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Income of the Local Public Treasury in Mexico

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Abstract. Own income for the local public treasury in Mexico must be more productive. One of its main characteristics is that in 2018 they financed 23 cents of each peso that was spent at the municipal level; while transfers contributed with 73 cents. On the other hand, the public debt contributed with 4 cents to the public spending of municipal governments. However, it was observed that property tax is not being well used, so it can generate more benefits if it is put to work in favor of providing quality public goods and services for the residents who live in the municipal space. Under the current fiscal coordination scheme, transfers will continue to be the most important resource for this level of government, but it is necessary that the level of property tax collection reaches at least one point of GDP for the next decade.

Keywords. public treasury, property tax, transfers

Introduction

The local public treasury receives internal and external income to finance its public spending. In Latin America, the vast majority of the resources that municipalities receive come from fiscal transfers. Of the internal or own income that they collect, in their space, the property tax is the most important. However, the income generated by this contribution represented 2 percent of GDP (OECD, 2020).

This work is organized as follows. In the first section, literature on property tax and transfers is explored; after that it is described the working method by which the qualitative information was collected; on the third, the antecedents of the local public finances are evidenced, which has its origin with the German economist Adolph Wagner (Oates, 1977). Section four contains the empirical evidence of municipal revenues in Mexico; conclusions are detailed in the last part, stating that the local public treasury must be more dynamic so that, despite the existing fiscal centralism, it emerges from fiscal laziness and better serves local residents, more so in the face of the COVID-19 health pandemic.

1. Property tax and transfers.

There are two important instruments in the local public treasury of any country that finance public spending: property taxes and transfers. The first comes from an internal source

of the municipal territory, while the second is generated outside the aforementioned territory and, later, they are shared with the subnational governments. (Intermediate and local¹).

In Mexico, as in most countries, "the property tax has come under considerable criticism and is less popular than other taxes" (Dahlby and McMillan, 2019: 2). On the other hand, transfers seek to "correct vertical and fiscal imbalances that are the result of the difference between the sources of income and expenses" (Spahn, 2009:79).

In the theoretical and historical review of the property tax, it is recognized as the oldest in the world. It was born in England. In this regard, Smith (2014:745) said that "its manifestation was the household currency; that is a lien of two shillings on each household, on things intended for habitation."

Fiscal decentralization has caused that "states and municipalities have different financial capacities to offer public services to their citizens" (Boadway and Shah, 2009: xxiii). For its part, the decentralization of "spending at lower levels of government is a widespread phenomenon, which seems to have become common in recent years" (Smart, 2009:210). There are those who consider (Oates, 1999) that fiscal decentralization should create conditions for municipal governments to provide better public services to residents who live in the locality.

The clearest evidence on the fiscal decentralization scheme in Mexico is represented by the property tax that, in 1983, derived from reforms to article 115 of the Political Constitution of the United Mexican States (CPEUM, 2020), the federative entities made the transfer of competences for the administration of the aforementioned contribution to the municipalities².

The purpose was not only to provide productive local taxes to this level of government, but also to give greater tax autonomy to the local public treasury. However, almost four decades after being assigned this contribution, the amount of income generated is 2 percent of GDP, while in France, in 2014, its collection was 4.3 percent of its production (OECD, 2020). The European country set a new world record, while in Mexico the property tax has not been put to work, it is wasted.

In Mexico, on this issue, empirical evidence concludes that conditioned transfers generate a greater negative impact on property tax collection (Canavire-Bacarreza, & Zúñiga Espinoza, 2015). It is the opposite case in Japanese municipalities where a higher leveling rate on tax compensation transfers provides municipalities with an incentive to increase tax rates (Miyazaki, 2020). In Italy, local fiscal autonomy performs poorly because much of the financing is done with grants (Bordignon, et al, 2020). The local public treasuries of Italy and Mexico can be classified as less productive than those of Japan.

2. Method.

There are many studies on the relations between transfers and the property tax, but under a quantitative methodology that uses econometric models. This work is different, the descriptive method is used by which the latest data from the National Institute of Geography and Information Statistics (INEGI, 2020) on municipal income for the year 2018 were taken. For this reason, when speaking of local public treasury, it is referring to the management of income, expense and debt carried out by all the municipalities of Mexico. However, for the case of this article, the data is taken only from municipal income (internal and external to the local space).

