

Micro-Incentives and Municipal Behavior: Political Decentralization and Fiscal Federalism in Argentina and Mexico

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Summary. — This article analyzes the mixed results of political and fiscal decentralization in Latin America by comparing taxing and spending policies in six cities in Argentina and Mexico. Consistent with previous studies, we find that decentralization has been frustrated by overconcentration of power at the provincial level and large vertical fiscal imbalances, though we characterize these as functional elements in a system of redistributive policy-making that benefits a wide array of provincial and municipal actors. We seek to add a new dimension to the literature by arguing that micro-level incentives (conditions and circumstances particular to specific places) are more important determinants of municipal behavior than macro-level structures (those policy and institutional changes intended to make officials more responsive to local conditions – federalism, local elections, intergovernmental transfers, and own-source revenues). We conclude that the theory of decentralization relies on a flawed conception of the causal mechanisms that are hypothesized to create responsiveness in local officials.

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1. INTRODUCTION

Political and fiscal decentralization should have resulted in extraordinary changes in the efficacy of governance in Latin America. The fortuitous coincidence of Hayekian local knowledge, close supervision by voter-consumers, and Tiebout-like interjurisdictional competition, coupled with the efficiency and equity benefits of the proper assignment of functions among the appropriate levels of government, were theorized to break the chains of the failed developmental state. Newly responsive to long-neglected interests, invigorated subnational governments would confine themselves to allocating public goods and apportioning their costs according the benefit principle while chastened central governments would focus on stabilization and redistribution, addressing regional inequalities and limited subnational fiscal capacity with strategically structured transfers (Bird, 1993; Brennan & Buchanan, 1980; Oates, 1972, 1993, 1999; Qian & Weingast, 1997).

The results have failed to live up to the theory. Decentralization has been notably uneven between and within countries, unreliably linked to democratization, subject to reversals, and highly dependent on the “vagaries of local leadership” (Dickovick, 2011; Montero & Samuels, 2004; Tulchin & Selee, 2004, p. 23). Latin American politics are more democratic than in previous centuries but experiments in participatory government in Brazil, Uruguay, Venezuela, and Peru, among other places, have resulted in widely divergent outcomes (Goldfrank, 2011; McNulty, 2011). Notable, though sporadic, successes in service delivery have been difficult to duplicate or sustain as illustrated in Mexico and Brazil (Grindle, 2007; Tandler, 1997). Environmental policies designed to empower and hold accountable local decision-makers and resource users have not resulted in greater efficiency, equity, sustainability, or inclusion (Larsen & Ribot, 2004; Wilder & Romero Lankao, 2006). Subnational governments account for record levels of public expenditure but regional disparities persist and in some cases continue to

widen (Garman, Haggard, & Willis, 2001; Montero, 2000; Montero & Samuels, 2004; Willis, Garman, & Haggard, 1999).

Explanations for this equivocal record vary. Theorists admitted that the guidelines for decentralization were far from determinative and would have to be adapted to local conditions; history, culture, and especially politics would play a role in the application of theory to specific cases (Bahl & Linn, 1994; Oates, 1999). In that process, however, the virtues of the ideal type have succumbed to the peculiarities of particular times and places. Political decentralization, far from representing a genuine effort to disperse power, emerged as top-down strategy to preserve the legitimacy and electoral continuity of established central authorities in crisis (Eaton, 2001; Eaton & Dickovick, 2004; Mizrahi, 2004; Tulchin & Selee, 2004; Willis *et al.*, 1999). Party elites, wielding power from different locations within national, regional, and local electoral structures, have used decentralization selectively to reinforce their influence, resulting in the persistence of cronyism which undermines accountability (Garman *et al.*, 2001; Grindle, 2007; Montero & Samuels, 2004; Willis *et al.*, 1999). Fiscal decentralization, often prompted by central government efforts to off-load burdensome services or to reduce debt, occurred with so many operational caveats and to such a limited degree that subnational officials rarely ended up with the authority necessary to control either local revenues or local spending (Escobar-Lemmon, 2001; Falletti, 2004; Gibson, 2004; Mizrahi, 2004; Smulovitz & Clemente, 2004; Willis *et al.*, 1999). Extreme differences in provincial and local fiscal capacity necessitate redistribution mechanisms that sustain huge vertical fiscal imbalances and encourage rent-seeking in spite of elaborate efforts to design transfer systems with the correct incentives (Gervasoni, 2010; Rodden, 2004). Political, fiscal, and administrative decentralization have unfolded independently of each other, leaving subnational governments with an incomplete toolbox for addressing responsibilities

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formerly in the hands of distant national officials (Falleti, 2010). Jurisdictional boundaries, the products of historical and cultural idiosyncrasies, are not designed for efficient service delivery or revenue collection (Oates, 1999).

In this article, we argue that this mixed record of decentralization in practice is due to flaws in decentralization theory itself.¹ We compare fiscal management in six cities in Argentina and Mexico – two federalist countries with different relationships between national and subnational governments – to illustrate four interrelated points. First, using Hirshman's (1970) "exit" and "voice" framework, we show that neither of the causal mechanisms of decentralization theory correctly describes how decisions are made in the cities and provinces in our study. Second, we argue that these causal mechanisms are not evident in actual practice because decentralization theory is based on the mistaken notion that allocation is the proper role of subnational governments whereas a review of what provincial and municipal officials actually do suggests that redistribution is their preferred activity. Third, rather than conforming to decentralization theory, the redistributive efforts of subnational officials are driven by what we call micro-incentives: idiosyncratic conditions and circumstances particular to specific places that create opportunities for redistributive policies both to advance personal careers and to serve client groups. In other words, micro-incentives are more important determinants of subnational behavior than those macro-level policy and institutional structures – federalism, local elections, intergovernmental transfers, and own-source revenues – intended to make officials more responsive to local conditions. Fourth, we speculate that two key features typically described as emblematic of the incompleteness of decentralization – the overconcentration of power at the provincial level and the persistence of vertical fiscal imbalances – play an integral role in the redistributive practices of subnational officials and thus should be interpreted not as evidence of a "stalled" process of decentralization but as quite functional elements of an expanded system of resource redistribution.

The article is divided into eight sections. Following this introduction, we summarize the causal logic of decentralization theory. The third part of the essay reviews existing literature on Argentina and Mexico with an emphasis on the presumed incompleteness of decentralization. In the fourth section, we present our rationale for using a case study approach as a preface to our description of taxing and spending practices in Santa Fe, Argentina, and Guanajuato, Mexico, in the fifth and sixth sections of the article, respectively. The seventh section reassesses the role of "exit" and "voice" in decentralized governance in light of our case material. We conclude with a discussion of the implications of our study for understanding the central role of redistributive activities in the partially decentralized state in Latin America.

2. "EXIT AND "VOICE" IN THE THEORY OF DECENTRALIZATION

Although theories of democratic decentralization and fiscal federalism rely on different motivational mechanisms, they proceed from a similar behavioral premise: a firm conviction in the power of macro-level institutional structures to create incentives in the form of "exit" and "voice" that shape the actions of subnational officials (Bird, 1993; Hirshman, 1970; Oates, 1993).² In short, decentralization produces responsiveness. The three major schools of thought supporting decentralization – the electoral model, the market model, and the fiscal efficiency model – are thus united by what might be called the

median public official theorem: both elected and appointed officials become more responsive to the demands of voter-consumers as the distance between them decreases because proximity increases the potency of sanctions.³ According to this theory of causation, public officials in a decentralized system must respond or lose their jobs; to keep their jobs, therefore, they become more responsive to local tastes and preferences and thus more accountable to local taxpayers.⁴ Bolstering each theory are arguments regarding the deficiency of the alternative to decentralization: a historical record of failure by the centralized state which undermines whatever theoretical benefits might be claimed by its advocates and which vitiates whatever dangers (corruption at the local level, for example) might be associated with decentralization (Prud'homme, 1995). Taken together, these approaches offer a collection of clear behavioral expectations about the effect of macro-level structures on local officials which, as our case studies will show, are not matched by the actual practice of subnational governance.

The electoral model of decentralization proceeds from the notion that competition at the ballot box prompts public officials to be as responsive as possible to voters. Unlike national elections, where central authorities might form winning coalitions even if they ignore or alienate local constituencies, local elections force politicians to placate a large segment of the local population which can effectively sanction politicians for their lack of responsiveness by voting against them (Faguet, 2014). Even where a history of undemocratic political culture or the persistence of authoritarian practices results in weak electoral competition, citizens can use other methods to pressure local officials, from popular protest and lobbying to petitions and grass-roots organizing (Cleary, 2007). Voters "throw the rascals out" or line up at their door; in every instance, public officials are compelled to act in accordance with local demands (Bird, 1993).

Advocates of the market model have little faith in the electoral system or in the inclination of public officials, left to their own devices, to distribute public goods and apportion their costs appropriately. In the market model, "voice" (political expression, whether voting or petitioning) is replaced by "exit." "The act of moving or failing to move is crucial," according to Tiebout (1956), since that "replaces the usual market test of willingness to buy a good" (p. 420). Although the shorthand for Tiebout's argument describes citizens as "voting with their feet," it would be more accurate to say that the political act of voting is replaced by the non-political act of moving, thus depoliticizing public service provision by transforming it into a market. In this spirit, public choice theorists are even more explicit in their attempt to replace politics by the market and "voice" by "exit." "The principle of federalism emerges directly from the market analogy," Buchanan insists (1995, p. 21). "To the extent that allocative and distributive choices can be relegated to the workings of markets, the necessity for any politicization of such choices is eliminated" (pp. 19–20). Public officials only become responsive in this scenario because voters (now recast as consumers) can abandon their jurisdictions; consumers exercise their "exit option" and thus force competition among public-sector actors just as occurs in the private market. Under the market model, then, consumers choose among competing territorially based packages of public services and taxes. That competition for consumer-voters goads public officials to responsiveness.

The efficiency argument for fiscal decentralization proceeds from more specifically normative premises while borrowing both sanction-by-"voice" and sanction-by-"exit" motivations. As developed by Musgrave (1959) and Oates (1972, 1999), fis-

cal federalism claims that the three objectives of fiscal policy – stabilization, redistribution, and allocation – can be handled most efficiently by their proper assignment to national and subnational governments along the geographical dimensions of the public services consumed: stabilization is the sole domain of national governments (assuming they can prevent local governments from borrowing beyond their means); because taxpayers are mobile, redistribution is also properly left to national governments whose reach cannot be avoided by exiting a local jurisdiction; local governments should focus exclusively on allocation of public goods by efficiently providing the correct services to taxpayers whose voices determine what services are offered. The responsiveness of local officials occurs within a fiscal federalist framework because they possess an understanding of local conditions unavailable to national officials. This sensitivity to local tastes and preferences causes local officials to deliver just those services voter-consumers want at precisely the cost taxpayers-users are willing and able to underwrite. The threat of interjurisdictional mobility further encourages local officials to favor user fees or property taxes so that the costs of services are apportioned as closely as possible to direct beneficiaries and the likelihood of free riders minimized.

