



# Poverty Alleviation in Federal Systems: The Case of México

FAUSTO HERNANDEZ-TRILLO\*

*Centro de Investigación y Docencia Económicas (CIDE), México DF, Mexico*

**Summary.** — The function of poverty relief has been the subject of debate in terms of the tier of government that should perform it. On the one hand, some of the literature in the economics and political science fields argues that this function should be federal because of factor mobility; on the other hand, because of the distance factor, which makes citizens more sensitive to poverty, others argue that it should be a subnational responsibility. Finally, others in both fields argue that it is more accurate to view the recent trends witnessed in developing countries as delegation of service delivery by the central government to different sets of agents. The fact is that the different levels of government across countries intervene in this government obligation. This paper employs the case of Mexico to test the different implications of the theories. This country is studied because it decentralized this activity in 1998, and thus, it is subject to evaluation. The results suggest that decentralizing the poverty relief function has not delivered results; thus, they suggest that this task should be a national one. However, the reason for this is the lack of political accountability at the subnational level and not mobility. That is, when accountability is introduced, a subnational government may in fact perform well.  
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## 1. INTRODUCTION

Poverty alleviation is one of the functions that many governments perform, but the theoretical literature has not reached a consensus on the question of which tier of government should perform this assignment. Economic theoretical arguments rely on efficiency grounds in that some claim that transfers of this power to lower levels of government yield suboptimal outcomes and that thus, central governments should conduct poverty alleviation efforts (Brown & Oates, 1987; Tiebout, 1956; Wildasin, 1991). On the same efficiency grounds, others argue that this holds only if there is no spatial dimension in the motivation for alleviating poverty; in this case, decentralization is superior (Pauly, 1973). More recently, Gordon and Cullen (2012) find that subnational governments will be actively involved in redistribution regardless of the amount of redistribution undertaken by the central government, which suggests policies to correct for any deviations between the redistributions already performed by the states and the overall amount of redistribution desired, which calls for shared responsibility.

The political science research on the topic suggests that decentralization can re-orient politicians' incentives downward toward local voters and thus increase the level of political competition (see Faguet, 2014). One line of the field's research has concentrated on the so-called welfare magnets (what economists called mobility) and examines how politico-economic structures are shaped in states or localities (see Allard & Danzinger, 2000; Peterson & Rom, 1990; Volden, 2002).

Others depart from that traditional theory and focus on the effects of decentralization on accountability in the service delivery process rather than on mobility (or magnetism) because, in line with the reality of most poor countries, communities have heterogeneous compositions, "with mobility costs high enough to prohibit any movements of people across communities" (Bardhan & Mookherjee, 2005; p. 679). In this sense, the outcome of decentralization will depend in part on the behavior of subnational governments (SNGs) over which the central government may have little control (Ravallion, 1999).

From the empirical point of view, there is a growing body of literature on the economic implications of the transfer of power and resources to SNGs. In particular, some of the literature has studied the impact of fiscal decentralization (FD) on income inequality and poverty alleviation (Neyapti, 2006; Sacchi & Salotti, 2013; Sepulveda & Martínez-Vazquez, 2010; Tselios, Rodríguez-Pose, Pike, Tomaney, & Torrissi, 2011, among others). The results are mixed and depend on a number of factors that include the indicator utilized to measure the degree of FD, the level of economic development, and the institutional strength of the countries included in the work.

In essence, the results of this empirical literature have contributed to the existing literature concerning the relationship between the degree of fiscal decentralization (which does not distinguish which functions of government were decentralized in each country) and income redistribution and/or poverty. Earlier results do not, however, test the implications of the existing theoretical literature, which addresses the question of which tier of government should perform specifically the *function* of poverty alleviation. It seems that there is dissociation between the theoretical and the empirical literature, and the objective of this paper is to help in building this bridge.

In particular, I employ Mexico as a case study because this country partly decentralized the poverty alleviation function more than 15 years ago.<sup>1</sup> Thus, I can test the theoretical implications (traditional and non-traditional) of the literature. I do this by analyzing the phenomenon for this country's municipalities after controlling for other federal poverty programs. The advantage of this type of analysis is that unlike with cross-country datasets, we need no formal definition of

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an FD indicator because we are directly evaluating the performance of the function under study. This is the first time this type of exercise, to my knowledge, has been performed for a developing country, with the exception of Alderman (2002), who studied the decentralization of targeted transfers in Albania.

The results suggest that the decentralization of the poverty relief function has not delivered results, which thus suggests that this task should be a national one. However, when political competition is introduced, the subnational government may, in fact, perform well; and it becomes the factor that matters the most when decentralizing poverty alleviation. This result means that more democratic municipalities may in fact perform well, whereas the undemocratic ones do not impact poverty alleviation, consistent with Giraudy (2013), who modifies Gibson's (2012) subnational undemocratic regimes (SURs).