¹ For the purposes of this work, the term intermediate governments will correspond to the 32 federal entities and local governments to the municipalities.

² Mexico has, until today, 2,457 municipalities.

In this sense, when in this work a reference to the concept of own income is made, the resources captured by the collection of taxes, rights, products and uses will be included. This classification is made to find out the fiscal effort made by the local public treasury to finance its spending with revenues managed in its space. In addition, this serves as a starting point to find out what is the weight that transfers have on municipal revenue budgets.

3. History of the local public treasury.

It is necessary to describe in this paper the background of this field of research. It is going to be 143 years (October 8, 1877) since "the German economist Adolph Wagner planted the first trees of the now lush forest of the local public treasury" (Oates (1977, p. XII). However, Oates himself (1977, p. XII) states that in the world, "since the 1960s, research and publications related to local public treasury have been generalized in the most scientifically developed countries." It is a young research field, it can generate discussion, debate on the application of taxes in the local space³. Public spending, loans and income are relevant pieces to study. In this work, only the income administered by the Mexican local public treasury is addressed.

Local public treasuries have a potential for local tax and non-tax income. In the first, the most important, for almost all local governments in the world, is the property tax, and it is also the longest-lived of the contributions. In addition to this, there are other types of taxes by the transfer of real estate, by capital gains earned by the owners of land and/or buildings. As for non-taxers, there is also a potential for resources by the collection of public services, fines for violations of local laws, financial returns on bank investments, among others.

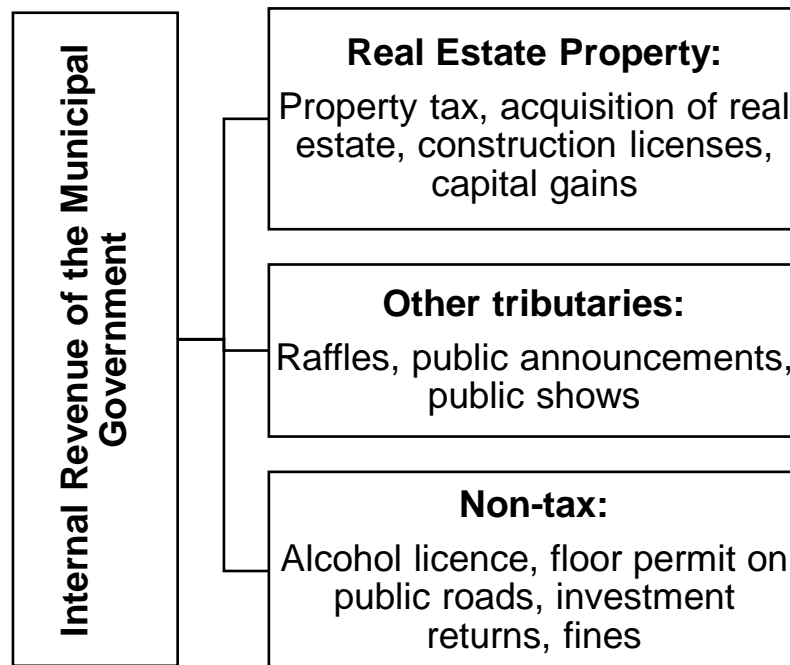
The Local Public Treasury in Mexico

The local public treasury⁴ of Mexico has internal and external sources of income that are exercised each year. Figure 1 shows that income from real estate, other tax and non-tax revenues are collected by municipal treasuries. In this responsibility of managing their own resources in their territory, local governments have not been efficient, so there is fiscal space to increase the level of income.

³ Oates (1977) says that local public treasury is born by combining: space and treasury.

⁴ The local public treasury will refer to the tasks of administration of income, expenditure and debt that the municipal governments exercise in their territory.