The electoral, market, and fiscal efficiency models all draw on the notion, most prominently argued by Hayek (1945), that proximity yields the familiarity necessary to be appropriately responsive. As Hayek put it, “knowledge of particular circumstances of time and place” (pp. 521, 522) and “knowledge of people, of local conditions, of special circumstances” (p. 522) are essential to allocating resources efficiently. “Because they are closer to citizens,” notes Escobar-Lemmon (2001, p. 25) referencing Hayek, “local governments are able to better know their citizen’s preferences” (see also Hatfield & Kosec, 2013). Knowing those preferences thus allows officials, whether motivated by the threat of “voice” or “exit,” to give consumer-voters precisely what they want at the exact price they are willing to pay.

As if this were not enough to persuade the skeptical, the practical failures of the centralized state make the alternative to decentralization unpalatable. Centralized governments either fail to respond to local needs at all (engaging instead in military spending or building palaces for national elites rather than roads and schools preferred by citizens) or they are inappropriately responsive (by forcing one-size-fits-all policies on local populations). Plagued by information asymmetries or unconcerned about local demands, distant central governments can afford to be unresponsive because they face little competition (citizens cannot easily move from one country to another in search of better packages of taxes and services). Whatever benefits may be associated with centralization – achieving economies of scale, absorbing high fixed costs, overcoming interstate externalities, capitalizing on spillovers, reducing tax avoidance through geographical mobility, or facilitating redistribution (Prud’homme, 1995) – are relatively inconsequential or can easily be addressed with intergovernmental transfers.

We can see, therefore, that the virtues of decentralization are theoretically over-determined, so to speak. Whether voter-consumers are mobile or stay in one place, whether elected leaders are inclined to consider local preferences or disinclined, decentralized political and fiscal structures force the median public official to respond efficiently, while centralized governments are incapable of acquiring the local knowledge necessary to meet the real needs of consumer-voters. What we should see at the subnational level, therefore, are public officials moved to action by sanctions from “voice” and “exit” using their greater familiarity with local conditions and

preferences to craft more appropriate public policies. By carefully deploying their own resources on allocative policies and then relying on limited transfers from the national government to overcome their fiscal limitations, those officials should use the freedom to maneuver provided by decentralization and federalism to “help improve the enactment and execution of government policy” (McLure, 1995). Decentralized authority and interjurisdictional competition, in sum, create incentives which, combined with unique access to knowledge of local circumstances, prompt efficient responses by officials on the frontlines of service provision: a compelling vision, indeed.

3. MACRO-INCENTIVES IN ARGENTINA AND MEXICO: A REVIEW

In the preceding section, we attempted to show just how persuasive decentralization theory can be: promising widespread benefits at all levels of government, especially in terms of efficiency and responsiveness. However, as we noted in the introduction, decentralization has produced mixed results in Latin America in spite of its transformative potential. In this section, we briefly review two characteristics of the incomplete process of decentralization – the overconcentration of power at the provincial level and the persistence of vertical fiscal imbalances – that are now well-established in the literature (Rodden, 2004). Our main purpose in reiterating them here is two-fold. First, we want to confirm that commonly cited macro-level differences between the two countries – subnational elections and party competition; subnational expenditures and local fiscal autonomy – are less pronounced than it would appear; as a result, the apparent macro-level differences between decentralized Argentina and centralized Mexico that should show up as large variations in responsiveness, governmental performance, and municipal behavior have not appeared in practice. Second, we want to set the stage for an argument central to our case studies: these factors which appear to represent evidence of an incomplete process of decentralization (which would, presumably, generate greater benefits once the process is completed) are in fact quite useful to a variety of actors in the policy process. When viewed from the perspective of subnational actors who focus on redistribution as a preferred governmental activity, concentration of power at the provincial level and large vertical fiscal imbalances can be very beneficial.

Mexican politics are notoriously centralized thanks to the nearly century-long domination of the Partido Revolucionario Institucional (PRI). Mexico’s federal system is comprised of a Federal District and 31 states with nearly 2,500 municipalities. Although the constitution of 1917 established direct popular election of state governors and legislators (as well as municipal presidents and councils), concentration of power in the hands of the PRI insured that presidents chose (or had a hand in choosing) governors who in turn controlled municipal presidents and councils; during 1929–89, there were no governors from opposition parties elected in Mexico. In 1989, however, the Partido Acción Nacional (PAN) won the governorship of Baja California, initiating a groundswell of opposition victories that culminated in the election of PAN candidate Vicente Fox as president in 2000. This electoral change complimented a series of earlier neoliberal measures undertaken by the national government, including efforts by PRI presidents Carlos Salinas de Gortari and Ernesto Zedillo to decentralize social spending (with programs known as *Pronasol* and *Progresas*), to open markets (most notably by embracing the North American Free Trade Agreement in 1992), and

to clamp down on leftist Zapatista protests in Oaxaca (Díaz-Cayeros & Magaloni, 2001; Ward & Rodríguez, 1995), to name just a few. PAN's success in congress facilitated a significant decentralization of resources to governors, although this has not reliably translated into further devolution of authority to municipalities or dramatic policy changes (Camp, 2014; Díaz-Cayeros, 2006; Hernández Trillo & Jarillo-Rabling, 2008), thus facilitating the resurgence of the PRI, which regained the presidency in 2012.

By contrast, it is commonplace to describe Argentina as one of the most decentralized states in Latin America (and the world) because so much political and policymaking power is held by provincial governors. For most of the twentieth century (and especially since the return of democracy in 1983), Argentine politics have been characterized by a constant struggle between a strong president and strong provincial governors with limited interference from a weak national legislature (Eaton, 2001; Falleti, 2004). Argentina's 23 provincial governors possess wide-ranging authority over electoral rules, candidate selection, and political careers, spending on education, health, housing, social security, and public works, and the administration of national social welfare policies and fiscal transfers. According to Ardanaz, Leiras, and Tommasi (2014, p. 27), "Almost every single important policy issue at the national level in the last two decades has been decided by the President and his/her ministers (or operators) with provincial governors who subsequently instruct national legislators from their provinces to go along."

At least at the national level, therefore, Argentine politics appear to be, and are routinely characterized as, far more decentralized than Mexican politics. However, it would be a mistake to conclude that these differences constitute a degree of decentralization that results in the benefits envisioned in theory. Once we shift the focus to the relationship between provincial and municipal governments, both countries look far more similar. In Argentina, overconcentration of power in the hands of governors undermines, rather than increases, democracy and accountability. Gradual changes in provincial law now allow indefinite reelection of governors who use patronage to build political machines and effectively establish one-party rule, resulting in subnational politics characterized by "executive dominance, limited political competition, and clientelistic political linkages" (Ardanaz *et al.*, 2014, p. 30). In Mexico, national electoral competition and the resulting independence of the national legislature have simultaneously increased the influence of governors whose power over municipalities is extensive, but term limits at every level of government mean that elected officials seek to build their careers by moving upward, thus requiring them to appeal to party officials who control crucial resources. Interestingly, it has been argued that both Mexican (Camp, 2014, p. 211) and Argentine (Ardanaz *et al.*, 2014, p. 31) governors operate with "feudal" authority, suggesting that while decentralization may accurately describe a power shift away from national governments, it is misleading when applied to municipal governments.

A comparison of fiscal decentralization leads to similar conclusions. Subnational revenue collection and expenditure are the standard macro-characteristics associated with fiscal decentralization (Buser, 2011; Davoodi & Zou, 1998; De Mello, 2000; Iimi, 2005; Joumard & Kongsrud, 2003; Martínez-Vázquez & McNab, 2003; Oates, 1972, 1985; Rodden, 2004; Thiessen, 2003). Measured by these indicators, Argentina appears to be far more decentralized than Mexico. During 1990–2011, subnational governments in Argentina on average collected 49% of total government revenues compared

to only 5.5% in Mexico. Estimates of subnational spending in Argentina are typically cited at almost 50% whereas in Mexico the figure is just over 20% (Ter-Minassian, 1997; Tommasi, Saiegh, & Sanguinetti, 2001). Rodden (2004), using the narrower category of total own-source revenue (revenue collected locally via taxes and fees), nonetheless concluded that subnational spending in Argentina (18%) was twice that of Mexico (9%).

However, there are ample reasons to question what benefits can really be expected of revenue and expenditure decentralization as it has unfolded in practice, especially in Argentina. In spite of the standard claim that it has a highly decentralized system, the list of caveats applying to Argentine fiscal institutions is long and distressing. Argentina's "fiscal labyrinth" is famously inefficient and malleable, largely because division of fiscal resources is the central battle between the president and provincial governors. The result, according to Tommasi *et al.* (2001, p. 157), is that "The country's tax allocation and spending authorities and its system of intergovernmental transfers do not correspond to any economic criteria, and they provide all sorts of perverse incentives and obstacles for sound economic policy" (see also Saiegh & Tommasi, 1999). Both countries have ceded revenue collection to the national government, creating enormous vertical fiscal imbalances. In Argentina in 2009, an average of 79% of provincial revenues came from the national government (Tommasi *et al.*, 2001). So profoundly does this distort fiscal relationships that Gervasoni (2010) even suggests that the combination of huge fiscal imbalances, national legislative malapportionment, and automatic, unconditional federal transfers has transformed Argentine provinces into rentier states unified by a shared bargaining process.

Mexico's states and municipal governments also rely heavily on intergovernmental transfers for their budgets thanks to legal arrangements which discourage local tax collection and create large vertical fiscal imbalances. The 1997 National Fiscal Coordination Law centralized most taxing powers in the national government which then redistributed revenues to states (and a small share to municipalities) through earmarked and un-earmarked transfers. States were made responsible for financing municipalities through the redistribution of a set share of their un-earmarked federal transfers with each state using its own criteria to determine municipal distributions. During 2001–10, for example, 85% of total state revenues came from federal transfers, 7% from total own sources, 2% from unfunded deficits, and the remaining 6% from "other" sources; 69% of municipal revenues came from federal and state transfers, 22% from total own source revenues, 6% from debt obligations, and the remaining 3% from "other" sources.⁵ This subnational reliance on federal transfers has led states and municipalities to avoid collecting taxes in spite of the fact that they do have the authority. Although Mexico uses a formula-based approach for its transfers, the resulting system of revenue collection and allocation creates the same inefficiencies and negative incentives as Argentina's "fiscal labyrinth" (Hernández Trillo & Jarillo-Rabling, 2008; Sour, 2008).

