MEXICO

FEDERAL COUNTRY

BASIC SOCIO-ECONOMIC INDICATORS

INCOME GROUP: UPPER MIDDLE INCOME

LOCAL CURRENCY: MEXICAN PESO (MXN)

POPULATION AND GEOGRAPHY

Area: 1 964 380 km^2
Population: 123.518 million inhabitants (2017), an increase of 1.4% per year (2010-2015)
Density: 63 inhabitants / km^2
Urban population: 79.9% of national population
Urban population growth: 1.6% (2017 vs 2016)
Capital city: Mexico City (17.5% of national population)

ECONOMIC DATA

GDP: 2 360.3 billion (current PPP international dollars), i.e. 18 274 dollars per inhabitant (2017)
Real GDP growth: 2.0% (2017 vs 2016)
Unemployment rate: 3.4% (2017)
Foreign direct investment, net inflows (FDI): 32 127 (BoP, current USD millions, 2017)
Gross Fixed Capital Formation (GFCF): 22.3% of GDP (2017)
HDI: 0.774 (high), rank 74 (2017)

MAIN FEATURES OF THE MULTI-LEVEL GOVERNANCE FRAMEWORK

Mexico, officially the "United Mexican States", is a federal presidential representative democratic republic in a multiparty system, composed of 32 federal states. The Political Constitution of the United Mexican States, approved in 1917 and revised several times, defines the federal system.

At the federal level, the head of the executive branch is the President of the Republic, directly elected for a six-year term, who is both head of state and head of government. The bicameral parliament, the Congress of the Union, is composed of an upper chamber, the Senate (*Cámara de Senadores*), and a lower house, the Chamber of Deputies (*Cámara de Diputados*), with 500 members elected for a three-year term. State governments are represented in the Senate. Two senators for each of the 32 states are elected under the principle of relative majority and one senator for each of the 32 states is assigned under the principle of first minority. The 128 Senators serve six-year terms, concurrently with the term of the President of Mexico.

At the state level, the country is divided into 32 states, each of them composed of municipalities. States are defined in the Constitution as being free, sovereign, autonomous and independent from one another. Each state has its own constitution, and can enact its own laws, as long as they do not contradict the national constitution. They also have their own judiciary branch, as well as civil and penal codes. The division of powers in states is similar to that of the national level, but with a unicameral legislature, i.e. the state congress (*Congreso del Estado*) which is composed of deputies, elected by universal suffrage for a three-year mandate. The state governor or gobernadores (except for Mexico City, which has a head of government) is directly elected by universal suffrage for a single six-year term as head of the executive branch.

At the local level, municipal autonomy is recognised by the constitutional reforms of 1983 and 1993. It is now enshrined in Article 115 of the federal Constitution as well as in the constitutions and legislation of each state. In particular, detailed provisions concerning the internal political organisation, municipal powers and responsibilities, inter-municipal cooperation, and local finance are included in Article 115 of the Constitution. These provisions are then detailed by each state constitution to which municipalities belong. Each municipality is headed by a mayor (presidente municipal) elected by direct universal suffrage, with the support of the municipal council (*ayuntamientos*). The municipal council consists of a *cabildo* (chairman) with a síndico and several regidores. Councillors are elected every three years while the mayor's mandate may vary across states.

The elections, which took place on 1 July 2018, were the largest in Mexico's history and the first to be held under the reformed electoral code enacted in 2014. The reform enables elected officials to serve consecutive terms in office for the first time since the establishment of democracy in Mexico. Before this reform a second term was prohibited. Now deputies, senators, state deputies, local council members, and mayors are permitted to run for re-election and serve a second term. The National Electoral Institute coordinated with state governments to align state and local elections with federal elections for the presidency and Congress. More than 3 400 representatives were elected in July 2018, including the governorships of eight states including the head of government for Mexico City and municipal councillors.

