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Is Local Beautiful? Decentralization in Mexico in the Presence of Elite Capture

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Abstract

Based on growing theoretical literature, we present evidence from Mexico regarding the weak effectiveness of federal transfers and low absorption capacity of states and municipalities in poor countries in the presence of corruption and opportunistic behavior. We show that the distribution of conditional transfers is discretionary due to the lack of accountability and deficiency in institutional frameworks, which may be cause for opportunistic behavior by political elites. The results suggest that the distribution of funds based on poverty levels, and intended to provide for the social infrastructure to poor communities, may partly be defined by size of municipality, which in turn may be politically motivated, given that larger populations are politically more profitable during the election process. We present, that in essence, this may be considered elite capture. Additionally, we find that distribution of anti-poverty, community-based development funds (CBDF) do not necessarily reach the poorest populations. We find that within municipalities CBDFs are disbursed to communities with larger populations, regardless the level of coverage for various public services, such as electricity, potable water, drainage, etc.

JEL Classification: H700, H730, O540

Keywords: Decentralization, Conditional Federal Transfers, Elite Capture, Community Development Funds, Social Infrastructure.

Resumen

Este artículo intenta determinar si las transferencias del Fondo de Aportaciones para Infraestructura Social Municipal (FAIS-M) se distribuyen con criterios compensatorios. Para ello el artículo se motiva con la literatura existente acerca de los procesos de descentralización con captura por parte de las élites locales. Ésta argumenta que los beneficios de los procesos de descentralización no se cristalizan si existe facilidad por parte de los grupos de presión locales para influir en la determinación del uso de fondos en su favor —directa o indirectamente—. Los grupos de poder pueden ser privados o públicos (políticos). Los resultados econométricos sugieren que a pesar de que existe redistribución, ésta es débil y que el fondo podría compensar todavía más. Es decir, existe un espacio de discrecionalidad que se encuentra relacionado de manera estadísticamente significativa con la población. En este sentido, la variable población podría ser una proxy de una variable política ya que en la literatura de economía política se ha encontrado que en este contexto ésta se encuentra directamente asociada con los electores. En adición se encuentra que los fondos no se dirigen hacia

las comunidades más pobres al interior de las cabeceras. Esto sugiere que lo "local" no necesariamente es tan hermoso como sugiere una parte de la literatura.

Introduction

Decentralization has been an issue raised in response to top-down regional development. It is viewed as a way to make government more responsive and efficient and thus, foster regional economic development and reduce poverty. The World Bank, for example, has embraced it as one of the major governance reforms on its agenda (World Development Reports 1999 and 2000). For this reason decentralization of the provision of public goods and services through federal transfers, flexible, ear-marked or matching, has been encouraged.

However, there has recently been growing concern regarding the weak effectiveness of federal transfers and the low absorption capacity of states and municipalities in poor countries[1] to foster development, or alleviate poverty (Bardhan and Mookherjee, 2000a; Bardhan and Mookherjee, 2000b; Galasso and Ravaillon 2005; Gaspart and Platteau, 2005). In this sense, theoretical literature has shown that disbursing committed funds to the ex ante designated recipient, irrespective of its performance, is caused by a budget-pressure problems arising from the high cost of not disbursing the money (Svensson, 2003). Furthermore, Gaspart and Platteau (2005) argue that the effectiveness of this money depends highly on the implementation of conditionality.

In turn, the implementation of conditionality may be lax in the presence of corruption and opportunistic behavior. In other words, community organizations or local governments fail when they are captured by elite interests (Bardhan and Mookherjee, 2000a; and Gaspart and Platteau, 2005). These issues do not disappear because expenditure is channeled through local levels. There is no reason to think that patronage is less present at these "lower" levels than at the top levels of government hierarchy. When these problems are present, they may undermine programs of decentralized development.

Bardhan (2005) claims that municipalities may actually be more vulnerable to capture by local elites because local power groups can easily collude beyond the control of higher-level institutions. Hommes (1995) and Shah (1994) document that these types of events occurred in the decentralization processes of Italy and Colombia,[2] and Begoev (1990) provides evidence for the case of Yugoslavia.

Decentralization processes in many countries have been based on transfers from federal to sub-national governments (SNGs). The effectiveness of these transfers has been little evaluated. The objective of this paper is to provide

[1] This literature includes, in addition, cheap aid money in poor countries. (Alesina and Dollar, 2000; and Easterly, Levine and Roodman, 2004, among others).

[2] In southern Italy with the existence of "mafia" groups; and, in Colombia with the "narcotraficante groups".

evidence from Mexico, a developing country which has based its fiscal federalism reform in transfers to SNGs and whose institutional and legal framework is weak. In particular, we focused on one fund known as FAISM (Fondo de Aportaciones para Infraestructura Social Municipal/ Social Infrastructure Municipalities Fund), which allegedly disburses resources based on a poverty-formula. Its objective is to reduce marginality through the construction of a social infrastructure in poor communities. We argue that FAISM has an inherent design problem, which encourages opportunistic behavior, thus reducing the effectiveness of the fund and is not providing a social infrastructure to poor communities. This paper presents empirical evidence that the distribution of these conditional transfers is discretionary due to the lack of accountability and institutional framework deficiency, which may cause opportunistic behavior by political elites. The results suggest that distribution of FAISM (which is supposed to be on the basis of poverty levels) may be partly defined by population, which can be interpreted as politically motivated, given that larger populations are politically more profitable in election times.