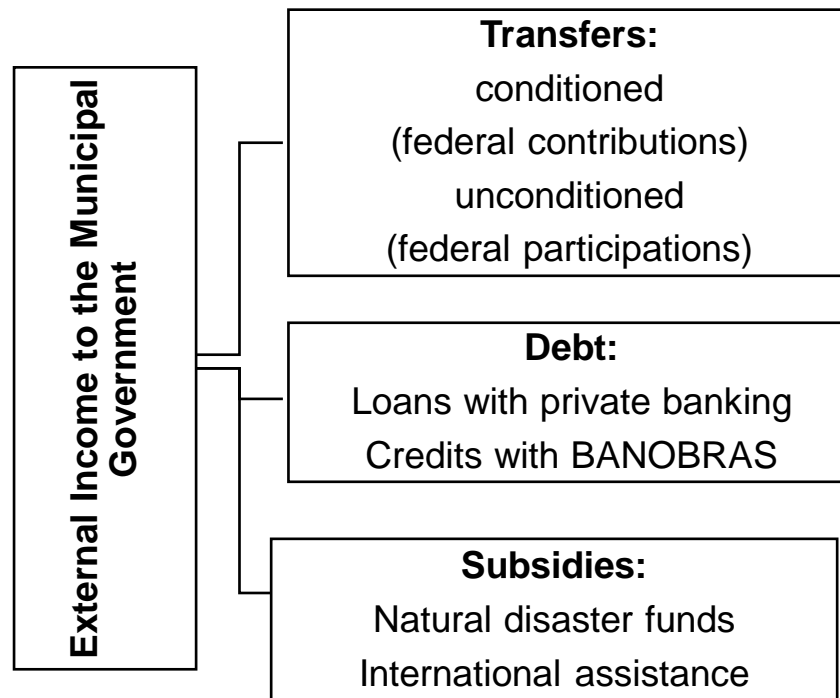
Figure 1. Sources of internal income.



Source: own elaboration based on review of income laws of Mexican municipalities, May 2020.

On the other hand, external income is considered, that is, income collected or managed outside the municipal territory, transfers, debt and subsidies (see figure 2). These are revenues that the other two higher levels of government share with the local government to try to balance their spending and reduce the vertical fiscal imbalance.

Figure 2. Sources of external income

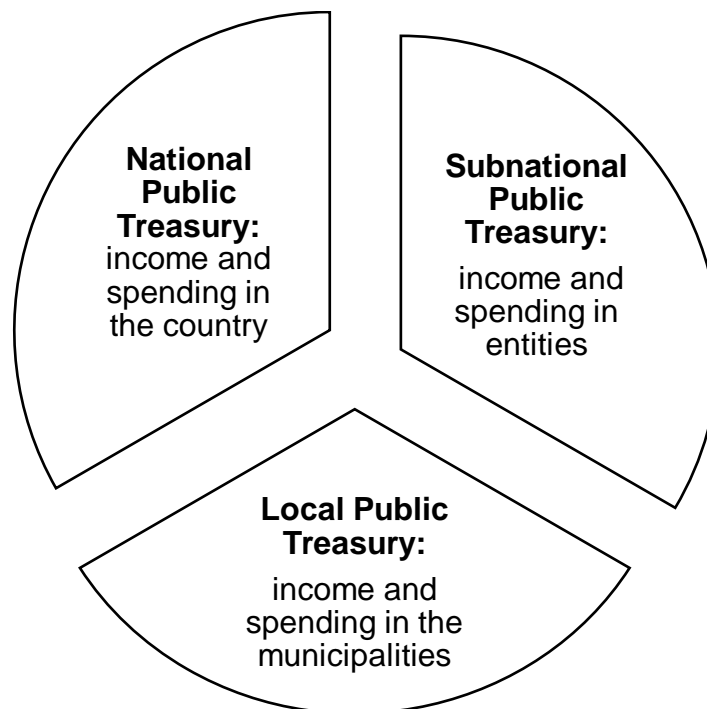


Source: own elaboration based on review of income laws of Mexican municipalities, May 2020.

In the case of income from transfers, these are shared under the framework of the National Fiscal Coordination System (SNCF), resources that are distributed in accordance with the Fiscal Coordination Law (LCF, 2018). Those who have experienced managing municipal public finances know that budgets are limited. Despite this, they have to face and resolve, to the best of their ability, the demand for services such as drinking water, pollution, public lighting, drainage and, more recently, health in favor of the population.

The local Public Treasury is closer to the residents who live in the territory than the National Public Treasury (federal) and the Subnational Public Treasury (state or provincial). For this reason, the former is faced with problems that, citizens consider, should be of public attention, that is, be included in the government agenda.