Mexico has experienced several phases of federalisation and decentralisation. The country was definitively established as a federal government in 1857, yet the fiscal agreements enacted in the 1920s and 1930s - and the rise of the Institutional Revolutionary Party - steered the country towards a highly-centralised political and fiscal model. Then in the 1980s, a series of reforms put the topic of decentralisation back on the agenda. First, the introduction of the National System of Fiscal Coordination (*Sistema Nacional de Coordinación Fiscal*, SNCF) in 1980 reorganised the whole intergovernmental fiscal system. It was followed by constitutional changes in 1983 that further decentralised functions and resources to subnational governments. In this respect, new responsibilities were further transferred to the states, basic education in 1992 and healthcare in 1996. An important reform of the National System of Fiscal Co-ordination was carried out in 1998 to strengthen fiscal decentralisation. Almost 10 years after, in 2007, a new fiscal reform provided the states with more taxing powers, while the incentives embedded in the formulas for the distribution of federal transfers were simplified and improved. Over the current decade, new important changes were made to the Mexican multi-level governance system. These changes affected the election of governors, state deputies, municipal councillors and mayors, and the legal status of the federal District of Mexico. In 2014-15, the fiscal framework was modified.

Vertical coordination is ensured by the Parliament, in particular through the role of the Senate. However, the Senate has limited power: its consent is not necessary for the approval of federal laws and it cannot veto federal laws. In addition, they do not have the same power over budgetary discussions: revenue is approved by both chambers while expenditure is approved only by the Chamber of Deputies. There are few other vertical coordination mechanisms. The National Institute for Federalism and Municipal Development (INAFED), within the Ministry of Interior (*Secretaría de Gobernación*, SEGOB), aims to coordinate the actions of the three levels of government to design and implement public policies and programmes to strengthen intergovernmental relations, and contribute to the development of states and municipalities. It provides technical advice to local governments, training to local public employees and serves as a source of information on municipal finance. There are also numerous sectoral councils imposed by sectoral laws (health, education, sport, etc.) involving representatives of the federation and states.

Horizontal coordination between the states takes place through the National Conference of Governors (*Conferencia Nacional de Gobernadores*, CONAGO). This forum for governors is responsible for defining a common agenda, fostering dialogue and strengthening the federal pact. At local level, the National Conference of Municipalities of Mexico (*Conferencia Nacional de Municipios de México*, CONAMM) serves as a national forum for dialogue among municipalities and groups the three main municipal associations in the country: the National Association of Mayors (*Asociación Nacional de Alcaldes*, ANAC); the National Federation of Municipalities of Mexico (*Federación Nacional de Municipios de México*, FENAMM); and the Association of Local Authorities of Mexico (*Asociación de Autoridades Locales de México*, AALMAC).

TERRITORIAL ORGANISATION

2017	MUNICIPAL LEVEL	INTERMEDIATE LEVEL	REGIONAL OR STATE LEVEL	TOTAL NUMBER OF SNGS
	2 479 municipalities *(municipios)*		32 states including Mexico City *(estados)*	
	Average municipal size: 5 010 inhabitants			
	2 479		32	2 511

OVERALL DESCRIPTION. Mexico is a federal country that includes 32 federal states, and 2 479 municipalities governed by state legislation.

REGIONAL LEVEL. The upper level of subnational government in Mexico consists of 32 states. Mexico City, previously considered a Federal District, became the 32nd state of the federation in January 2016. Called CDMX, Mexico City has its own constitution, enacted in 2017, and it now has autonomy in terms of its political and administrative structure. The executive power is exercised by the head of government, who is elected by universal suffrage while the legislative branch is in the hands of the Congress of Mexico City.

Mexican states are very diverse. While the average population size is around 3.86 million inhabitants (as of 2017), the least populated state counts 748 000 inhabitants (Colima) and the most populated 17.36 million inhabitants (state of Mexico). After the State of Mexico, three states have between 8 and 9 million inhabitants: Jalisco, Veracruz and Mexico City (now a state). Economic and social disparities are particularly high at the regional level. GDP per capita in Mexico City – the country's second richest region after Campeche (where natural resources significantly contribute to the economy) – was more than five times higher than in Chiapas in 2016. Even when resource-rich regions such as Campeche or Tabasco are excluded, regional economic disparities in Mexico remain larger than in any other OECD country. However, regional disparities as expressed by GDP per capita (regions in the top and bottom 20% on the wealth scale) have slightly decreased in Mexico over the last 16 years.