What, then, does the literature tell us about the macro-context in which Argentine and Mexican municipalities operate? We are inclined to agree with Blöchliger and King (2007) that, with respect to their degree of decentralization, both governments have "less than you thought." Fiscal decentralization to provincial levels has not resulted in a dramatic shift of power away from the national government, for the revenue game is still played very much at the national level: resources in Mexico and Argentina come from above. Revenue collec-

tion in both countries is a national responsibility separated from service delivery, which is often subcontracted to provincial governments. Taxing is thus a political act that does not resemble market pricing in the least. Finally, decentralization of resources and authority to the provincial level does not automatically extend to large urban areas or cities, which means that decentralization stops at the provinces.⁶

Even though it may still be appropriate to conclude that Argentina is more decentralized than Mexico, the macro-context of decentralization in both countries does not suggest that the theoretical benefits of the institutional changes have in fact been manifested in radically different policy environments. As we will argue in the case studies below, the incompleteness of decentralization (concentration of power at the provincial level and large vertical fiscal imbalances) creates many benefits for subnational officials – benefits that would largely disappear if decentralization were pushed further, which means that provincial and municipal actors have a substantial stake in the system as it is currently configured. Even though this incompleteness is due to other historical factors, in other words, it is now held in place by a multitude of interested parties who use it as a source of opportunity.

4. METHODOLOGY: A CASE STUDY APPROACH

As detailed in section two above, decentralization theory specifies both causal effects (responsiveness; efficiency) and causal mechanisms (“exit” and “voice”). The incompleteness of decentralization described in section three (that is, the failure to realize all the purported beneficial effects of the devolution of national government power) suggests that the causal mechanisms at the heart of the theory may also be flawed. To test the causal mechanisms of the decentralization-produces-responsiveness hypothesis, we chose a case study approach. As [Gerring \(2007, pp. 101, 102, 103\)](#) argues, “case studies are often useful for the purpose of elucidating causal mechanisms... It is now well established that casual arguments depend not only on measuring causal effects, but also on the identification of a causal mechanism... Case studies, if well constructed, may allow one to peer into the box of causality to locate the intermediate factors lying between some structural cause and its purported effect.” [Gerring \(2007, pp. 103, 105\)](#) further notes that understanding causality benefits from the fine-grained approach characteristic of the case study: “When studying decisional behavior case study research may offer insight into the intentions, the reasoning capabilities, and the information-processing procedures of the actors involved in a given setting... Tracing causal mechanisms is about cultivating sensitivity to a local context.” By taking a case study approach, we are thus following [Snyder’s \(2001\)](#) advice to scale down the analysis of public policies to the subnational level where we can understand in more detail how local government officials go about collecting and spending revenues and thus test whether the “putative causal mechanisms” ([Gerring, 2007, p. 104](#)) of decentralization theory (“exit” and “voice”) operate as the theory suggests.

Our cases are comprised of six cities – three in the state of Guanajuato, Mexico, and three in the province of Santa Fe, Argentina – to capture a range of leadership styles, political ideologies, and legal frameworks commonplace in Latin America ([Figure 1](#)). Within each subnational government, we chose an industrialized city, a state capital, and a small-to mid-size town to approximate the diversity of urban life subsumed in larger sample studies. The cities were selected because they exhibit different degrees of fiscal autonomy, with total own-source revenues (TOSR) ranging from 100% to less than 25% ([Figure 2](#)); TOSR includes locally collected taxes and fees, which is an indication of how fiscally independent cities are from superior levels of government. Fiscal autonomy also varies widely with respect to both budget composition and legal authority, as is common in Latin America.

To understand how local officials approached revenue collection and public spending, we first completed a cross-sectional analysis of budgetary, legal, and policy data sources with an emphasis on the years from 1990 to 2010. We conducted over 100 on-site interviews with mayors, budget experts, economic development representatives, and other public authorities and private-sector actors, in addition to provincial and national government officials involved in municipal affairs. In those interviews, we focused on how public officials made decisions regarding what taxes to collect and how to spend the revenues at their disposal and how they interacted with higher levels of government politically and fiscally.

In the process of testing theories regarding the role of “exit” and “voice” as causal mechanisms for municipal fiscal behavior, our interviews turned up other factors that influence local decision-makers even more than the macro-incentives associated with decentralization. Therefore, the case studies that follow also contain an exploratory component as we elucidate the role of micro-incentives in provincial and municipal public policies. By comparing the role of politics, ideology, geography, history, leadership, and institutional capacity in each of our cases, we show that local and provincial officials seek to advance their careers by adding free riders, by avoiding fee-for-service approaches to taxation, and by politicizing service delivery – an approach quite at odds with the image of efficient allocation of resources as the primary role of local government in a decentralized system. Taken together, the six cities create a portrait of decentralized government that is bewilderingly heterogeneous, with local officials responding to idiosyncratic local conditions not contemplated by decentralization theory. This diversity should not be read as a fulfillment of the prediction that in a decentralized system interjurisdictional competition will produce different packages of taxes and services. Instead, what emerges is a picture of municipal officials engaged in the same desperate search for revenues from any and all sources whose choices are shaped by factors peculiar to each city and province. Rather than focusing on efficiency strategies suggested by theory, these officials engage in techniques similar to those mentioned by [Krane, Ebdon, and Bartle \(2004, p. 519\)](#): “(a) transfer the costs upward, (b) export the costs, (c) seek revenues from superior levels of government, or (d) adopt (or seek permission to adopt) less visible sources

Case Selection			
Province, Country	Large Industrial Cities	State Capitals	Mid-size towns
Santa Fe, Argentina	Rosario	Santa Fe	Rafaela
Guanajuato, Mexico	León	Guanajuato	San Miguel de Allende

Figure 1. Case selection.

Revenue composition	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Rosario Total										
Transfers	0	1	0	1	1	2	3	2	5	2
Total Own Source Revenues (TOSR)	100	99	100	99	99	98	97	98	95	98
Rafaela Total										
Transfers	36	33	30	32	33	32	32	31	27	29
TOSR	64	67	70	68	67	68	68	69	73	71
Santa Fe Total										
Transfers	46	n/a	n/a	50	n/a	0	19	12	5	11
TOSR	54	n/a	n/a	50	n/a	100	81	88	95	89
León Total										
Transfers	26	65	60	49	50	59	68	50	65	71
TOSR	74	35	40	51	50	41	32	50	35	29
San Miguel de Allende Total										
Transfers	61	59	63	51	77	39	53	49	70	75
TOSR	39	41	37	49	23	61	47	51	30	25
Guanajuato Capital Total										
Transfers	36	38	7	6	7	6	5	4	4	5
TOSR	64	62	93	94	93	94	95	96	96	95

Figure 2. Revenue composition of municipal budgets (percentage of total revenue).

of revenues.” As we will show, local officials in Santa Fe and Guanajuato use all these strategies, most especially by appealing to national and provincial officials, both to satisfy local demands and to advance their own political careers by focusing on redistribution as a primary function of government.

5. SANTA FE, ARGENTINA

For the last 25 years, the province of Santa Fe has been run by politically ambitious socialists with ample resources. Ideologically committed to redistributive policies, they have used provincial wealth to implement an extensive social services agenda. With a population of 3,242,551 and an annual GDP of nearly \$23 billion, Santa Fe is one of only three provinces that are net revenue donors to the national government's coffers. This economic might has allowed the ruling socialists to leverage revenue decentralization to create centralized provincial power, thus illustrating how decentralization stops at the provincial level even in this most decentralized of Latin American countries and how micro-incentives, rather than macro-structures, determine spending patterns in subnational governments.

Public policies in Santa Fe province encourage redistribution for ideological, developmental, and political purposes. Although socialist politics date back to student movements at the National University of Rosario in the early 1970s, the current political dynasty began in 1991 with the election of mayor Hector Cavallero, who was followed by Hermes Binner, a physician who served two terms as Rosario's mayor (1995–2003) before becoming the province's first socialist governor (2007–11) – a string of victories capped by a spectacular loss in the country's presidential election in 2011. Binner hand-picked his successors – mayors Miguel Lifschitz (2003–11) and Mónica Fein (2011–present) and provincial governor Antonio Bonfatti (2011–present) – while recruiting university students to participate in campaigns and to serve as municipal staff. Binner's political strategy, developed in Rosario and then exported to the province as a whole, explicitly rejected pro-

business policies like tax incentives in order to focus on social spending to improve the health, education, and quality of life of the workforce. These priorities are clearly reflected in the provincial budget, nearly half of which has been devoted to health, education, and social services with largest portion of the wage bill going to teachers, police officers, and nurses (Figure 3). The province also allocates funding for developmental projects like infrastructure, but such outlays are tiny compared to social spending.

Santa Fe's redistributive social policies work hand-in-hand with fiscal policies that sever the relationship between revenue collection and government spending, which means that taxes do not serve as proxies for prices, benefits are unrelated to costs, and distribution is independent of payment. Were Argentina's revenue system truly decentralized, Santa Fe could collect internally all the revenue it needs to support the socialists' ambitious agenda. However, the co-participation system requires taxes collected by the national government in the province to be returned to Santa Fe through two principal redistributive mechanisms: (1) revenue-sharing grants determined by formula and automatically dispersed from the national government to the provinces and (2) un-earmarked national treasury grants (Aportes del Tesoro Nacional or ATNs) which are used primarily to subsidize poorer provinces. Because Santa Fe is a net donor to the national treasury, it pays more in taxes than it gets in co-participation transfers, even though it receives between 30% and 40% of its budget from the national government. In other words, taxes are collected in the province, sent to the national treasury, and a lesser portion of them is later returned to the province, thus dissolving the linkage between payment and distribution. This uncoupling of cost and benefit serves the socialist government well, both politically and ideologically, for it erodes the image of taxes as direct payments for specific services while bolstering the notion that spending is a political act rather than a market phenomenon.

This commitment to redistribution within the province has profound consequences for local revenue collection and public spending by discouraging local tax collection and bolstering the idea that resources come from above. Within Santa Fe,

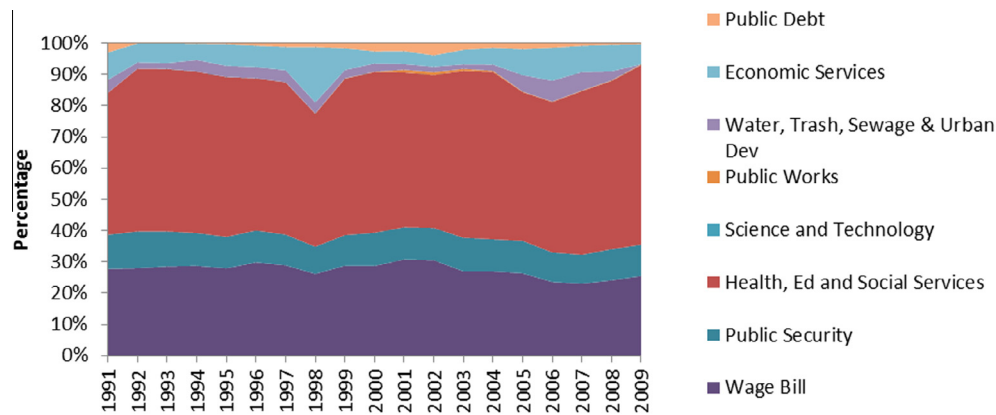


Figure 3. Santa Fe provincial budget. Source: Ministry of the Interior.