Second, we found that distribution of CBDFs do not necessarily reach the poorest populations. In this sense we found that FAISM, within municipalities, is disbursed to communities with larger populations, regardless the level of coverage of various public services such as electricity, potable water, drainage, etc. This further supports evidence that in presence of elite capture, local may not be beautiful.

Hence, this paper supports the theoretical literature that municipalities, in the absence of accountability[3] and an adequate institutional and legal framework, may be more vulnerable to be captured by political elites.

The paper is structured as follows. Section 1 briefly describes Mexican intergovernmental fiscal relations. Next, we examine the legal and institutional aspects of the FAISM, and in section 3 we introduce the empirical study, whereas in section 4 and 5 the empirical model and results are presented and discussed. Section 6 provides some evidence on the ineffectiveness of CBDFs in Mexico and in section 7 we present our conclusions.

[3] Hernández and Torres (2006) show that political accountability is weak in Mexican SNGs.

1.- Mexican Intergovernmental Fiscal Relations: A Brief Description

México is a Federal Republic consisting of three levels of government: the central government; 32 local entities (which include 31 states and the federal district), and 2477 municipalities. As with many Latin-American countries, Mexico is characterized by strong regional and state disparities. While the Federal District, State of México and Nuevo León produce approximately 40 percent of total GDP, Chiapas, Guerrero, Hidalgo and Oaxaca reach only a subtotal of 7 per cent of the total GDP; clearly indicating that the southern region of México is by far in the country, and that income is geographically concentrated, both because of agglomeration economies and infrastructure facilities.

México follows a revenue sharing system where federal government collects main taxes, namely, corporate and personal income taxes, value-added tax, and most excise taxes. These constitute more than 90 percent of the total public sector tax revenue. Twenty per cent of this revenue is redistributed among the states and municipalities through a formula. These net-block transfers are known as *participaciones*. The main deficiency identified of this system has been the lack of tax independence by local governments from the formula itself. These resources are allocated through a formula based mainly on two elements: i) a factor that accounts for tax collection effort and, ii) population.

Recently, efforts of decentralization have been made, particularly since 1996 during the Zedillo Administration (1994-2000). This decentralization, however, did not include the revenue aspect and concentrated only on expenditure (Hernández, 1998).

As in most low-income countries this process of decentralization is primarily about providing centrally collected tax revenue to lower levels of government, rather than about seeking to empower lower levels of government to collect taxes. Hence, Mexican decentralization has focused on public-expenditure assignments, unaccompanied by any significant financial devolution.

These public-expenditure assignments, which are made through transfers, are mostly ear-marked for the provision of public activities such as education, health and public security. As previously noted, FAISM is one of these funds and is to be spent on various forms of social infrastructure, such as potable water works, drainage and sewage, rural electrification, urbanization works, basic education and health infrastructure, and construction of rural roads.

In principle, ear-marked transfers make it possible to introduce bottom-up decision making mechanisms. In México municipalities are structured in such a way that important decisions are made by popular representatives, who conform to so-called "*cabildos*", a type of "local congress" in that they are

popularly elected. Other decisions, especially those regarding public infrastructure, can also be made by community committees known as "Coplademuns",[4] a legal entity of Mexican Law. In this sense, FAISM can be seen as a type of CBDF.

In this sense, FAISM is an effort to place participation and empowerment of the poor squarely on the agenda and in accordance with the World Bank's Comprehensive Development Framework,[5] which encourages CBDF.

As discussed earlier, the success and effectiveness of this type of transfer highly depends on institutional and legal mechanisms and the weak schemes brought about by the risk of elite capture, regardless of the informational advantage local authorities have in the sense that they possess better knowledge regarding prevailing local conditions and the ability to better enforce rules, monitor behavior and verify actions related to interventions.

In the case of Mexico, we argue that provided the weak institutional and legal framework, CBDF programs such as FAISM may be subject to elite capture (Bardhan and Mookherjee, 2000a; Bardhan and Mookherjee, 2000b). Next, we briefly examine the legal and institutional framework and proceed by providing some evidence of the phenomenon.