MUNICIPAL LEVEL. The lower-tier of subnational government in Mexico comprises 2 479 municipalities (*municipios*). Following the transformation of the Federal District of Mexico into an autonomous entity in 2016, the 16 boroughs (*delegaciones*) of the new State became municipalities in July 2018, date of the local elections.

Municipalities vary greatly in terms of size and capacity, in particular in terms of staff capacity. The biggest gap is between rural and urban municipalities (236 of them), with the latter concentrating the largest share of the population. Urbanisation in most states took off during the 1960s and 1970s, yet there remains some states with low levels of urbanisation. The average size of Mexican municipalities is among the largest within the OECD (almost 50 000 inhabitants vs 9 700 on average in the OECD). The median size (12 730 inhabitants) is also large by international comparison. In 2016, only 28% of municipalities have fewer than 5 000 inhabitants (vs 44% in the OECD), while 37% have more than 20 000 inhabitants (vs 30% in the OECD). This situation is, however, quite common in Latin America where municipalities are quite large on average.

However, large municipalities are sub-divided into smaller sub-municipal entities, called urban or rural localities (*localidades*). Although they can have an auxiliary presidency and council (*presidencia auxiliar* and *junta auxiliary*) they are not self-governing entities but depend on the municipality in which they are located. Some municipalities also have an internal administration called boroughs, or delegaciones, whose leaders are appointed by the municipal president.

Municipalities have had the right to enter into inter-municipal associations since 1999. Around one-quarter of municipalities have formalised inter-municipal agreements for the joint supply of public services such as water and sewage, public security and public transport.

There are in total 33 metropolitan areas with more than 500 000 inhabitants in Mexico. They concentrate 56% of the national population (in line with the OECD average of 55%), with an average population growth rate of 2.5% throughout the country, and account for 63% of national GDP. The General Law on Human Settlements (LGAH) has been the main regulation governing the management of metropolitan areas in Mexico since the mid-1970s. It provides the legal basis for the establishment of institutions of inter-municipal and inter-regional co-operation and enables the creation of metropolitan agencies and urban metropolitan commissions for co-operation and co-ordination. Most metropolitan areas in Mexico are covered by metropolitan arrangements. They were created in response to financial incentives from the federal government, which allocates since 2008 special funds for officially-recognised metropolitan areas (with a "Metropolitan Development Council). Disbursed through the Metropolitan Fund, these incentives are used to finance studies, plans, evaluations, programmes, projects, and infrastructure works that prove to be viable and sustainable. However, few metropolitan areas have metropolitan commissions that include the three levels of government and the broader civil society. States can also be involved in the promotion of metropolitan governance arrangements, which is the case for the state of Jalisco with the Guadalajara metropolitan area; the state of Nuevo León with the Monterrey metropolitan area; the state of Hidalgo.

MEXICO

FEDERAL COUNTRY

SUBNATIONAL GOVERNMENT RESPONSIBILITIES

Article 124 of the constitution establishes that: "The powers that are not expressly given by this Constitution to federal functionaries are understood as reserved to the States". The reality is however more complex and powers are defined as follows: powers given to the federation (money, foreign affairs, defence, tax, macroeconomic policy, research and development, control of natural resources, etc.), powers given in an explicit or tacit way, to states, powers prohibited to the federation, powers prohibited both absolutely (art. 117) or relatively (art. 118) to states; coincident powers, coexisting powers, aid powers and finally, powers given by the jurisprudence of the Nation's Supreme Court of Justice. Given this, the federation's remit seems considerably vast. The allocation of responsibilities across levels of government in Mexico is blurry, resulting in overlap between federal and state responsibilities. This poses several multi-level governance challenges.

In particular, states were devolved shared responsibilities with the federal state in several areas, i.e. primary education in 1992 then healthcare in 1996. They also have joint responsibilities with the federal government including poverty alleviation, social protection and water management (since 1983), and in the field of economic affairs. They have a predominant role in spatial planning, the territorial coordination of urban areas, regional transport, municipal affairs, etc.

In the case of municipalities, the Constitution explicitly defines their functions and powers. The Constitution empowers them with responsibilities related to local matters and the delivery of public services such as local roads and transport, urban planning and development, public safety, and utilities (water distribution, waste). Municipalities are jointly responsible, with the federal and state governments, for school buildings and implementation of social programmes; and the Constitution enables them to develop, adopt, and manage zoning and municipal urban development plans. Municipalities can delegate some responsibilities to the state by agreement (water, urbanism, road, tax collection).