Figure 3. The Public Treasury in Mexico

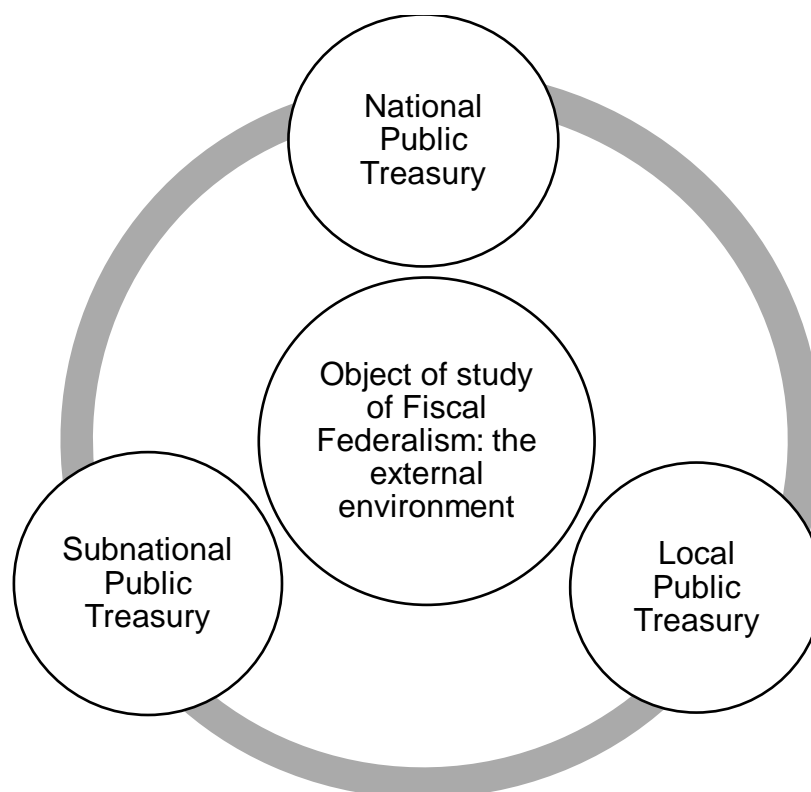


Source: self-made.

According to literature (Oates, 1977), figure 3 was made, adapted for all three levels of government that exist in our country. Under this scheme, it is understood that the local public treasury, inside, decides how to generate income and how to spend it. The local public treasury receives income from taxes, rights, products and uses. These sources of public money are supported, mainly, by the municipal treasure laws and the respective income laws, where the latter are approved each year by each of the 32 local legislatures.

Regarding the external relations that the local public treasury has with other treasuries of the same level of government (municipalities) or with treasuries of different government levels (state and national), it allows the use of fiscal federalism (see figure 4), instrument used for "the analysis of the interrelationships that arise from the income and spending between the treasuries of the same level and of different governmental levels" (Oates, 1977, XIV). Under this scheme, Mexican municipalities receive income from fiscal transfers.

Figure 4. The external relation between Public Treasuries



Source: self-made.

Empirical evidence: municipal revenues

Although it is true that the main instruments which are highlighted here are the property tax and transfers, the statistical data obtained from INEGI (2020) includes also the income raised by the public treasury such as taxes, rights, products and uses. Likewise, income from public debt, which in most cases increases the fiscal deficit of the municipalities.

Table 1. Municipal income, 2018 (thousands of pesos).

| Concept | Figure | Percentage |
|------------------------|-------------|------------|
| Taxes | 61,704,714 | 13.6% |
| Improvements | 679,785 | 0.1% |
| Rights | 27,043,353 | 5.9% |
| Products | 5,049,440 | 1.1% |
| Uses | 8,297,298 | 1.8% |
| Federal Participations | 168,712,238 | 37.1% |