2.- FAISM as a Community Based Development Fund: Legal and Institutional Framework

FAISM is a federal transfer distributed through a poverty formula to states which in turn are supposed to transfer funds to local governments, according to the same criteria. Once this is done, municipalities decide the destination of this money through CBDF committees, or as previously mentioned "*cabildos*". There is no legal regulation for this process and thus, there exists two significant weaknesses in the process. First, per the Constitution of Mexico, the federal government is not allowed to channel funds directly to municipalities. All transfers must be made through state government. Second, it is not clear whether state governments should, or should not, deliver resources utilizing federal criteria. The Mexican Constitution is clearly states that block transfers are state funds and as such are monitored and supervised by state congress. Likewise, other ear-marked transfers are clearly defined and for example, there is no confusion regarding the distribution of basic and secondary education money. However, in the case of FAISM this is not the case,

FAISM has been subject to these two legal shortcomings. States have claimed that these funds are theirs and hence, only state congress is

[4] Municipal Committees for Planning which involve many sectors of local population such as civil society organizations, neighborhood organizations, NGOs, and so on.
[5] World Development Report 2000: "Attacking Poverty".

accountable for the use of these funds. Thus, they distribute the money to municipalities based on their own state criteria (this is well documented in Guerrero, 1998). So, Federal government distribution of funds only determines the total amount that is given out to a state, despite the fact that a poverty-based formula is used to determine it, and by this definition, federal government and the Federal Congress cannot verify the use and destination of the ear-marked transfer, despite the fact that the Law clearly states that it is federal money and should be held accountable by the Federal Congress.[6]

This debate has had two important consequences. First, FAISM has not been accountable, as it remains undefined what legal entity should perform this function. Secondly, and related to the first point, state governments may distribute the money to municipalities at their own discretion and this does not provide for information regarding the use and destination of the money. Some authors have claimed that this is in the interest of governors and municipal mayors (for example, Díaz, 2004). Langston (2005) shows that under new Mexican political reality, where the PRI no longer rules the Executive Branch, governors have significant control of Congressmen, at both local and federal levels, and this facilitates their use of judgment in assigning cash to municipalities, among other things.

However, it should also be pointed out that state governments argue that their disbursement of FAISM is also based on poverty levels. Unfortunately, because of the lack of accountability and a weak legal framework, many states do not report the distribution exactly. In turn, municipalities do not report the allocation within the locality, nor the destination of the allocation.

In sum, weak legal and institutional design may make local organizations vulnerable to the risk of elite capture. In the next section we argue that although these funds are disbursed in a redistributive manner, some degree of discretion makes this redistribution weak. The interesting question is then establishing what other non-poverty variables determine the reallocation of cash. This is also the objective of the following sections.

3.- Redistribution versus Population: An Empirical Motivation

As noted, states do not report the distribution of FAISM and, in turn, neither do municipalities report the allocation of funds within the locality, not the destination of the funds.[7] For this reason federal government has been forced to seek this information through a National Survey conducted by the National Institute of Geography and Statistics (INEGI). We based our study on the survey known as the Municipal Presidents' National Survey (MPNS). Hernández

[6] For the legal framework review in this topic, see Ortega (2004).

[7] The Ministry of Social Development acknowledges that in 2002 only 17 states (out of 32) and 283 municipalities (out of 2479) reported the allocation and destination of FAISM resources. See SEDESOL (2003).

and Jarillo (2005) briefly describe the Survey and perform statistical testing to verify that this is within an interval of consistency, with respect to other INEGI data sources.[8]

Mentioned earlier in this paper, FAISM's objective is to alleviate poverty through the construction of a social infrastructure. Its distribution is allegedly based on a poverty-formula so that poorer municipalities should receive more funds than richer ones. Simple figures normally confirm that this fund is disbursed in a progressive manner. For example, Figure 1 shows the per capita amount of FAISM, according to poverty level categories received by municipalities. As can be noted, we divide them in five categories of poverty level: very high, high, medium, low and very low; based on this scale, FAISM looks progressive, as poorer units receive more. Figure 2 provides further evidence that in effect the FAISM assigns more per capita cash to poorer entities as "rurality" in Mexico is highly associated with poverty (see Davila *et. al.*, 2002). That is, rural communities receive more than urban ones even within the categories of poverty levels. However, this second figure poses a new question: is the resource allocation redistributive enough? It's difficult to conclude this by just looking at the figures, but there is doubt that it is not. Should we respond with the following question: why and what are the determinants of the allocation? We try to answer that question.

To answer these questions one needs to consider all other federal transfers in the Mexican fiscal federalism system.[9] There are other transfers whose allotment is based on population and on tax collection capacity. Hence, FAISM distribution should not be related (furthermore, in theory it should be negatively correlated) to other transfers. Table 1 presents the correlation between different funds. Surprisingly, correlation between FAISM distribution and the Poverty Index (developed by the Mexican government) is only 0.3266 suggesting a weak fiscal progressivism.

For this reason we perform other correlations that allow us to explain this phenomenon. First, note that the correlation index between the revenue sharing transfer[10] and the FAISM is positive (0.3228), which suggests that allocation may be associated to population, or tax collection efforts. Thus, population may be an important factor in explaining the above correlation. There exists another federal transfer to municipalities that is disbursed and based completely on population, the Municipal Fund (FOFAMUN). Should this be correlated with FAISM, then one may suspect that this factor is present when assigning it. Surprisingly, the figure reaches 0.6572, confirming this possible conjecture. Next, we attempt to clarify it.