MAIN RESPONSIBILITY SECTORS AND SUB-SECTORS

	STATES	MUNICIPAL LEVEL (GENERAL SCHEME)
1. General public services	Supervision of municipal affairs	Construction permits, cadastres
2. Public order and safety	State public order and safety (state and special police)	Local order and safety (municipal police); Emergency fire
3. Economic affairs /transports	Roads (state roads, rural road development, maintenance of federal secondary roads); Regional transport and transit; Some airports; Agriculture, rural development and tourism (shared); Economic affairs and industrial policies (shared)	Local roads and public transport; Municipal transit; Local markets; Slaughterhouses; Local fairs
4. Environmental protection	Protection of environment (shared); National parks (shared); Own state environmental standards	Waste management; Drainage; Waste water; Public Parks and gardens; Protection of environment (shared); Local parks; Local use permits
5. Housing and community amenities	Spatial planning; Water management and co-financing of water infrastructure (shared)	Urban development plans; Water distribution; Street lighting; Cemeteries
6. Health	Healthcare (shared): organisation and operation of healthcare services for the uninsured population; Primary care for the rural and urban poor; Health services; Administration and maintenance of hospitals for primary care; Preventive and reproductive care	
7. Recreation, culture & religion	Culture (public libraries) and recreation	Culture and recreation; Local exhibitions and festivals; Maintenance of monuments
8. Education	Primary and secondary education (shared); State universities; Adult education programmes; Indigenous and special education; School-lunch programmes	School buildings construction and maintenance (shared)
9. Social protection	Poverty alleviation (shared); Social protection (shared) including food assistance for the poor	Implementation of social infrastructure programmes (shared)

SUBNATIONAL, STATE AND LOCAL GOVERNMENT FINANCE

Scope of fiscal data: at the regional level, states, including Mexico City; at the municipal level, municipalities.	SNA 2008	Availability of fiscal data: **Medium**	Quality/reliability of fiscal data : **Medium**

GENERAL INTRODUCTION. Despite its federal structure and the strong decentralisation process, Mexico remains a centralised country in many respects. Large spending areas are delegated and controlled by the federal government, which takes most of the strategic decisions regarding the country's development. Decentralisation at the local level is very limited. Moreover, the subnational financing system is rife with vertical imbalances; states and municipalities are heavily dependent on federal transfers; and subnational debt continues to increase.

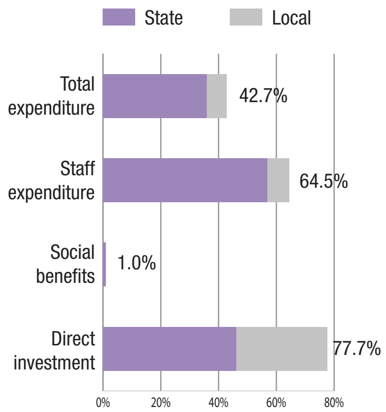
The National Fiscal Coordination System (SNCF), created in 1980, defines and regulates the country's intergovernmental fiscal relations. Under this system, states accept to yield part of their tax powers to the federation, through a Coordination Convention with the federal government. In exchange, they receive a share of federal. The Fiscal Coordination Law (*Ley de Coordinacion Fiscal*) as well as the Laws on General Public Debt and on General Government Accounting set the framework for subnational finance. The 1997 Fiscal Coordination Law determines the distribution of the General Participation Fund among the 32 states and the municipalities, based on several criteria. It was revised in 2007 and 2013 to improve the system and strengthen fiscal decentralisation. In 2014-2015, a new fiscal reform, part of Pacto Por Mexico, aimed to improve the tax system, strengthen the fiscal responsibility framework and overhaul rules for states and municipal debt.

The Fiscal Coordination Law created the National Reunion of Fiscal Civil Servants, which includes the Treasury and Public Credit Secretariat, and the Treasury head of the states' governments. The reunion, ordered by the law, must meet at least once a year to consider how to improve the national fiscal coordination system. The *Centro de Estudios de las Finanzas Públicas* (CEFP), established in 1998, also provide objective, non-partisan, and timely analysis to Congress on public finances, including intergovernmental transfers from the federal budget to states.

