructure investment or to cover financial imbalances from the pension fund accounts. In 2002, Congress formalized this program, which now will be disbursed under *Ramo 39*, and modified its rules so that states can use these resources for infrastructure and debt relief. The size of the program is relatively small, about 1.5 percent of the *recaudación federal participable*.

IV. COMMON CHALLENGES ACROSS SECTORS

Mexico's decentralization process has been characterized by three features: strong presence of unions in health and especially education, the lack of clear and stable definitions regarding the responsibilities of each level of government in the provision of services, and emphasis on the expenditure side of the federal budget. These three factors have shaped outcomes, both at the macro and microeconomic levels. To move forward, the roles and responsibilities of each level of government will have to be clearly defined. Since the 1997 reforms to the LCF, the federal government has initiated new programs or continued with old ones in areas that clearly should be the responsibility of subnational governments. This generates duplication of administrative costs and sends a confusing signal to citizens as to the level of government responsible for services. It can also generate perverse incentives that induce subnational governments to shirk some of their responsibilities and shift costs to the federal government, while reaping political benefits. The proliferation of programs and duplication of tasks are not the most efficient and effective ways to use resources, hold subnational governments to their responsibilities, and induce them to develop the administrative and technical skills required for these tasks. All levels of government should engage in a collaborative process with clear roles and responsibilities based on their comparative advantage.

In some sectors, ongoing discussions are taking place about the level of decentralization. Further discussion clearly is needed based on the national and international experience of programs. For example, in education should the model be to decentralize at the school level, while strengthening capacity at all levels of government for planning, supervision, and so forth? In rural development the right model may be to decentralize not to the municipality but perhaps to the micro region.

Institutional and administrative fragmentation and duplication of programs have made the decentralization process even harder. For example, in rural development, the lack of coordination of federal programs and policies makes it difficult to undertake planning and allocate resources at the state level. In health, systemic fragmentation and rigid organization of public provision have led to "producer immunity" from emerging accountability instruments. These characteristics add to the cost of the system and constrain the emergence of choice and competition as sources of pressure to perform. They further block professional management of public facilities because the absence of authority limits the facility's director to simple administration.