[8] This is normally done when different data sources can be used to cross reference information and thus determine the reliability of the Survey.

[9] See Hernández (1998) and Giugalle and Webb (2000) for a detailed description of this system.

[10] Recall from section 2 that these funds are allocated through a formula based on i) a factor that accounts for tax collection effort and, ii) population.

Figure 3 plots the poverty index against per capita FAISM values. For this fund to be redistributive one would expect a positive, 45 degree sloped curve. As demonstrated, the slope is positive but with a value of 0.15, suggesting a weak redistribution. This implies that there are other factors to explain the allocation, apart from level of poverty. The following section uses an econometric analysis to study this phenomenon.

4.- Data and Empirical Methodology

This section presents the empirical methodology. We use the Municipal President National Survey (MPNS), which originated as a result of, among other things, the necessity to gain information about FAISM. The survey is conducted by the National Institute of Geography and Statistics (INEGI, Spanish acronym), and contains information of 2429 municipalities (this does not include approximately 50 Indian municipalities, which are ruled by "uses and customs"). As noted earlier, surveys normally have to be tested for consistency and veracity with other INEGI information.[11] Hernández and Jarillo (2005) present these tests which statistically confirm that this survey is reliable.

It is important to mention that there exists a study that addresses similar problems we have mentioned here. Diaz and Silva **(**2004) also find that there is some discretion in the allocation of FAISM related to the revenue-sharing federal transfers. To explain this and by using dummies, they test the political party of governor versus the municipal president as an explanatory variable. Their result is neither statistically significant, nor robust. In the end, it's not clear what the main factor is in determining FAISM distribution. Furthermore, methodologically there is a problem in their estimations, which may imply spurious correlations. They use simple OLS and omit possible important variables. Because of this, their findings present an endogeneity problem.

Here we correct for the endogeneity problem for omission of variables, and the typical heteroscedasticity present in this kind of exercise. We use instrumental variables and GMM (Generalized Method of Moments) to correct for heteroscedasticity and account for endogeneity as suggested by Baum *et al*. (2002) in these types of problems.[12] Here we only present the specification we propose to address the problem as follows:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon \quad , \qquad (1)$$

where $E(\varepsilon) = 0$ and $C(X_1, \varepsilon) = 0$, $C(X_2, \varepsilon) \neq 0$, $C(X_3, \varepsilon) = 0$; that is, X_1 & X_3 are exogenous and X_2 is endogenous variables. In our case, Y is the FAISM per

[11] INEGI's Municipal Information System (SIMBAD), E-local, and the Mexican/United States President's Office information system.

[12] For a lay out of this empirical methodology see Baum et al. (2002).

capita, X_1 is the poverty index (PI), X_2 is the revenue-sharing transfer per capita (RST), and X_3 is the municipal fund per capita (MF). X_2 is introduced to capture the possible discretion in the allocation of resources. Observe that X_3 cannot be instrumentalized because there is no possibility of discretion in its disbursement as it is based exclusively on population and it is easily verifiable.

As noted, the specification presents an endogeneity problem because one or more independent variables may be correlated with the error term due to the existence of a non-observable variable, which may explain the discretion (the so-called omitted-variable problem). To address this problem we use a set of instrumental variables that might be correlated with explanatory variables, but at the same time is independent of the error term.

We hypothesize that a set of instrumental variables that capture the discretion in fund allotment between states and municipalities are $Z = \{ Z_1, Z_2, Z_3 \}$, such that $C(Z, \varepsilon) = 0$, where Z_1 (*same*) is a dummy in which if the state and municipality belong to the same political party it takes the value of 1 and 0, otherwise. Z_2 is the municipal income index (*iin*), and Z_3 is the inverse of population (*ipop*). Allow the following explanation.

Z_1 is introduced to account for a political variable because in principle it's possible that governors punish non-partisan municipal mayors. Z_2 tries to capture whether wealthy and rich municipalities can influence a governor more in comparison with a poor municipality. Finally, Z_3 is used to capture a large entity, large being defined in terms of population Diaz, Gamboa and Hernández (2002) showed that large population bodies receive better treatment than small ones. In this sense the "too-big-to-fail" concept is in place. In turn, they argue that this hypothesis may be interpreted as a mean to capture more votes. Next, we present the empirical results.

5.- Empirical Results

Please note that we will use two poverty indexes. The first one is the poverty index (PI), estimated by the Mexican Government agency on population policy, the Conapo. This is the one normally used by states to assign resources. Alternatively, the second index we use is the human development index estimated by the UNPD (HDI).[13] The other variables are those in equation (1) above.

First we verify that Z_1, Z_2, Z_3, through simple OLS regressions against FAISM, are uncorrelated statistically with the fund. This allows us to determine that there is no direct effect of the IVs. Then we use those variables as instruments and run the GMM model proposed in equation (1) as

[13] The Development Index is estimated by the United Nations Development Program (UNPD), which is the most accepted index of poverty in Mexico as it considers human capital, income and infrastructure conditions at municipal levels. The higher the index, the more advanced the municipality.

in Baum *et al*. (2002), which in addition solves the typical heteroscedasticity in cross-section regressions. We present the results in Table 2.