362 local governments (50 municipalities and 312 smaller communities) are legally permitted to collect taxes on property, car registrations, business licenses, and public utilities, as well as levy fines and fees. A majority of these funds are retained at the municipal level, but provincial handouts can be as high as 75% of local budgets, although poverty rates, city size, and especially political affiliation affect how much each city actually receives. Some municipalities also obtain up to 30% of their budgets from unconditional transfers (ATNs) from the national treasury. As a result, total own-source revenue (TOSR) collection varies considerably among municipalities in Santa Fe (Figure 2), though large annual changes and inconsistent accounting practices make generalizations difficult. As the descriptions of Argentine cities below will show, even though Santa Fe's provincial government takes a highly centralized approach to resource distribution, the particular political and fiscal circumstances of individual cities shape the way political elites scramble for and dispose of tax revenues.

(a) Rosario

Rosario is the urban powerhouse of Santa Fe, serving as both a generator of provincial resources and a policy laboratory. With nearly one million residents (making it the third largest city in Argentina), Rosario lies at the center of an industrial agglomeration 300 km from Buenos Aires, channeling the wealth of an extensive agricultural periphery to regional and international markets through a busy port on the Paraná River. Rosario's diverse and extensive economy constitutes approximately 50% of provincial GDP and 5% of national GDP. This economic strength has been used to support the ambitions of a self-proclaimed socialist government of the people and to translate urban dominance into provincial influence.

Insofar as there is a philosophy behind Rosario's approach to taxation (other than the sort of practical opportunism that leads to taxing whatever cannot avoid being taxed), it would be "ability-to-pay" rather than "taxes-as-prices." Levies on property, drivers' licenses, car registrations, and business licenses (that is, sources that reflect private wealth) are channeled to public art displays, educational forums, museums, and a children's art center, along with parks, municipal banks (offering micro-credit loans to public employees), a large and environmentally friendly public transportation system, and neighborhood administrative offices providing birth and death certificates, buildings permits, and business licenses. Local revenues are combined with provincial transfers to fund an

extensive public health program which consumes 25% of the municipal budget to provide primary coverage to nearly 80% of the population. The socialist administration in Rosario also pioneered a bankcard system for welfare benefits – a program replicated by the Kirchner administration at the national level (*Plan Jefes y Jefas de Hogar*) to provide social assistance after the financial crisis of 2001. Although some of these expenditures might accrue to taxpayers in the form of higher property values, most of the benefits are directed at residents (often poor migrants from rural areas) who receive far more than they contribute (Figure 4).

It might be argued that local redistributive policies like these, based as they must be on potentially mobile local revenue sources, would result in protests in the form of "exit" (out-migration, as in the market model of fiscal decentralization) or "voice" (defeat at the polls, as in the electoral model). However, no such signals are sent to the socialist administration in Rosario. The population of the metropolitan area continues to grow – a fact easily interpreted as support for the socialist agenda. Economic opportunities and social services draw new residents who tend to favor socialist candidates. Even though the socialists are always challenged at the polls by factions within their own movement and by more conservative Partido Justicialista (PJ) candidates, they have consistently garnered enough votes (though rarely an outright majority) to stay in power. Business owners and wealthier native residents who bear the burden of taxation could conceivably leave the city to avoid those taxes, but economic opportunities and an appealing standard of living tend to keep them in Rosario, in spite of the fact that their resources are redistributed within the city, within the province, and within the country.

(b) Santa Fe (Capital)

One of the benefits of centralized power is the ability to garner loyalty through resource redistribution: a point illustrated by the provincial capital of Santa Fe, site of several of the most important political events in the country's history and home to the three branches of provincial government.⁷ Santa Fe is a city of extremes – of wealth and poverty, of human capital and human misery, of large institutions and institutional failures – with a fragile middle class sustained by employment in the provincial government. Faced with these difficulties, political leaders in Santa Fe have chosen a policy of dependence on the province which allows some groups to avoid fiscal responsibility for the city by ceding management of its problems to a higher level of government.

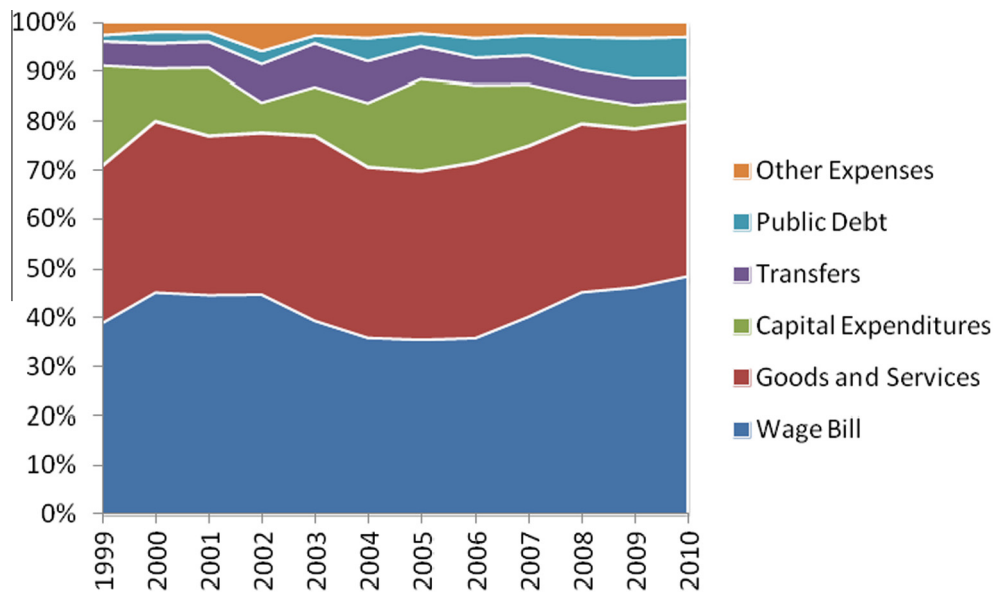


Figure 4. Rosario municipal budget. Source: Office of the Municipal Treasury.

Santa Fe appears to be blessed with assets that should make it fiscally self-sufficient: an abundance of important scientific, technical, and educational institutions and proximity to a busy port.⁸ However, in spite of its strategic location and institutional strengths, the city has low rates of private sector employment and high rates of government employment. High levels of poverty and at-risk youth are driven by inadequate job opportunities and rural in-migration. The port, rather than anchoring large industrial operations that might provide jobs, primarily benefits investors from Buenos Aires and Rosario who speculate on grain futures and use Santa Fe as a secondary base of operations. Although provincial power and communications networks are headquartered in the capital, the city itself is underserved by infrastructure. Fertile lands on the western bank of the Paraná are used primarily by agribusinesses that employ undocumented migrant labor from Bolivia and Paraguay, with precarious working conditions and substandard housing the norm.

Because the economy of Santa Fe is dominated by government, education, and wealthy groups who want to be in the capital but who do not want to pay taxes – institutions and people that avoid such obligations by “voice” rather than “exit” – the city depends on the province to address the obvious needs of its many poor inhabitants. Because of its size, Santa Fe is ranked as a first-tier city and therefore eligible for the same level of benefits as Rosario. Although the capital city has nearly half a million people, its budget is less than a third of the size of Rosario’s. Obtaining accurate budget information is difficult, even for public officials who describe their own data as unreliable (Figure 5). Because city managers cannot say for certain what revenues they have or what their expenses are, they are in no position to apportion costs to benefits. The city’s budget has fluctuated from a high of \$31 million in 1998 to a low of \$5 million in 2004. Although partly a reflection of national economic distress, these swings also illustrate how little emphasis municipal officials place on managing the local tax base efficiently or even understanding its true potential. Instead, the city depends on the province for both financial and technical assistance, with officials moving frequently between municipal and provincial posts and major public services often run by provincial authorities using

provincial funds. Political leaders in Santa Fe, who customarily run for higher office after victories in the capital, typically campaign on an incongruous combination of increased social services and fiscal austerity, leaving them few choices but to turn to the province for assistance.

(c) Rafaela

Whereas Santa Fe shows how a dependent city benefits (and suffers) from centralized provincial power, Rafaela illustrates the fate of cities that are politically in conflict with those same provincial authorities. Located 90 km west of the capital and 230 km northwest of Rosario, Rafaela has a population of 92,945 (2010). Formally established in 1913 as a railway hub, Rafaela currently has over 400 small- and medium-size industrial firms and a high rate of private sector employment compared to both the province and the nation. Municipal officials have worked aggressively to foster local businesses with tax incentives and to support the city’s three industrial parks and strengthen its four industrial clusters: metal work, dairy products, masonry, and train and car parts. This entrepreneurial spirit is accompanied by a strong sense of local solidarity (verging on insularity) deeply rooted in Rafaela’s history thanks to extensive in-migration from the Piedmont region of northern Italy, which means that residents and business owners are tied to the area culturally and economically and are thus more likely to address problems through “voice” rather than “exit.”