SUBNATIONAL GOVERNMENT EXPENDITURE BY ECONOMIC CLASSIFICATION

2015	DOLLARS PPP / INH.			% GDP			% SUBNATIONAL, STATE AND LOCAL GOVERNMENT EXPENDITURE		
	SNG	State	Local	SNG	State	Local	SNG	State	Local
Total expenditure	2 161	1 818	344	12.1%	10.1%	1.9%	100%	100%	100%
Inc. current expenditure	1 820	1 580	240	10.1%	8.8%	1.3%	84.2%	86.9%	70%
Staff expenditure	1 052	926	126	5.9%	5.2%	0.7%	48.7%	51.0%	37%
Intermediate consumption	288	211	77	1.6%	1.2%	0.4%	13.3%	11.6%	22%
Social expenditure	5	4	1	0.0%	0.0%	0.0%	0.2%	0.2%	0%
Subsidies and current transfers	439	407	32	2.4%	2.3%	0.2%	20.3%	22.4%	9%
Financial charges	28	25	3	0.2%	0.1%	0.0%	1.3%	1.4%	1%
Others	8	7	1	0.0%	0.0%	0.0%	0.4%	0.4%	0%
Incl. capital expenditure	342	238	104	1.9%	1.3%	0.6%	15.8%	13.1%	30%
Capital transfers	86	86	0	0.5%	0.5%	0.0%	4.0%	4.7%	0%
Direct investment (or GFCF)	255	151	104	1.4%	0.8%	0.6%	11.8%	8.3%	30%

% GENERAL GOVERNMENT EXPENDITURE (SAME EXPENDITURE CATEGORY)



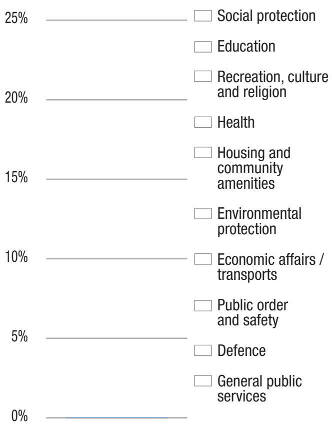
EXPENDITURE. Mexico's subnational governments are responsible for a significant share of public expenditure compared to their limited own-source revenue and low fiscal autonomy. The share of SNGs in total public spending increased sharply from 10% of public spending in 1990 to 50.6% in 2013, and decreased recently to reach 42.7% of public spending in 2015 (below the OECD average for federal countries of 50%). The share of Mexican SNG expenditure in GDP also remains below the OECD average for federal countries (12% vs 19.2%), and municipalities in particular have a quite limited spending role. 83% of SNG expenditures originated from the state governments in 2016, compared to 17% from the municipal level, and the share of municipal expenditure in total public spending is among the lowest of OECD federal countries (6.8%). The largest part of SNG spending is allocated to staff expenditure. SNGs are key public employers at the national level, and are responsible for 65% of public staff expenditure. This is particularly the case for states, which accounted for 57% of total public staff spending while municipalities accounted for less than 8%. Staff expenditure accounted for 51% of total state expenditure, which is high by international comparison (36% in the OECD and 38% of OECD federations).

DIRECT INVESTMENT. Mexican SNGs account for a big share of total public investment, significantly above the OECD average (50.7%), especially above the average of OECD federal countries (62.3% in 2016). In 2016, state governments were responsible for 53% of total SNG investment, against 47% for municipalities. However, direct investment represents a much larger share of local expenditure for municipalities (29.5% of municipal expenditure) than for state governments (6.8% of state expenditure). Yet, remit overlap between the three levels of government undermines the effectiveness of public investment. Investments at the metropolitan and municipal scales are often decided at the state level, and as a result, many local government projects are discarded. Likewise, due to vertical fiscal imbalances, states have contracted significant amounts of subnational debt in recent years to finance public investments and infrastructure. Mexico's National Development Plan 2013-2018 stressed the need to involve all levels of governments in fostering national development. Mexico's subnational investment strategy also needs to take into account the fact that 1) each state has a diverse investment profile, and 2) urban, rural and mixed areas have different infrastructure needs.