This outcome is also consistent with the theoretical literature that focuses on the decentralization of service delivery and the role of accountability (Bardhan & Mookherjee, 2005). In the case of Mexico, the evidence suggests that the federal government is more accountable than are SNGs (see Gibson, 2012; Giraudy, 2013). This might be the reason that in this particular country, the federal government is the tier of government that should perform this responsibility, at least in the short run.

The rest of the paper is organized as follows. Section 2 reviews the existing literature, and Section 3 argues why Mexico is an interesting case and briefly reviews the decentralization process in Mexico. Section 4 outlines the empirical strategy and presents and discusses the results. Finally, Section 5 concludes.

## 2. LITERATURE REVIEW

During the past two decades, the world has seen a wave of fiscal decentralization processes that occurred in both developed and developing countries (see Faguet, 2014).<sup>2</sup> The agenda included, among many other features, the shift of some traditional central government functions to lower levels of authorities, which arguably makes public decision making closer to the people. In this shift, which assumed that public decision makers are benevolent maximizers of the social welfare (Weingast, 2009, 2014), more efficient allocation of resources in the public sector was expected to be attained and to yield welfare gains (Oates, 1972, 2008).

All of these reforms, however, have proven to be controversial. Shah (2013, p. 2) argues that decentralization is perceived as a solution to some problems such as a dysfunctional public sector with a lack of voice and exit. Others have noted that it has introduced new costs that undermine the benefits.

On the one hand, fiscal and political decentralization created incentives for opportunistic behavior among state and local officials (Bardhan & Mookherjee, 2005; Galasso & Ravallion, 2005). In particular, Diaz-Cayeros, Magaloni, and Weingast (2003) argue that making federal fiscal transfers to finance local public goods and services—such as water, road maintenance, or schools—depends on whether voters in a locality support these transfers and whether the incumbent local regime can persuade the voters to support them; hence, in the presence of fiscal dependence and opportunism, elections become a means of political control rather than of citizens' expression.

Others have argued that the main cost of decentralization has been the softening of the hard budget constraints

(Rodden, Eskeland, & Litvack, 2003).<sup>3</sup> According to those authors, these constraints entail a multiplicity of sources, including existing fiscal institutions, political systems, and poor functioning of markets, among others.

In turn, Besley and Coate (2003) demonstrate that the centralized or decentralized provision of public goods or services involves a tradeoff between the gains from improved coordination under the centralized regime and a greater sensitivity to local preferences and, ideally, increased accountability under the decentralized regime, depending upon fiscal and political institutions.

Moreover, most of these processes have only included the decentralization of authority over the administration of redistribution programs to local governments,<sup>4</sup> which arguably would enhance accountability in the service delivery process by limiting the problems inherent in the traditional centralized system.

One thing is clear: one must also analyze each government function to determine whether there are sufficient arguments for decentralization. For example, environmental policy is subject to an increasing debate on what should be the arrangement among levels of government, as are poverty alleviation and income redistribution.

In the latter case of poverty alleviation (and redistributive policy), there is still a debate on which tier of government should perform it. Arguments rely on efficiency grounds in that some claim that transfers of this power to lower levels of government yield suboptimal outcomes, and hence, central governments should perform the poverty alleviation work (Brown & Oates, 1987; Tiebout, 1956; Wildasin, 1991).<sup>5</sup>

One of the key elements in favor of centralizing redistributive policies and poverty relief is the inter-jurisdictional mobility of the population and productive factors. That is, localities with strong poverty alleviation policies may induce the immigration of poor people because these people are more responsive to resources that are targeted to the unemployed. In turn, there may be emigration of wealthy residents because middle- and high-income populations respond more to tax differentials. This is thus a source of economic distortions and inefficiencies (Brown & Oates, 1987; Peterson & Rom, 1990; Wildasin, 1991).<sup>6</sup>

On the same efficiency grounds, others argue that the above effects hold only if there is no spatial dimension in the motivation for alleviating poverty; when introduced, the spatial dimension would make a local government more efficient in combating destitution because proximity supposedly makes authorities more sensitive to the problem (Pauly, 1973).

Gordon and Cullen (2012) argue that states do in fact play an active role in redistribution. Based on this fact (that is, shifting from a normative to a positive perspective), these authors find that when states are identical, the role of national governments in equilibrium is confined to correcting for the effects of interstate migration on a state's choice of tax structure.

The political science research on the topic suggests that decentralization can re-orient politicians' incentives downward toward local voters and thus increase the level of political competition (see Faguet, 2014).

This field's research has been based on a similar assumption with respect to poverty alleviation, i.e., that interstate competition exerts downward pressure on the generosity of welfare policies and benefits (Peterson & Rom, 1990). This issue has also considered how political structure and interstate competition shape state policy-making processes (see Plotnick & Winters, 1985). Allard and Danzinger (2000) found more

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