The province considers Rafaela a second-tier city (with fewer than 100,000 inhabitants) and therefore eligible for fewer provincial transfers than Rosario or Santa Fe, thus placing a greater burden on TOSR. At least in theory, this should provide an incentive for officials to favor user fees, to apportion costs according to benefits, and to direct scarce local revenues toward the most urgent local needs. However, the city has adopted a different strategy. During 1999–2008, the city averaged 68.5% TOSR, collected primarily through taxes on property, industry registration fees, and other licensing fees, although none of these approximate user charges since all revenue is placed in a general fund to pay for every sort of city service. The city has no property appraisal office, which means

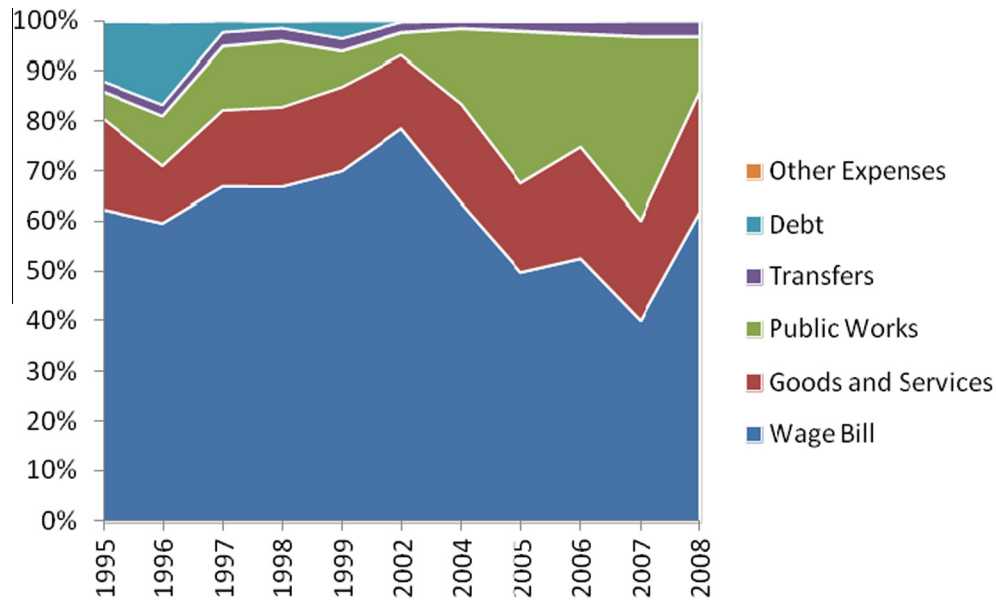


Figure 5. Santa Fe municipal budget. Source: City of Santa Fe.

that property taxation is not based on market prices, value per square foot, or quality of construction. Instead, property tax rates are levied according to a series of concentric rings around the city; the highest rates apply to properties near the center plaza, with rates decreasing for properties located in rings further out, regardless of property size or use (in other words, taxation is framed neither as ability-to-pay nor as payment-for-services). Rafaela spends about 35% of its budget on public employee wages and about 30% on public works (Figure 6). However, the city's needs and ambitions outstrip its resources, compelling local officials to seek funding from higher levels of government, a strategy which is complicated by political differences between the city (dominated by the pro-business PJ) and the province (dominated by the socialist party).

Nowhere is this difference of perspective between the city and the province more evident than in infrastructure development, particularly the provision of water and sewer facilities.

Even though the city spends almost a third of its budget on public works of every sort, Rafaela has long struggled with a dearth of potable water and inadequate drainage; standing water in residential areas complicates waste disposal, creating sanitation problems that have been evident for years. Both water and sewer are municipal matters that could be addressed with special assessments, user fees, and local debt. However, the city has chosen to pursue infrastructure funding from above, resulting in simmering conflicts with provincial officials who view the city as a gateway to the rural north which should focus on human capital development while city officials seek commercial connections to Rosario and Buenos Aires to enhance local employment. The city has therefore sought funding from the national government – which is in the hands of the PJ and thus more likely to look favorably upon a PJ-dominated city – for water, sewer, and road projects that are neglected by the provincial government.

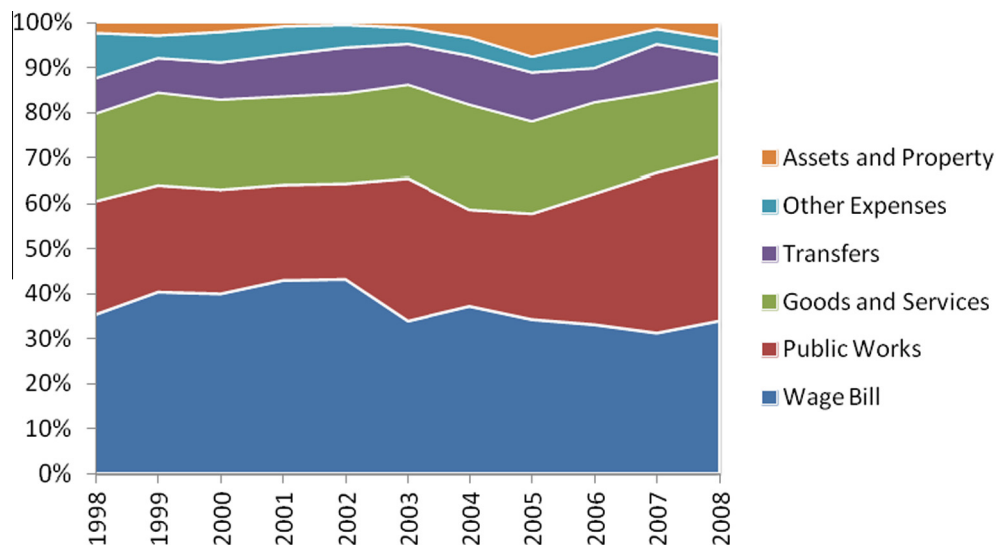


Figure 6. Rafaela municipal budget. Source: City of Rafaela.

6. GUANAJUATO, MEXICO

For the last 25 years, the state of Guanajuato has been run by politically ambitious conservatives with considerable resources. Ideologically committed to pro-business policies, they have focused discretionary state funds on economic development with the belief that the problems of poverty, limited skills, and inequality that confront so much of the population are best resolved via neoliberal growth strategies, even though federal mandates have required increased spending on health, education, and social services (Figure 7). Although Guanajuato is a small state, it has a substantial population (4,893,812 in 2010) and the sixth largest economy in Mexico. Four large industrial cities and a small but highly productive agricultural sector are supplemented by a growing tourism complex: at the center of Guanajuato is the village of Dolores, where on September 16, 1810, the priest Miguel Hidalgo led a peasant uprising that began Mexico's war of independence from Spain. In spite of this plenty, Guanajuato has one of the highest rates of emigration in Mexico. Politicians from Guanajuato have been at the forefront of decentralization, but their success in shifting power away from the national government has also resulted in a reduction of tax effort by cities within the state, prompted by local officials who search for ways to advance their own careers and to create room for their own redistributive efforts within an increasingly centralized state policy environment which, for ideological and cultural reasons, leaves many policy problems unaddressed.

Guanajuato is a state of rich and poor. Lying at the heart of the fertile Bajío region in central Mexico, Guanajuato grows wheat, strawberries, broccoli, and onions that are sold nationally; its tomato production is the second largest in the country. The industrial cities of León, Irapuato, Celaya, and Salamanca (site of a Pemex refinery), comprising nearly half of the population, are home to the state's large manufacturing sector (26% of GDP), although small business sales account for 50% of the state's total output and 80% of its employment. However, only 39% of the population participates in the formal economy, resulting in below average earnings. The average level of education is 7.2 years; half the population over

15 has not completed primary school. Inadequate housing is the norm for much of the population; access to basic services is limited.

The state's approach to these conditions is shaped decisively by ideological and cultural factors. Guanajuato has the highest concentration of Catholics (almost 96%) of any Mexican state and this deep-seated Catholicism forms the basis of the state's tradition of Sinarquismo, an outgrowth of the Unión Nacional Sinarquista founded in León in 1937 as part of the extreme right-wing opposition to the secular governments that ruled Mexico from 1929 to 2000. Many "Sinarquistas" joined the PAN after local elections in 1964, allowing it to blossom into a full-fledged national opposition party fighting against PRI paternalism and corruption (Bailey, 1990). Vicente Fox, a native of Guanajuato, began his political career in 1988 representing León in the federal Chamber of Deputies before becoming the state's first PAN governor in 1995. The state continues to manage its finances and public policies much as it did during Fox's tenure as governor, with an emphasis on direct foreign investment and business relocation incentives. In keeping with this approach, the state avoids references to poverty and inequality, choosing instead to paint a picture for potential investors of a region with high-end tourism, bountiful business opportunities, and linkages to national and international markets.

Although ideologically quite different from Santa Fe, Argentina, the conservatives who run Guanajuato nonetheless follow the same approach to distribution of state resources. While advocating decentralization of power to the states, they believe in the centralized distribution of resources within Guanajuato. As a result, they focus on infrastructure to support large-scale enterprises, even though small-scale agriculture employs many more people. Resources are also distributed to reward political loyalty and to garner votes, which means that cities dominated by PAN voters receive more transfers than cities where the opposition is strong. Just as in Argentina, these practices put local officials in the position of searching for room to maneuver while still looking up the ladder for as much help as they can get. Budgetary choices are more restricted in Mexico, since federal transfers come with more

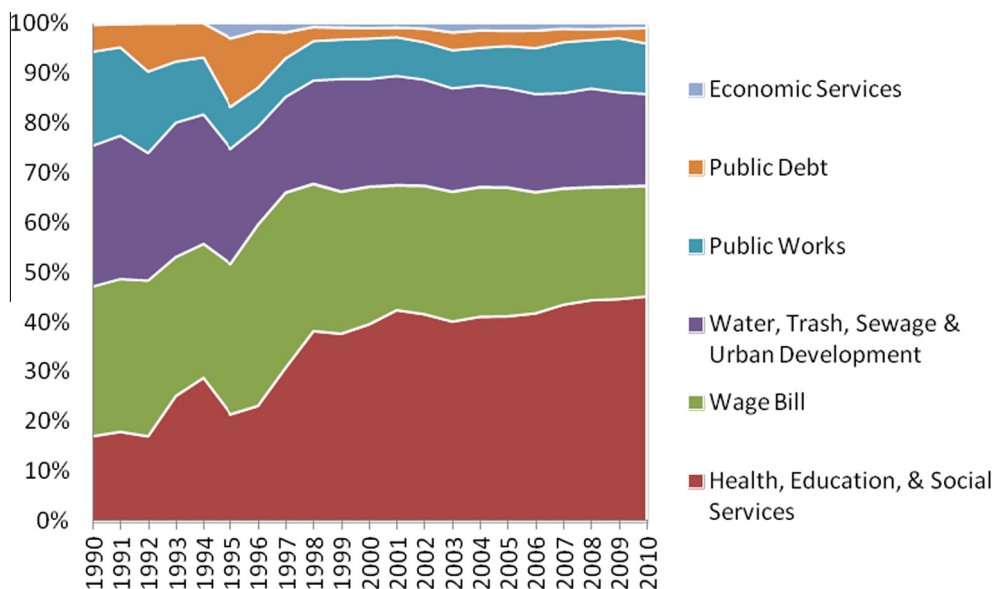


Figure 7. Guanajuato provincial budget. Source: INEGI.

strings attached, but municipal leaders face the same problem of servicing local constituents while petitioning for more resources from above.