SUBNATIONAL GOVERNMENT EXPENDITURE BY FUNCTIONAL CLASSIFICATION – COFOG

	% GDP			% SUBNATIONAL, STATE AND LOCAL GOVERNMENT		
	SNG	State	Local	SNG	State	Local
Total expenditure						
1. General public services						
2. Defence						
3. Security and public order						
4. Economic affairs / transports						
5. Environmental protection						
6. Housing and community amenities						
7. Health						
8. Recreation, culture and religion						
9. Education						
10. Social protection						

SNG EXPENDITURE AS A % GDP



% OF TOTAL SNG EXPENDITURE

MEXICO

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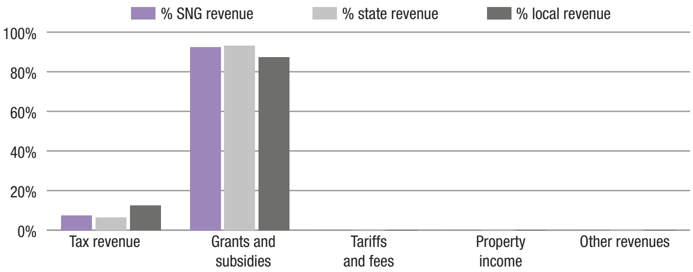
Mexican states carry out the majority of subnational spending (83%) and have responsibility over major areas of spending such as health and education. In these areas, SNGs are in charge of school and health facilities, including teachers. Most of the funds allocated to these sectors come from transfers from the federal government, calculated based on previous budgets, and are primarily earmarked for current and staff expenditure. In the health sector, state governments also contribute to the financing of public hospitals, together with the Mexican government, and allocate 50% of the total resources of the national health insurance programme (*Seguro Popular*, adopted in 2004). These resources are earmarked to salary payments, purchase of pharmaceuticals and outsourcing services. Staff compensation swallows up 90% of states' spending on education. Municipal spending (16% of SNG spending) is much more limited, and concentrated in the provision of local services, local equipment and maintenance of school buildings.

SUBNATIONAL GOVERNMENT REVENUE BY CATEGORY

2015	% GDP			% GENERAL GOVERNMENT (SAME REVENUE CATEGORY)		
	SNG	State	Local	SNG	State	Local
Total revenue	12.4%	10.4%	2.0%	53.6%	45.0%	8.6%
Tax revenue	0.9%	0.7%	0.2%	6.7%	4.9%	1.8%
Grants and subsidies	11.4%	9.7%	1.7%			
Tariffs and fees	0.0%	0.0%	0.0%			
Property income	0.0%	0.0%	0.0%			
Other revenues	0.0%	0.0%	0.0%			

% SUBNATIONAL, STATE AND LOCAL GOVERNMENT REVENUE



OVERALL DESCRIPTION. The System of Fiscal Coordination determines the intergovernmental financing scheme and established the types of own resources that can be levied by state and municipal governments. The resources of SNGs comprise tax revenues, earmarked transfers and matching transfers and other own-source revenues.
Mexican SNGs, both states and municipalities, are mainly funded through grants (92.4% of total SNG revenue in 2015, the highest share among OECD countries), whereas the share of taxes in SNG revenue is the lowest of all OECD federal and unitary countries (except Estonia), leading to strong vertical imbalance. Municipal governments, which receive transfers from both the state and federal levels, are allowed to collect only minor taxes and small fees. The 2013 fiscal reform modified the guidelines on the Transfer Fund for Municipalities (FFM) to encourage municipalities to increase collection of property taxes in a more efficient way. This is to be done in collaboration with states by using economies of scale and the states' existing tax collection capacities.