First note that statistics for relevancy of instruments (Shea partial R^2) and for checking that the group of instruments is uncorrelated with error term (J statistic) indicate that the IVs are adequate.

The upper segment of Table 2 shows the exercise using the poverty index developed by the Mexican government, whereas the lower part substitutes it for the human development index calculated by UNPD. Remember that he Mexican Law requires FAISM to be distributed solely on the basis of poverty level, so if another element, uncorrelated to this variable, affects the allocation then one may suspect some discretion when doing it. Empirical results suggest that both measures of poverty, the PI and the HDI, have the expected sign and are statistically significant suggesting that they explain the allocation of FAISM. However, two other explanatory variables that are included are also statistically significant, which may indicate that other factors are considered by state governors when distributing the fund.

In section 1 we briefly described other federal transfers which were included in regressions. The revenue sharing transfer (RSF, X_2 in regression) is disbursed based on tax collection efforts and on population (around 50 per cent each component), and the Municipal Fund (MF, X_3 in equation 1) is completely allocated on population basis. Having said this, results suggest that the more MF per capita a municipality receives the more FAISM per capita is allocated to that entity. Likewise, from regression we know that RSF is related to population and in turn, it is positively related to FAISM.

The conclusion of this exercise is that not only is the FAISM distributed through a poverty index but also through using some discretion associated to other federal transfers. This suggests that the allowance is to some extent discretionary.[14] Based on this result we hypothesize that the bigger the municipality, in terms of population, the larger the share of all funds it receives. In turn, as other studies have suggested (Diaz, Gamboa, Hernández, 2002), that within the context of electoral terms, this could be interpreted to demonstrate that population is associated with electoral votes. In other words, FAISM's redistributive power is weak since other elements also explain its provision.

It is also worth mentioning that we ran some other OLS and two-stage OLS regressions on equation 1, which we do not report here. In these we obtained larger coefficients on the two measures of poverty, which suggest that once we eliminate the bias of omitted variables the redistributive effect is smaller because discretion is taken into account. Another point worth mentioning is that when we linearize the coefficient of poverty measures, PI reaches 0.18 and HDI -0.39. They are both far from ± 1, respectively. However this tells us

[14] Note that the Shea Partial R^2 implies that the IVs are relevant, that is, each one is correlated with X_2.

that HDI is a more powerful index when redistributing resources based on poverty level. PI is the one used in Mexico.

These results pose a new question. Once resources are allocated among municipalities, do they distribute FAISM resources based also on population?

6.- FAISM as a Community Development Fund: Is Local Beautiful?

Mexican Law requires that there be some community decision-making on the final use of FAISM resources. As we described earlier in section 1, municipalities are structured in such a way that important decisions are made by "*cabildos*" (*cabildos*), popularly elected community members who form a type of local congress. Other decisions, especially those of public infrastructure, are made by community committees, "coplademuns",[15] a legal entity in Mexican Law. In Table 3 we present the participation in decision making by these two bodies regarding FAISM resources. We calculated these figures out of the MPNS, which explicitly poses that question. Thus, these bodies can be considered as figures in community development, in that decisions are made by members of the locality, and by virtue of this consideration we may in turn consider FAISM as a Community-Based Development Fund (CBDF).

This section investigates whether FAISM is spent based on local necessities, or other elements, such as population, which as laid out in the previous section, may suggest a presence of political elite capture; because of the lack of data, this is a difficult thing to accomplish. However, the MPNS provides some useful elements. For example, we may know if resources were spent within the "municipal *cabecera*," or "out-of- c*abecera*" ("non-*cabacera"*). This is an important variable for our purpose because evidence indicates that within a municipality the "municipal *cabecera*" is the most advanced locality in relation to the rest of the entity. Hence, "non-*cabecera*" is where poverty is deeper (in relation to *cabecera*), social infrastructure is more deficient, and there is more of a dispersion of inhabitants (see Davila *et al.*, 2002). In fact, FAISM was designed to target these communities so that through social infrastructure construction these could be integrated, and thus reduce poverty.

Table 4 presents the distribution of FAISM between the **"**municipal *cabecera,"* (*cabacera*) and the "non-*cabecera*," (non-*cabacera*) according to municipality size (metropolitan, urban, small urban, semirural and rural). As can be seen, weighted average indicates that nearly 60 percent of FAISM expenditure is exercised in the *cabeceras*. This only shows that there may be some evidence that municipalities through community stances of decision

[15] Municipal Committees for Planning involves many sectors from the local population, such as civil society organizations, neighborhood organizations, NGOs, and public officials at the state and municipal levels.

invest more in *cabeceras,* where more population live. This indeed could be explained by arguing that the money goes to projects where social benefit is higher, which is the case of *cabeceras*. However, the target population of FAISM is not reached with this criterion.