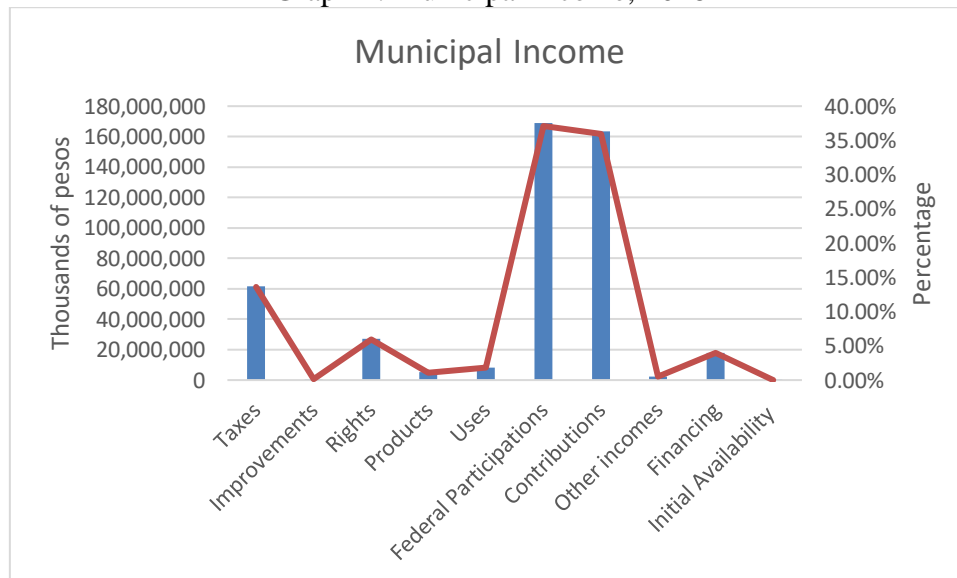
| | | |
|----------------------|-------------|--------|
| Contributions | 163,363,077 | 35.9% |
| Other incomes | 2,158,038 | 0.5% |
| Financing | 17,976,317 | 4.0% |
| Initial Availability | 105,795 | 0.0% |
| Total | 455,090,055 | 100.0% |

Source: own elaboration based on State and Municipal Public Finances (INEGI, 2020).

Like most municipal governments in the world, in the Mexican local public treasury own income and transfers (conditional and unconditional) are managed. This source of conditional income in Mexico is called “federal contributions” and unconditional resources are known as “federal participations.” Municipal revenue figures corresponding to the 2018 fiscal year were taken (INEGI, 2020).

Of the 445 billion pesos that the Mexican local public treasury had in municipal income, most of it, 37 percent, came from unconditional transfers, followed by approximately 36 percent from conditional transfers. The income obtained from local taxes represented 13.6 percent.

Graph 1. Municipal income, 2018



Source: Own elaboration based on data from INEGI (2020)

In reference to local taxes, the most relevant source of income were those that fall on the patrimony, which represented approximately 83 percent of all tax collection; while the taxes levied on income barely represented 0.2 percent of the total resources managed by the local mexican public treasury.

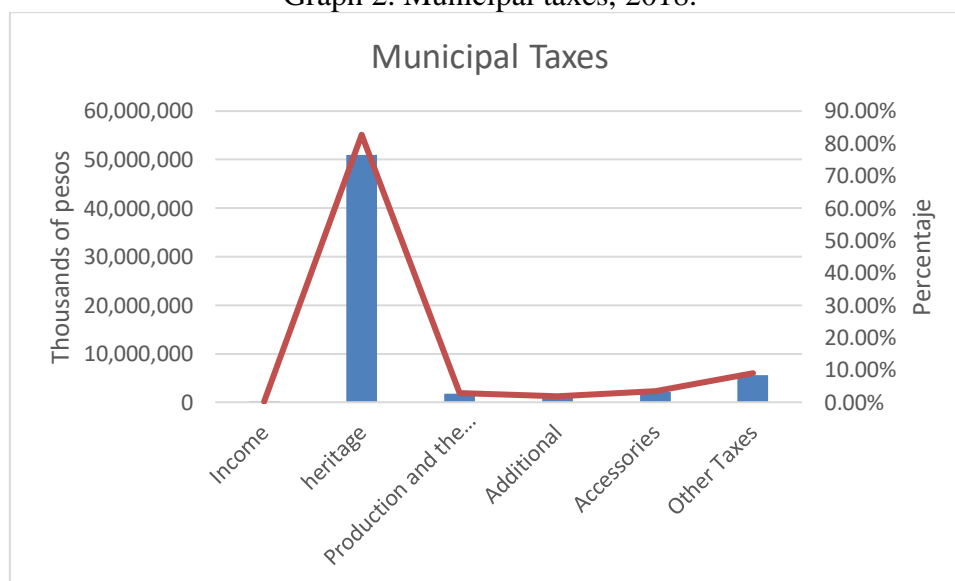
Table 2. Municipal taxes, 2018 (thousands of pesos).

| Concept | Figure | Percentage |
|--------------------------------|------------|------------|
| Income | 138,285 | 0.2% |
| Heritage | 51,023,273 | 82.7% |
| Production and the Consumption | 1,723,197 | 2.8% |
| Additional | 1,150,745 | 1.9% |
| Accessories | 2,142,883 | 3.5% |
| Other Taxes | 5,526,332 | 9.0% |
| Total | 61,704,714 | 100.0% |

Source: Own elaboration based on State and Municipal Public Finances (INEGI, 2020).