TAX REVENUE. Mexico has the smallest share of SNG tax in SNG revenue and GDP within the OECD federal countries (8.8% of GDP and 47.5% of SNG revenues on average), and stands well below the OECD overall (respectively 7.1% of GDP and 44.6% of SNG revenues in 2016). It also has the second-lowest share of SNG tax revenue in public tax revenue within OECD federal countries (42.2% in OECD federations), after Austria. Reforms passed in 2007 and 2013 introduced new taxes for the states, transferred the power of the vehicle tax and increased incentives for SNGs to increase tax revenues. States, and later municipalities, were allowed to charge income tax on the payrolls of their administrative staff. However, states and municipalities are reluctant to use their taxation power. State and municipalities are autonomous in setting their own tax rates and bases on the property tax, vehicle tax and payroll tax. Tax sharing arrangements between the federal government and SNGs do not exist.
The major source of tax revenue for states comes from the payroll tax (57% of state tax revenue in 2015, and 3.6% of total state revenue). The tax rate of the payroll tax varies from 1% to 3% in the state of Mexico. It is followed by the tax on motor vehicles (16% of state tax revenue), a share of the property tax (11.5%), and a tax on financial and capital transactions and property purchases (6.7%). Other minor taxes for state governments include a lodging tax, a tax on industrial activities, and a gambling tax. The collection rates vary across states, and can be hampered by high level of informality, low institutional capacity coupled with a small tax base and low rates for taxes and fees. Due to low collection rates, some states have significant room to increase their fiscal revenues.

Municipalities derive the bulk of their tax revenues (63%) from the property tax (impuesto predial), over which they have little control as rates are set by the state congress. On average, the property tax represents 6% of the total revenue of Mexican municipalities. Yet in practice only Mexico City and a few other big municipalities effectively collect the property tax, due to low enforcement in the update of cadastres and urban development plans in other municipalities. The property tax collected by both states and municipalities accounts for only 0.2% of GDP, one of the lowest levels in the OECD and less than the average of 1.1% of GDP in 2016. The Fiscal Federalism law in 2014 introduced an incentive for municipalities that transfer the administration of the property tax to the state government, in the form of access to special transfer funds (for municipalities and for states). Other tax revenues for municipalities include a share of the tax on financial and capital transactions (24.6% of municipal revenue), a public entertainment tax, a lottery tax, and a tax on commercial activities.

GRANTS AND SUBSIDIES. Under the fiscal coordination system, states agree to yield part of their tax powers (on income, consumption, production and services) to the federation in exchange for contributions from the federal funds. As a result, Mexican states and municipalities are heavily dependent on federal transfers, well above the OECD average (37.2% in 2016) and the average for federal countries in the OECD (31.5%).
Therefore, the system of intergovernmental transfers combines revenue sharing (non-earmarked) transfers (*participaciones*), a myriad of earmarked transfers (*aportaciones*), and some matching transfers (*convenios*). Both participaciones and aportaciones account for about 80% of total federal transfers (27% of the federal budget).

A public finance reform bill passed in 2007 ushered in a host of changes in the allocation formulas of transfers. According to the revenue-sharing grant scheme, called the General Participation Scheme (*Fondo General de Participaciones*), 20% of federal tax revenues are to be allocated to the states as unconditional transfers based on different demographic, fiscal and compensatory criteria, which are defined in the Fiscal Coordination Law (branch 28 of the Federal Expenditure Budget). The states are then required to transfer 20% of the Fund to municipalities, to be redistributed according to local criteria with substantial discretion (see below).

The second-largest category of transfers is comprised of the aportaciones (branch 33), including funds earmarked for financing basic education, healthcare services, public safety, adult and vocational education, and transfers. The aportaciones, through the Social Infrastructure Fund, have an 'equalisation' mission. However, these transfers remain, oftentimes, unpredictable and do not directly reach state governments, which may lead to increasing disparities across regions in terms of quality of the health system. Similarly, difficulties in tax collection at the federal level may lead to delays in transfers to state governments and therefore to underspending of resources. Finally, states also receive matching transfers from federal ministries and agencies for co-financed projects.

Overall, most transfers to the states come from earmarked funds (approximately 62% of transfers), which limits their autonomy and the autonomy of municipal governments within their jurisdiction. Finally, non-earmarked (28%) transfers are highly volatile. Regarding the fact that non-earmarked transfers may be subject to variations due to the economic situation at the national level, the *Fondo de Estabilization de Ingresos de las Etidades Federativas* (FEIEF) is also used to mitigate such fluctuations and provide additional revenues to federated entities when grants from the federal governments are reduced in times of fiscal stress.