Furthermore, one would need to determine whether that expenditure matches coverage to support that argument. That is, if some communities have a high degree of coverage for i.e. electricity, potable water, etc., then financial resources should go where the coverage is low. We investigate this next.

In Table 5 we present the degree of coverage for rural electricity (or electricity in poor localities), potable water, and drainage.[16] Notice that necessities are higher in non-*cabeceras*. Also, in Table 6 we present the destination of FAISM funding in terms of infrastructure type. From here we can also see that the most important infrastructure work is urbanization activity, which includes construction of sport facilities, painting of churches and government buildings, etc). This also suggests that expenditure does not necessarily follow the satisfaction of priority services, but other objectives, as well.

To formally test some of these issues we analyze the determinants of the different FAISM infrastructure investments. Consider the following equation:

$$Y_i = \gamma_0 + \gamma_1 X_{i1} + \gamma_2 X_{i2} + \varepsilon, \quad (2)$$

where

Y_i**:** per capita FISM assigned to public service i.

X_{i1}: is a poverty measure (either PI or HDI), which may indicate if community bodies assign money based on poverty levels.

X_{i2}: percentage of different services coverage in the *cabecera* and non-*cabecera*. This variable allows us to determine whether FAISM is used to reduce poverty and level up the degree of development among different localities.

Table 7 presents the results of equation 2. The regressions were corrected for possible heteroskedasticity, typical of this type of exercise. We selected five public services: potable water, drainage, electricity, urbanization works, and rural roads; as above, poverty measures are PI (developed by Mexican Government), and HDI (the UNPD index). As mentioned, a variable that accounts for coverage in the cabecera and non-cabecera is included as explanatory variable. First, note that poverty measures do not explain FAISM expenditure in the selected public services; furthermore they even present the opposite in some of the regressions. With respect to coverage, notice that coverage within the cabecera presents robustly a positive sign and a statistical

[16] We consider only these three examples because these are the only ones in the National Census, 2000, which matched with the public services allowed by the conditionality of FAISM.

significance, which suggests that FAISM expenditure is strongly biased towards cabeceras, regardless of degree of coverage, and at the expense of non-cabeceras.

In sum, these results support the idea that in the presence of an elite, CBDFs do not necessarily deliver better results, nor make the right decisions. Locality is not necessarily beautiful. In our case, it seems that people living in cabeceras make decisions that favored them at the expense of the rest of the municipality. There is some evidence that cabildos are formed with people close to the mayor (Cabrero, 1998). It is true that more research is needed to further support this preliminary conclusion, but this exercise shows that an explanation is due regarding this lack of consistency when assigning this kind of funding. An investigation regarding this point is on the future agenda of the authors, herein.

Conclusions

This paper has attempted to provide empirical evidence to the growing theoretical literature on the perverse effects of decentralization funds when an elite capture exists (Bardhan and Mookherjee, 2000a; Bardhan and Mookherjee, 2000b). First, the paper provided some empirical evidence demonstrating that the distribution of conditional transfers is discretionary due to lack of accountability and deficiency in the institutional framework, which may cause opportunistic behavior by political elites. The results suggests that distribution of FAISM (which is supposed to be on the basis of poverty) may be partly explained by size of municipality, which in turn may be interpreted as political motive given that larger populations, who live in large municipalities, are politically more profitable in election times. In essence this might also be considered as an elite capture case.

Second, we found that distribution of anti-poverty funds made by Community-Based Development stances do not necessarily reach the poorest population. In this sense we found that FAISM is disbursed towards communities with larger populations within the municipality, regardless of the social infrastructure level of coverage. This further supports the evidence that in the presence of elite capture, local may not be beautiful.