(a) *León*

Fiscal management of the city of León illustrates how the practice of decentralization actually undermines its objectives even in the most favorable of cases. León seems to offer the ideal circumstances for decentralization to work as anticipated. With 1,132,842 residents (nearly a quarter of the state's population), León – known as the shoe capital of Mexico – has a robust economy and a substantial tax base that public officials have managed diligently. In 1992, PAN Mayor Eliseo Martínez Pérez led a successful effort to restructure the city's cadastre by hiring small crop-duster airplanes to take photographs of city lots which were then evaluated by a cartographer to create more accurate tax assessments; stiff penalties encouraged citizens to pay their bills, resulting in a 92% increase in revenues in a single year. This approach helped boost property tax revenues from \$43 million to \$207 million during 1997–2009. Under Mayor Luis Ernesto Ayala Torres (2000–03), administrative functions were consolidated in a new Office of the Treasury, Cadastre, and Development Planning (IMPLAN) and property records and tax billing were moved online to improve revenue management. Subsequent administrations increased the tax base by establishing three technology parks, a university research center, and a large-scale micro-credit program, in addition to restoring historic areas of the city to promote tourism, though most of local spending is consumed by wages and public works (Figure 8). Here, then, is evidence that a city with economic resources has made considerable effort to expand revenue sources and manage them efficiently, thus allowing it to become increasingly self-sufficient.

Over this same period, however, “decentralization” policies at the federal level have made the city less fiscally self-sufficient while further politicizing budgetary decision-making. By 2008, only 43% of León's annual budget was collected locally compared to 57% received in transfers from the national government. León's TOSR actually decreased in response to the 1997 federal decentralization law. This does not mean that the city is not collecting revenue, but these are sent to the federal treasury, only to be returned to the city as part of the revenue sharing process, thus severing the connection between paying taxes and spending revenues. A growing portion of the city's revenues comes in the form of either earmarked funds from the state and national governments or as unearmarked transfers that are then distributed according to locally determined political criteria: in both cases, taxes cannot be portrayed as payments for services while spending becomes the subject of political choice rather than a proxy for market decisions. Because of its size, León has become the primary training ground for politicians in Guanajuato who want to move from the municipal level to state and national offices. Transfers provide a political tool for these aspiring politicians – both as a reward for loyalty and as a resource to encourage loyalty – whose terms in office are constitutionally limited to 3 years, prompting them to use local budget choices to audition for higher office.

(b) *Guanajuato (Capital)*

The capital city of Guanajuato is not in such a favorable political position as León; its budgetary choices illustrate how a fiscal cash-cow provides municipal officials room to maneuver within an unfriendly centralized system. Guanajuato, birthplace of muralist Diego Rivera, is famous for its old-world charm, a legacy of its days as a colonial mining center. The city's real claim to fame, however, is the Museo de las Momias (the Mummy Museum), which draws

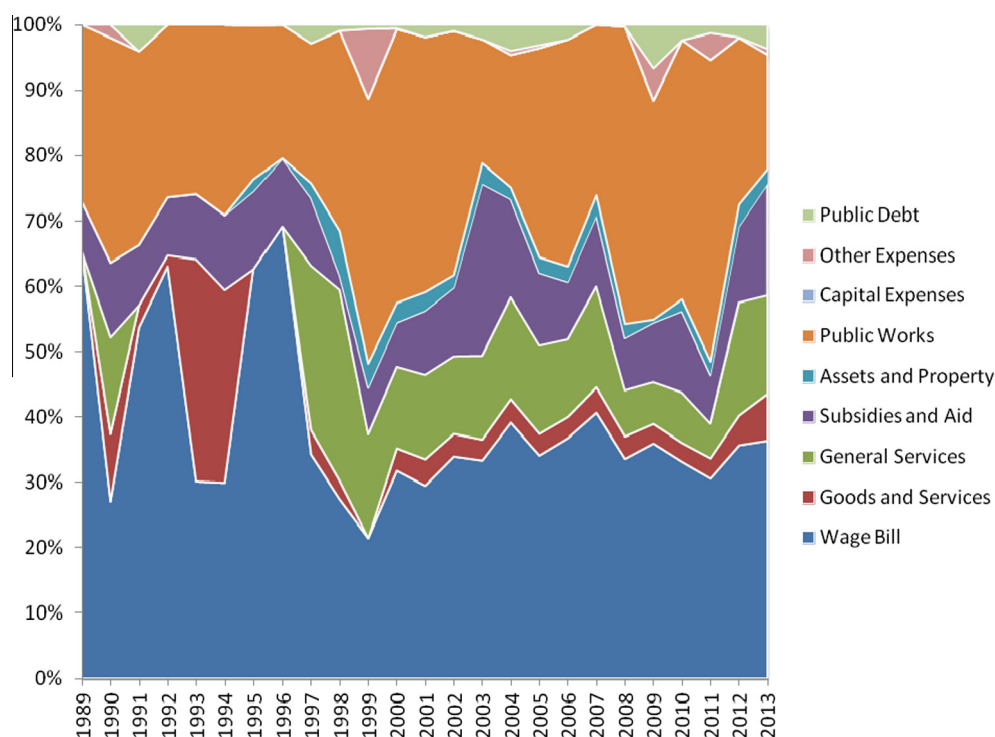


Figure 8. *León municipal budget. Source: INEGI.*

hundreds of thousands of visitors each year, making it one of Mexico's most popular tourist destinations. By obtaining control over the museum, Guanajuato secured a source of revenue for its relatively small populace of 171,709 that opened up a panorama of opportunities for local redistributive policies.

Guanajuato's fiscal difficulties arise from its political inclinations. In a state that is dominated by the PAN, Guanajuato remains an unreliable ally, changing hands among PRI, PRD, and PAN administrations. Although the state does receive some federal transfers destined for city budgets – 65% from participaciones (unearmarked transfers from Ramo 28) which are generally used for current expenditures and debt; 35% from aportaciones (earmarked transfers from Ramo 33) used for infrastructure – these are quite small, forcing Guanajuato to rely on over 90% TOSR. The Museo de las Momias helped enormously with this problem. Formerly a federal responsibility, the museum was considered a minor administrative distraction that was happily unloaded when local officials in Guanajuato offered to take charge of it. Since that time, the museum has generated more revenue for the city than property taxes, rents, and fines combined. This holds true even though the city has also redefined its cadastre to boost property tax revenues and aggressively pursued fines and fees. Guanajuato spends a higher percentage of its budget on wages and a lower percentage on infrastructure than León or San Miguel de Allende (Figure 9), which means that city officials scramble for resources to improve tourist infrastructure – paving, sidewalks, and monuments – even resorting to borrowing (a \$1.5 million World Bank loan) to restore public areas, fix streets, and upgrade storefronts. Even with these efforts to eke out some measure of fiscal autonomy, public officials look up the institutional ladder to fund their wish lists: as one public official from the recently elected PRI administration noted, the city sought up to 30% of its budget in federal transfers to fund needed water supply and rubbish collection projects.

(c) San Miguel de Allende

Whereas political relationships with higher levels of government are the most important factor for understanding fiscal choices in León and Guanajuato, San Miguel de Allende demonstrates the influence of an unusual local population on government spending. Like Guanajuato, San Miguel de Allende relies principally on tourism, and the city has made similar efforts to boost property tax revenues by investing in infrastructure used by visitors. Even more than León, the city receives most of the revenue for its fairly small budget (around \$30 million, with wages and public works as the largest expenses (Figure 10)) from state and national transfers, relying less and less on TOSR over the last 15 years, making it the most fiscally dependent of the three Mexican cities in this study. Although the city has elected PAN candidates as municipal presidents, the political landscape is quite diverse, with council members from the PRI, PRD, and even the environmental party, PVEM (Partido Verde Ecologista de México). With only 161,383 residents, most of them living in rural areas around the city, San Miguel de Allende does not represent a significant political prize and probably receives as much as it does because in absolute terms its budget is so small. This would suggest that city officials would do everything possible to curry favor with political actors in higher levels of government.

However, the driving force behind the city's spending patterns is the large expatriate population that shapes policy choices in spite of the fact that its members are not officially part of the body politic. Although long known as a center of art and culture, San Miguel de Allende began to attract American writers, artists, and retirees in the 1950s (the beat writer, Jack Kerouac, died in the city in 1968) and this group has changed the landscape of civil society with voluntary organizations like the Rotary Club and the Lions Club, along with ad hoc committees to support favored expatriate causes. Because

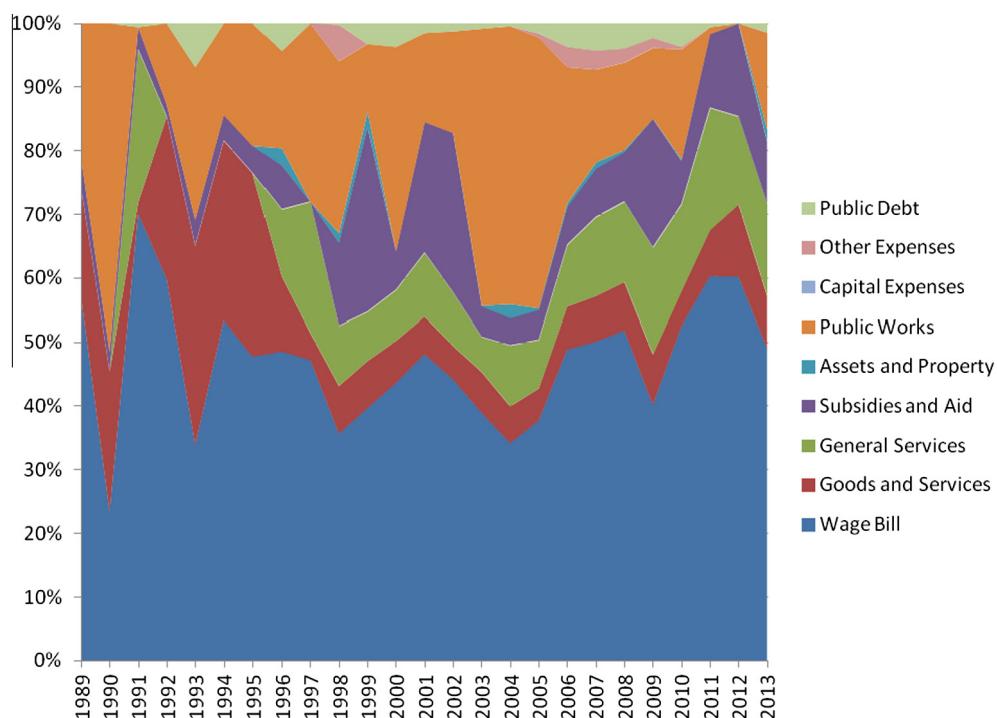


Figure 9. Guanajuato municipal budget. Source: INEGI.

