

Abstract

This paper is part of the research activities of the Program of Budget and Public Expenditure at CIDE, under the auspices of the Ford Foundation. It analyzes the effects of federal transfers on the tax effort of Mexican municipalities. There is some preliminary evidence that the federal aid has produced fiscal substitution among local governments: policymakers prefer to rely on federal funds to finance local initiatives, rather than increasing local taxes. The document presents some estimation models to test that proposition using data from all municipalities of Mexico. Its principal findings tend to support the fiscal substitution hypothesis in the case of the conditional grants created in 1998 to finance basic infrastructure projects. The paper also describes the principal features of the intergovernmental fiscal arrangement created in the Eighties, and shows the strong dependency of local governments with respect federal funds in the last ten years. It attempts to make a contribution to the current debate about reforming the fiscal federalist system in Mexico, by showing how intergovernmental transfers might deteriorate local tax effort. I am grateful to Robert Wilson, Shama Gamkhar and Peter Ward, professors of The University of Texas at Austin, and to Enrique Cabrero and Fausto Hernandez, professors from CIDE, for their valuable comments to an earlier draft of this paper. I also acknowledge Juan Pablo Guerrero for his support for this research.