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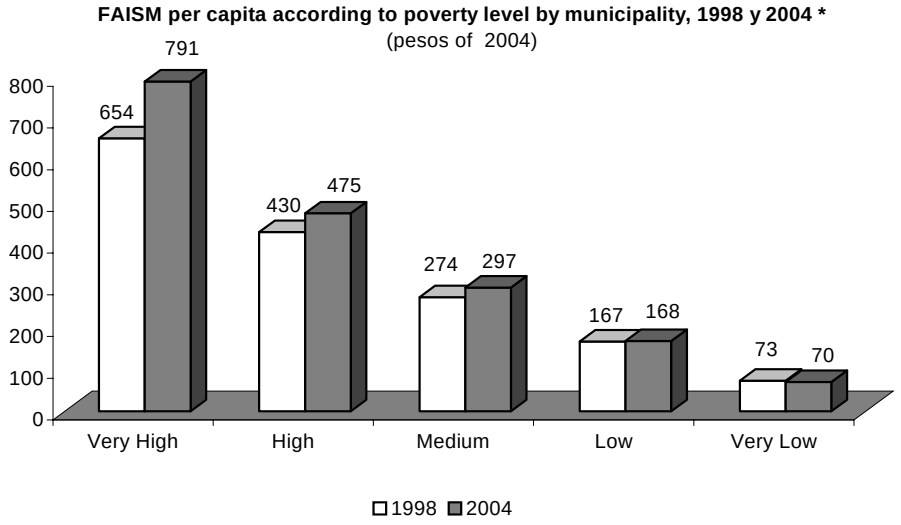
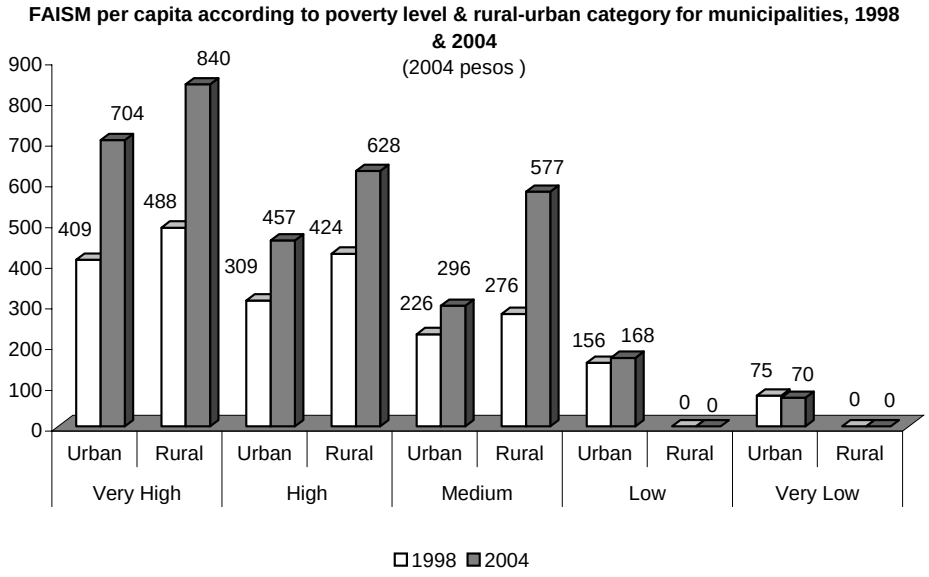
Figure 1



*Excluding Federal District
Source: Conapo y SHCP

Figure 2



* Excluding Federal District
Source: Conapo y SHCP

Figure 3

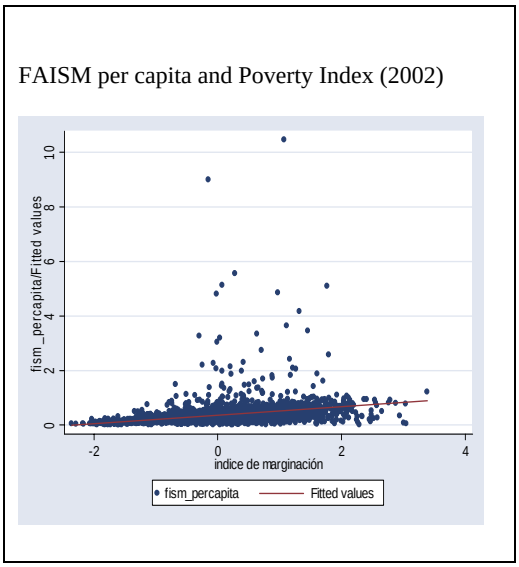


Table 1

Correlation of Federal Transfers

FUND	FAISM (per capita)	Poverty Index	Revenue-Sharing Transfers (pc)	Municipal Fund (FOFAMUN) (pc)
FAISM (per capita)	1			
Poverty Index	0.3266	1		
Revenue-Sharing Transfers (pc)	0.3228	-0.1539	1	
Municipal Fund (FOFAMUN) (pc)	0.6572	0.1357	0.2355	1

Source: Municipal Presidents Surveys, INEGI. 2426 observations

Table 2

GMM & INSTRUMENTAL VARIABLES

Estimation A	**(1)**	**(3)**	**(5)**	**(6)**	**(7)**	**(8)**	**(9)**
	same ipop	iin ipop	same Iin ipop	predial ipop	same ipop	iin ipop	same Iin Ipop
Constant	-1.0263***	-1.1538***	-1.1777***	-.3006***	-.3519***	-.3536***	-.3703***
	0.0600	0.0450	0.04333	0.0625	0.0619	0.0668	0.0642
PI	.6123***	.5711***	.56191***	.5110***	.4939***	.4711***	.47921***
	0.0228	0.021	0.0220	0.0197	0.0193	0.0179	0.0173
RST	.4005***	.2557***	.2258***	.1724***	.1778***	.0880*	.11525**
	0.0640	0.04951	0.0477	0.0498	0.0519	0.0394	0.0375
MF				.5851***	.5572***	.6093***	.5815***
				0.0459	0.0435	0.0454	0.0423
Shea Partial R^2	0.0879	0.1282	0.1475	0.0912	0.0722	0.1119	0.135
Uncentered R^2	0.8046	0.812	0.8116	0.882	0.8766	0.8737	0.8752
J statistic	0.00001	0.0000	0.0000	0.04965	0.12479	0.60759	0.07119