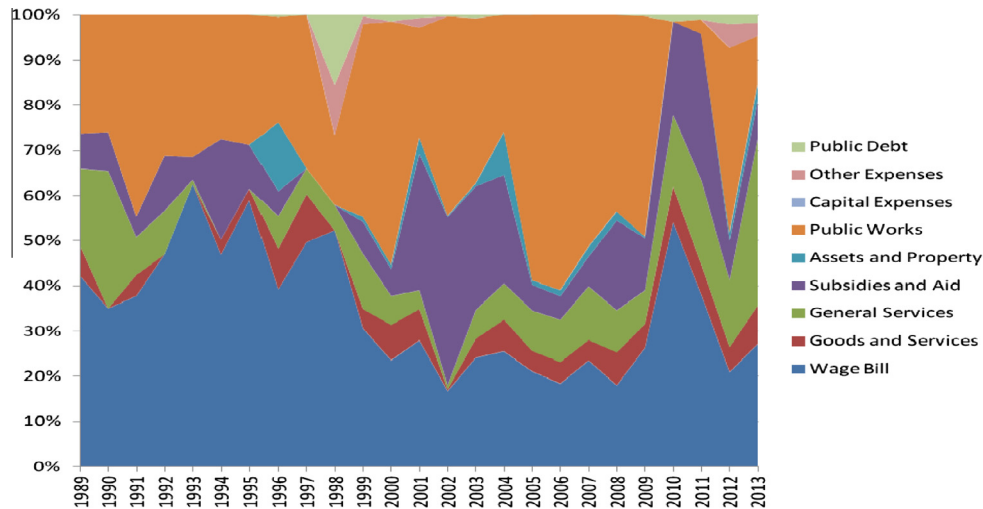


Figure 10. *San Miguel de Allende municipal budget. Source: INEGI.*

agriculture, with its low wages, is the largest economic sector for city residents (employing about 25% of the population), the presence of the American expat community has created tensions between rich and poor. City schools mainly serve primary grades, with few students attending high school, but the expat community focused its resources on building a school of fine arts to provide short-term classes for American and European retirees and on expanding the services of its English-language library. While many of the residents in the 950 villages (often with fewer than 50 inhabitants) surrounding San Miguel de Allende leave to pursue work abroad, the expat community, through the Audubon Society (with 300 members, making it the largest international chapter of that organization), has successfully advocated reforestation and other environmental rehabilitation projects. Although in some cases the foreign population has contributed its own resources to such projects, public officials complain that the NGOs supporting expatriate interests are long on demands and short on solutions. In spite of the fact that none of the foreign population can vote, politicians feel obliged to consider their interests, simply because there are so many of them and because their private spending injects needed resources into a community that would otherwise suffer as yet another poor rural outpost. In San Miguel de Allende, “voice” works to influence public policy even though the expatriates are unlikely to use their “exit option,” are deprived of an official say in public affairs, and are not the main providers of budgetary resources which come overwhelmingly from above.

7. A REASSESSMENT OF THE CAUSAL MECHANISMS OF DECENTRALIZATION

In the case studies above, we find that municipal officials in both Argentina and Mexico are in a constant scramble for money and they are more than willing to reframe local needs in order to secure funding, regardless of its original source. In some cases, revenues are available locally, though no attempt is made to apportion costs according to either benefit or geography. Instead, officials take advantage of local revenues to create as large a pot of money as possible to pursue as many projects as possible and appease as many constituencies as politically necessary. Because those sources are always insufficient, local officials petition allies in both provincial and

national governments for additional resources. That process inevitably means aligning local needs with the priorities of those patrons, both for the purpose of channeling money from higher levels of government and as a means to secure relationships that lead to political advancement. The resulting process looks nothing like the fiscal federalism portrayed in theory, nor does it correspond to the dynamics of public choice theory. Instead, we see subnational officials motivated by personal ambition – which includes a desire to serve heterogeneous local needs, to create some degree of policy autonomy, and to facilitate career advancement – courting favor with at least two audiences to whom they may be responsive: one local, the other either provincial or national (each of which may be subdivided further into competing interests). This multiple-audience problem, together with idiosyncratic fiscal rules, political pressures, and local cultures and economic conditions, creates micro-incentives that explain municipal behavior far more than the macro-characteristics commonly used to categorize countries along the centralization–decentralization spectrum.

(a) “Exit” as a sanction for subnational officials

What do these case studies tell us about the role “exit” plays in determining the behavior of subnational officials? The market model of fiscal decentralization suggests that taxpayer mobility sends signals about the correctness of geographically delimited packages of services and prices (Oates, 1999). But that is not the role mobility plays in the lives of subnational officials in either Argentina or Mexico. The first point to be made in this regard is that it is not usually taxpayers that move. Most mobility in both countries is in the form of consumers, often from rural areas, coming to cities in search of better wages and life prospects: it is the “entrance option” rather than the “exit option” that most concerns elected leaders and career managers alike. Officials do not conclude from in-migration that they are offering appropriately priced packages of public services. Instead, they recognize that rural poverty prompts migration and that cities must deal with that fact, unwanted though those migrants are. Attempting to sour the milk, by offering fewer social services, does not deter migrants who come to cities for economic opportunities; rural migrants tend to become free riders, for officials can do nothing to restrict their movements and have little choice but to

give them access to whatever services government may provide. In the case of Santa Fe, the redistributive ideology of the ruling socialists has encouraged them to enlist those rural migrants in the political system, but only because the provincial government has considerable resources at its disposal; elsewhere, they are seen as burdensome.

In Mexico, migration is even less clearly tied to public services because migrants tend to be sojourners. The market model of decentralization presumes a unitary taxpayer-consumer-voter (Bird, 1993; Buchanan, 1995; Oates, 1972, 1993, 1999; Qian & Weingast, 1997; Tiebout, 1956). Mexican migration separates those activities. Studies of migration all emphasize the role of wage differentials: migrants seek higher pay in distant places and then remit part of those earnings to families remaining at home (Arguayo-Téllez & Martínez-Navarro, 2013; Durand, Massey, & Zenteno, 2001; Massey & Parrado, 1994). This pattern, typical in all of Mexico and other Latin American countries, leads to a division of the taxpayer-consumer-voter. When a family member temporarily seeks employment elsewhere and then remits wages, a consumer-voter has, in effect, exited the community while the taxpayer remains: working abroad, the wage-earner neither votes nor consumes local services but continues to pay for them by sending money to his or her family. Those family members may be wage-earners (and thus taxpayers), but they may simply be consumers of public services, sustained by a wage-earner living in another jurisdiction. From the perspective of public officials, this sort of “exit” is quite welcomed: the taxpayer/wage-earner stays (effectively) while the consumer-voter leaves; resources flow back to the community while demand for services falls.

Taxpayers, on the other hand, tend to have more resources and are more likely to have family or cultural ties to cities, factors which discourage them from relocating. The conservative Piedmontese business owners of Rafaela will not move to the socialist stronghold of Rosario, or anywhere else in Argentina, given their roots in the community. Agricultural equipment manufacturers are unlikely to abandon bustling Rosario, with its extensive agro-industrial networks, for sleepy Santa Fe just to avoid high taxes. Shoe manufacturers are similarly unlikely to leave León because of its aggressive approach to property taxation, since that city has long been the center of the footwear industry. The expatriate community in San Miguel de Allende stays in the city for unique cultural reasons. People with these sorts of resources and connections are much more likely to exercise their “voice option” (by voting or, more likely, seeking alliances with local officials to obtain more services or to avoid taxes) rather than their “exit option.”

“Exit” as a sanction for inappropriate public policies does not operate at the municipal or the provincial level in either Argentina or Mexico. It is not so much that residents are too poor to move or that local loyalties prevent them from moving, although both those things are evident as well. Instead, their movements do not send signals to public officials about the correctness of geographically delimited packages of services and prices as envisioned in theory. Exit may be welcomed when a poor resident leaves, thus reducing demand for public services, or it may be welcomed because that resident, now a wage-earner in another part of the country or abroad, sends wages to remaining family members; in neither case does it suggest to public officials that they must adjust service levels or prices to prevent other residents from using their “exit option.” No public official interviewed for this research expressed any concern that taxpayers would exit their jurisdiction, but many acknowledged the difficulties faced by the

entrance of poor rural migrants. Insofar as decentralization as a public policy relies upon this causal mechanism to encourage responsiveness, it fails as a description of the actual behavior of both taxpayer-consumer-voters and the subnational officials who are supposed to be reading their movements in order to improve the efficiency and responsiveness of public service provision.

(b) “Voice” as a sanction for subnational officials

If “exit” does not operate as envisioned by theory, “voice” is called upon to do all the work of signaling public officials. Hayekian knowledge of local preferences and political action thus carry the burden of operationalizing decentralization theory. Here, too, our case studies indicate that this element of the theory fails to capture what subnational officials actually do.

Neither elected leaders nor appointed bureaucrats are politically inert actors responding to median voters (Downs, 1985). They have ideological and professional convictions that motivate their behavior. They seek to rally like-minded voters and interest groups to their cause, to persuade those who have no particular conviction, and to marginalize those whose ideological inclinations run against them (Hetherington, 2009; McCarty, 2011; McGann, Koetzle, & Grofman, 2002). They attempt to persuade the public to adopt their preferences, rather than adopting the preferences of median taxpayer-consumer-voters as though they were trying to determine which product to sell. Indeed, many officials show a remarkable willingness to suffer electoral defeats while they wait for an uncooperative public to come around to their point of view: Hermes Binner endured a staggering loss as candidate for the presidency of Argentina rather than change his political beliefs in order to garner more votes; the Sinarquistas of León draw their political enthusiasm from religious traditions that make them unlikely to seek the votes of PRI supporters even if that would help them win elections. Officials rarely want to stay in office simply to carry out someone else’s agenda, so they redistribute the resources at their disposal to bolster a constituency to support their own agenda. It is not merely a matter of understanding the interests of the median voter; officials seek to change the median, organizing at the extremes rather than appealing to the middle.

Without question, some officials modify their policies in the face of electoral losses. However, being responsive to taxpayer-voters is not the only way to advance one’s career. As one observer of Mexican municipal politics noted, “The best position for a local government official is to lose a national election. In that way, they would be selected to be the next director of public works for their state team” (Interview with Municipal Treasurer, León, Guanajuato, July 2009). Since resources come from above, being responsive to provincial officials can lead to promotion even more reliably than being responsive to voters. Public officials face multiple audiences, which means that the “voice” they hear and to which they may respond may not be the voice of the voters in their districts but the voice of the resource-holders (party, provincial, or national) who can help them climb the institutional career ladder.