While poverty and inequality remain high in Mexico by international comparison, in particular at the regional and local levels, there is no explicit equalisation framework unlike other federal countries (except the US). The overall distribution of transfers is not particularly equalising. However, some earmarked funds (e.g. the Social Infrastructure Fund) have an equalisation purpose that seek to improve services in the poorest states and municipalities.

At local level, since 2007, in addition to their share of 20% of FGP, municipalities receive, via the states, an additional share of federal revenue via the Municipal Support Fund *(Fondo de Fomento Municipal)*. This is allocated on the basis of the collection of the municipal residential property tax and water fees. They also receive earmarked and non-earmarked grants from their state. Federal government funding for metropolitan areas is channelled through a Metropolitan Fund (*Fondo Metropolitano*). The resources from the Fund are not earmarked, and are generally spent on investments in transport infrastructure, maintenance and expansion of sewage and parks, etc. For the Fund to be operational, it is required to create a Metropolitan Development Council that receives the funds.

OTHER REVENUES. Other sources of revenue received by Mexican SNGs comprise charges for services such as civil registry, public property registry, certificates, construction licences and permits, and water services fees. Taken together, they generate relatively little revenue for municipalities. Other revenue sources include fines, penalties and donations. Several states are considering the use of congestion charges to increase local revenues for infrastructure projects while dealing with traffic and environmental challenges. They are also considering supporting local governments in increasing revenue from municipal services. Overall, revenues derived from local public services and property income are very limited, and well below OECD averages.

SUBNATIONAL GOVERNMENT FISCAL RULES AND DEBT

	DOLLARS PPP/INH.			% GDP			% GENERAL GOVERNMENT DEBT			% SNG DEBT		
	SNG	State	Local	SNG	State	Local	SNG	State	Local	SNG	State	Local
Total outstanding debt												
Financial debt*												

* Currency and deposits, loans and bonds

FISCAL RULES. The Federal Budget and Fiscal Responsibility Law (FRL), approved in 2013, strengthened Mexico's fiscal rule by building a stronger, structural balance rule by adding a current expenditure cap to the previous fiscal rules. In 2016, the Law on Financial Discipline of the States and Municipalities went further to address the subnational deficit, debt limits and expenditure control. In May 2015, the Mexican Congress passed a series of governance reforms to enhance public sector accountability, integrity and transparency, which led to the creation of the National Anti-Corruption System and the National Transparency System. The reforms also provided a legislative foundation for the National Auditing System (*Sistema Nacional de Fiscalización*, or SNF). The *Auditoria Superior de la Federación* (ASF) was empowered to audit subnational governments in 2012. However, the ASF has low enforcement powers and limited capacity to apply sanctions. The Mexican auditing system for subnational government is complex compared to other countries' "single audit" approach. There are also overlap risks, and the ASF's findings are limited.

DEBT. According to national sources, the debt levels of states and municipalities remain well below the OECD average regarding its share of GDP in 2017 (3% vs 24.5%), but its rapid increase since 2008, and especially since 2013, led to cautious adjustments. The 2016 Law on Financial Discipline of the States and Municipalities made constitutional changes to impose stricter controls of SNG debt, based on revenue and debt levels, and created a system of alerts as well as a single debt registry to monitor SNG debt. Depending on the category assigned to its debt ("sustainable", "under review" or "high"), each SNG's annual debt level is now limited to a percentage of the revenue available to it. Mexican SNGs can only borrow to finance productive investments (the "Golden Rule") and have access to four sources of long-term financing: private commercial banks, the national development bank, loans guaranteed by own-source revenues or based on future transfers, and bonds issued on the Mexican securities market. In the last 15 years (2002-2017), Mexico SNG debt registered a rapid growth (+6.3% per year on average).

Some 75% of SNG debt is composed of credit loans and is distributed heterogeneously among all subnational governments. While all municipalities account for approximately 7% of total subnational debt, 50.5% of the debt is concentrated in five states. State governments account for 85.3% of overall SNG debt.

SNGWOFI
World Observatory on Subnational Government Finance and Investment

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Socio-economic indicators: OECD // World Bank // UNDP // UN Desa // ILO // INEGI.
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