Estimation B	**(1)**	**(3)**	**(5)**	**(6)**	**(7)**	**(8)**	**(9)**
	same ipop	iin ipop	same iin ipop	same ipop	predial ipop	iin ipop	same Iin Ipop
Constant	2.1390***	1.3795***	.96565***	1.7685***	.73128***	1.3572***	1.3071***
	0.38282	0.31467	0.2948	0.2800	0.22143	0.2260	0.2160
Hdi	-3.8621***	-3.3196***	-2.8676***	-2.4444***	-1.0905***	-1.9900***	-1.9249**
	0.4553	0.37686	0.3561	0.36177	0.3057	0.2928	0.2800
RST	.9132***	.43750***	.3262***	.51585***	-0.0040	.2575***	.2402***
	0.1079	0.07149	0.06597152	0.09324	0.0928	0.0573	0.0524
MF				.62297***	.8632***	.7045***	.71209***
				0.0420	0.0436	0.0387	0.0377
Shea Partial R^2	0.0603	0.1045	0.1206	0.0489	0.0994	0.0975	0.1167
Uncentered R^2	0.5113	0.6849	0.7025	0.743	0.8038	0.7967	0.7986
J statistic	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000

Table 3: FAISM Decision Bodies

Decision Made By	**Percentage**
Cabildo	69.2
Coplademun	29.5
Other Participatory Forms	0.7

Source: MPNS, INEGI, 2002

Table 4

Type of Municipality	**No. of Municipalities**	**Criterion: No. of Inhabitants**	**FAISM spent in the cabecera**	**FAISM spent out of cabecera**
Metropolitan	26	>500 000	65.94	34.06
Urban	127	Between 100,000 and 500,000	50.51	49.49
Small Urban	867	Between 15,000 and 100,000	61.85	38.15
Semirural	1025	Between 2,500 and 15,000	51.65	48.35
Rural	382	< 2,500	75.79	24.21

Source: MPNS, INEGI, 2002

Table 5: Coverage for Selected Services

	Potable Water		Drainage		Electricity	
	Within Cabecera	Out-of-Cabecera	Within Cabecera	Out-of-Cabecera	Within Cabecera	Out-of-Cabecera
Metropolitan	89.66	71.29	83.07	53.22	91.61	75.08
Rural	72.86	54.01	33.28	14.75	71.54	53.69
Semirural	76.45	60.9	58.99	31.55	78.65	62.8
Urban	85.03	65.79	78.92	47.61	86.48	68.29
Small Urban	80.87	63.42	72.85	42	83.38	65.93

Source:MPNS,

INEGI, 2002

Table 6: Destiny of FAISM

Public Service	**Percentage**
Urbanization Works	20.4
Potable Water	14.5
Education Infr.	13
Rural and poor localities Electrification	11
Rural Roads	10.5
Drainage	8
Health Infr.	5.5
Housing	3.5
Productive Developments	3.1
Others	5.1

Source: MPNS, INEGI, 2002

Table 7

FAISM Distribution Determinants

Endogenous Variable: FAISM designated to public services

	drinking water			drainage			electrification			urbanization			rural roads		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
Constant	14.84***	14.821***	14.376	15.053***	14.805***	14.842***	15.130***	15.223***	15.005***	15.444***	15.509***	15.165***	15.501**	14.958***	15.205
	0.302	0.141	0.237	0.412	0.143	0.325	0.310	0.155	0.256	0.303	0.102	0.244	0.380	0.122	0.299
HDI	-0.020			-0.399			0.270			0.049			-0.507		
	0417			0.558			0.398			0.407			0.521		
PI		0.043			-0.054			0.098**			-0.111***			0.359***	
		0.013			0.064			0.042						0.055	
iin			0.857*			-0.113			0.540			0.522			-0.094
			0.371			0.503			0.361			0.369			0.466
Coverage in cabezera	0.005***	0.005***	0.004**	0.004*	0.004*	0.005*	0.006**	0.006***	0.005*	0.011***	0.001***	0.010*	0.011***	0.013***	0.011
	0.002	1.002	0.002	0.002	0.002	0.002	0.002	0.002	0.006	0.002	0.002	0.002	0.002	0.002	0.002
Coverage in non-cabezera	-0.001	0.000	-0.002	0.000	0.000	0.000	-0.006***	-0.005***	-0.005*	-0.001	-0.002	-0.001	-0.007***	-0.006***	-0.007
	0.002	0.002	0.002	0.002	0.002	0.002	0.002	0.002	0.001	0.002	0.002	0.002	0.002	0.002	0.002
Adjusted R^2	0.005	0.009	0.011	0.009	0.009	0.009	0.009	0.013	0.010	0.030	0.034	0.032	0.029	0.068	0.028
Breusch –Cook tes	0.801	0.747	0.784	0.801	0.784	0.747	0.889	0.566	0.951	0.367	0.950	0.226	0.037	0.002	0.052
Ramsey RESET test	0.068	0.048	0.032	0.679	0.032	0.041	0.135	0.023	0.284	0.020	0.038	0.007	0.163	0.342	0.137

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