As a result, public officials do not use Hayekian knowledge as envisioned by theory. When provincial officials in Santa Fe refuse to fund water projects in Rafaela, it is not because they are unfamiliar with Rafaela’s needs. Provincial leaders can argue convincingly that the voters of Santa Fe consistently give priority to social services over infrastructure; as elected

officials, they are being “responsive” when they fund health clinics in Rafaela but not sewer projects. Decentralization of power to the province has not translated greater familiarity with local needs into more responsive public policies for those in the political minority; instead, it has served to highlight how political differences shape the distribution of resources regardless of institutional proximity. No electoral jurisdiction is small enough that all local needs can be met, even by public officials who are intimately familiar with those needs; even at the municipal level, officials must favor some groups over others. Public policy is always about deciding who will receive limited resources and who will not. Familiarity with local needs is rarely the issue. Instead, familiarity is mixed with ideology, maneuvering for political advantage, and, above all, scarcity in the subtle calculations public officials use to distribute resources.

A chronic dearth of resources translates into a standing political preference voiced by all participants in the system: find someone else to pay. Fiscal federalism assumes that public officials thrust upon their own resources try to improve efficiency by apportioning costs to benefits because they have no choice but to listen closely to mobile taxpayers who will flee from any other arrangement (Oates, 1999); but that is hardly the approach exhibited in our case studies, even in cities that have very high percentages of TOSR. To be sure, municipal officials in León, Guanajuato, and San Miguel de Allende made serious efforts to increase local revenues by managing their tax bases more efficiently. However, in no instance did they create a payment system that linked taxpayers and service users at the municipal level (some states have won concessions from the national government in Mexico in order to build toll roads; in these limited and unusual cases, there is a direction connection between payment and service). In Santa Fe province, severing the linkage between the two is an ideological necessity; in the capital city, the wealthiest residents and institutions use their “voice” to avoid taxation. Even in conservative Rafaela, user fees are avoided because local officials do not want to burden the businesses they try so hard to foster. In nearly every case, the goal of public officials is not to minimize free riders, but to maximize them. For this reason, the municipal managers in our case studies constantly look up the institutional ladder for help. This is why vertical fiscal imbalances are so important to the system. Wherever there is vertical fiscal imbalance, fiscal federalism is undermined for the simple reason that if revenue goes up the institutional ladder, it loses any sense of being interpreted as a price for services, which means that there is no market effect in taxation; when revenue comes back down the ladder, it is inevitably distributed according to political criteria rather than being seen as a fee-for-service. It is always viewed as a resource for garnering political support, even when it is distributed via formulas or earmarked for specific purposes: everyone knows those purposes and those formulas result from political negotiations.

8. CONCLUDING REMARKS

“Decentralization is not working as some theories suggest,” observe Larsen and Ribot (2004, p. 7). “[T]his ‘failure’ is partly because of the fact that decentralizations are not being implemented, but is also due to the factors that democratic decentralization theories cannot or do not account for... When factors outside of the models dominate outcomes, it is time to rethink those models or to systematically locate them in a broader political economy.” Our case studies of fiscal

decision-making in Argentina and Mexico give us reason to concur with this assessment. Political and fiscal decentralization have produced such equivocal results because subnational officials do not behave as theory suggests. In part, this is because revenue collection continues to be concentrated at the national level, producing large vertical fiscal imbalances that undermine the image of taxes as payments for specific services while sustaining the impression that spending is primarily a political act rather than a proxy for market transactions. It is also due to the fact that decentralization stops at the provincial level, which means that fiscal decision-making is not forced down to the lowest institutional actors: everyone appeals up the ladder for resources. These problems might be attributed to the incompleteness of decentralization; they would be resolved, therefore, but pushing centralization beyond its current state: the right set of macro-institutional changes would, at long last, reshape the bad behavior of subnational officials by compelling real people to act as theory says they should. From this perspective, completing macro-level decentralization will solve the problems that currently plague partial decentralization, though it is by no means clear how vertical fiscal imbalances, based as they are on profound differences in productive capacity and economic development at the subnational level, will be eliminated.

However, we argue that the theory of decentralization itself is flawed because its main causal mechanisms – “voice” and “exit” – do not describe the behavior of actual public officials whose actions are highly context specific. Micro-incentives, which we define as idiosyncratic local conditions and interests, shape the actions of municipal and provincial officials far more than macro-level structures intended to compel them to shift their focus away from redistribution of resources and instead focus on allocation.

Furthermore, the conception of the role of subnational governments embedded in decentralization theory fails to recognize that public officials are judged (and prefer to be judged) not by their allocative efficiency but by their redistributive acumen. Redistribution is the preferred function of government at all levels, which means that allocation and stabilization may be sacrificed to feed a system predicated on the shifting of resources to satisfy client groups and advance individual careers. We hypothesize, therefore, that decentralization has not so much “stalled,” leaving the process in a state of incompleteness because jealous national officials or political elites are resistant to change, but that it has reached a functional stage in which opportunities to participate in the redistribution of resources have been broadened (though not democratized) and now involve even more actors (national, provincial, and municipal) with a stake in the current system than under previous highly centralized regimes. The concentration of power at the provincial level and the persistence of vertical fiscal imbalances are not evidence that decentralization is not working. Instead, these show that structural changes intended to enact decentralization theory have been repurposed by participants to accommodate an increased array of public officials who now have access to resources that make them even more effective at responding to the micro-incentives presented by idiosyncratic political, cultural, and economic circumstances.

This, too, is a flaw in the theory of decentralization. Assigning redistribution to higher levels of government goes back to Musgrave (1959) and Oates (1972) and was predicated on taxpayer mobility: since taxpayers were presumed to be mobile, local governments could not engage effectively in redistribution since taxpayers would only pay for services for themselves; any redistribution would prompt them to “exit,”

which meant that redistribution had to be conducted by national governments whose reach could not easily be evaded through mobility. But as our cases show, there is no threat of mobility at the local level, in which case redistribution becomes the prerogative of all levels of government. Even if mobility prevented local officials from collecting revenues for the purpose of redistribution, a system of vertical fiscal imbalances (with national governments collecting revenues from mobile sources and transferring those revenues to local governments) would still make local redistributive policy possible and desirable, since it is not the redistribution but the collection of resources that presents the greatest political problems. Even in an environment of high taxpayer mobility, in other words, local officials would have a strong interest in retaining vertical fiscal imbalances. The onerous part of fiscal policy is extracting resources from taxpayers. The rewarding part (figuratively and literally) is redistributing those resources to client groups for political and personal advantage (Grindle, 2007). In a system with large vertical fiscal imbalances that necessitate transfers between levels of government, extraction can be separated from distribution, and this is why the current “incomplete” stage of decentralization is so beneficial to so many actors. What Oates (1979) called “fiscal illusion,” in other words, is really a central feature of the current system, except that no one treats it as product of confusing the average

and marginal prices of public goods (Bailey & Connolly, 1998). Instead, municipal officials quite consciously prefer a system in which resources are negotiated from above and redistributed locally, even though many of them wish they fared better in those negotiations: with the exception Rosario (and perhaps León), no city in this study had the wherewithal or desire to rely on its own resources.

It may be that the centralized state in Latin America has shown itself to be irredeemably dysfunctional. Because centralization seemed to be the defining feature of the failed developmental state, it makes sense that decentralization would appear as the appropriate alternative, since theoretically it features two powerful sanctions – “exit” and “voice” – that were missing from the policy process directed from the national level. However, as our case studies show, neither “exit” nor “voice” operates as anticipated even in more decentralized environments, nor do local officials show much enthusiasm for confining themselves to efficient allocation of their own resources. This suggests the need to look beyond the centralization-decentralization dichotomy – including the painstaking search for statistically significant relationships between decentralization and its alleged benefits predicated on the effect of structure on behavior – and focus more attention on micro-level behaviors that undermine the purported effects of macro-level policy structures

NOTES

1. For a critical analysis of decentralization theory that raises many of the same issues we explore here, see Treisman (2007), especially chapter 4.

2. “Voice” and “exit” are, of course, used here in Hirschman’s sense (1970). Oates (1993) makes similar contentions regarding fiscal decentralization: “both through responsiveness to the local electorate and through fiscal mobility (the “voice” and “exit” options as Hirschman (1970) has called them), the local sector makes an important contribution to efficient resource allocation by ensuring that individuals, as in their choices of private goods, are able to obtain outputs of local services that equate fairly accurately marginal benefits and costs” (pp. 238–239). Bird (1993) likewise cites both “voice” and “exit” alternatives for insuring governmental accountability, though he describes migration as a “last ditch option that will be exercised only after (possibly repeated) electoral defeat” (p. 223).

3. Our inspiration here, of course, is the median voter theorem articulated by Downs (1955/1957).

4. At one extreme, government officials might demonstrate “public service motivation,” in which case they conscientiously attempt to determine and then implement the “public interest.” Such officials need neither elections nor competition to compel them to respond to consumer-voters, since they do so out of professional conviction (see, for example, Perry, Hondeghe, & Wise, 2010). This view, prominent in public administration, is looked upon with great skepticism in much of the literature on federalism, which is more likely to cite favorably the view (notably in Brennan & Buchanan, 1980) of malevolent public officials bent on maximizing tax revenues at the expense of the public. At the other extreme, ideologically rigid officials may not respond to electoral incentives or engage in information-based moderation (Canes-Wrone & Shotts, 2007; Fiorina, 2006). Between these extremes we find the median public official: concerned to stay in power and convinced that responding to voter interests is the best way to do that.

5. See Mexico’s Instituto Nacional de Estadística Geografía e Informática (INEGI), “Sistema Municipal De Base De Datos (Simbad)” (<http://www.inegi.gob.mx>).

6. If the benefits of decentralization flow from customizing public services to local preferences, then it is hard to argue that decentralization to the municipal level is unnecessary for the realization of the full benefits of decentralization as a national strategy to improve governance. The average population (2010) of Argentine provinces (excluding Buenos Aires) is nearly one million while Mexican states (excluding Mexico City) average almost three million. In Argentina, provincial populations range from 127,205 in Tierra del Fuego to 3,308,875 in Córdoba, while provincial populations in Mexico range from 637,026 in Baja California Sur to 7,643,194 in Veracruz-Llave. Conditions within provinces vary from dense, industrialized cities to small rural villages, which strongly suggests that the “one-size-fits-all” problem applies equally to provincial policies. Of course, local administrative capacity may be a problem for decentralization beyond the provincial level, but that is a practical rather than a theoretical barrier. As we argue below, local administrative capacity in the cities in our study suggests that this is not, in fact, as much of a barrier to further decentralization as has been claimed in the past.

7. Juan de Garay founded Santa Fe in 1573 and in 1660 the port became a major taxing center for the colonial government. The first Argentine Constitutional Convention took place in Santa Fe in 1853, and subsequent constitutional assemblies occurred in 1860, 1866, 1957, and, most recently, 1994.

8. The Regional Center of Research and Development, the National Water Institute, the National Institute of Limnology, Institute of Technological Development for the Chemical Industry, and the Technology Park Coastal Center, the Universidad Nacional del Litoral, the Universidad Tecnológica Nacional, and the Universidad Católica de Santa Fe.

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