The other taxes on raffles, commercial advertising, vehicle acquisition, public shows, among others, are marginal and not very representative for the local public treasury.

Graph 2. Municipal taxes, 2018.



Source: Own elaboration based on data from INEGI (2020)

Regarding the taxes that are levied on the patrimony, the property tax generated 62 percent of the income, followed by the real estate acquisition tax (ISAI) that represented approximately 33 percent of the aforementioned fiscal resources. The ISAI is a contribution that is closely linked to the performance of local economic development, since a good performance of this means that there is more buying and selling of real estate to carry out business.

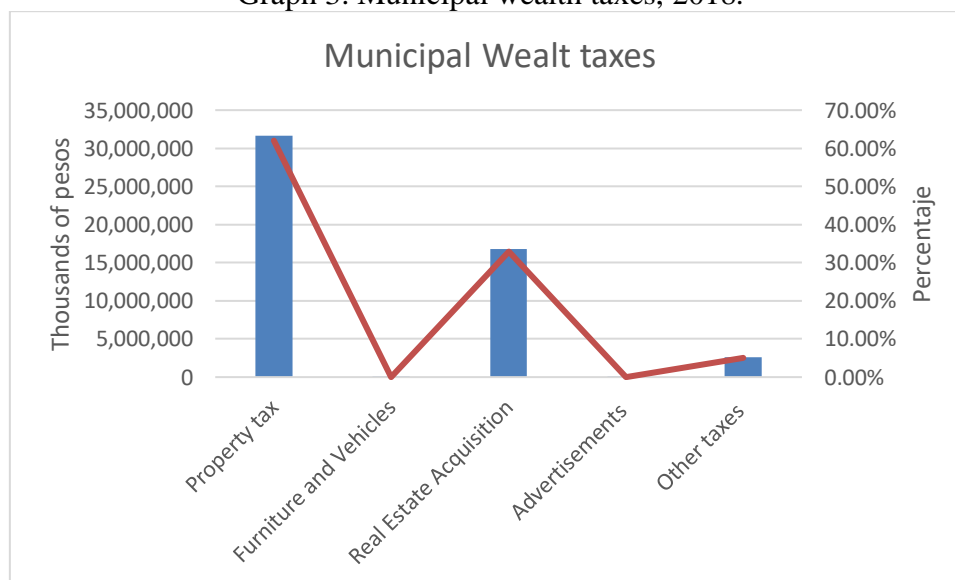
Table 3. Municipal wealth taxes, 2018 (Thousands of pesos).

| Concept | Figure | Percentage |
|-------------------------|------------|------------|
| Property tax | 31,632,364 | 62.0% |
| Furniture and Vehicles | 11,789 | 0.0% |
| Real Estate Acquisition | 16,789,317 | 32.9% |
| Advertisements | 23 | 0.0% |
| Other taxes | 2,589,781 | 5.1% |
| Total | 51,023,273 | 100.0% |

Source: Own elaboration based on State and Municipal Public Finances (INEGI, 2020).

The tax on commercial advertisements is frowned upon by the business sector, they consider it an additional burden that does not encourage investment. In addition, in this year 2018, it was not representative in the collection of taxes, for which its administration is considered to be expensive for the local public treasury.

Graph 3. Municipal wealth taxes, 2018.



Source: Own elaboration based on data from INEGI (2020).

The fiscal effort made by the local public treasury to collect its own income within its territory managed to obtain, in 2018, 102 billion pesos, of which 60 percent were generated by local taxes. The lowest figure was for the contributions of improvements, equivalent to 1 percent of the aforementioned own income. In Mexico, given the exacerbated fiscal centralism,

municipalities collect few taxes, so there is a high dependence on the transfers shared by the Ministry of Finance and Public Credit (SHCP) of the federal government.

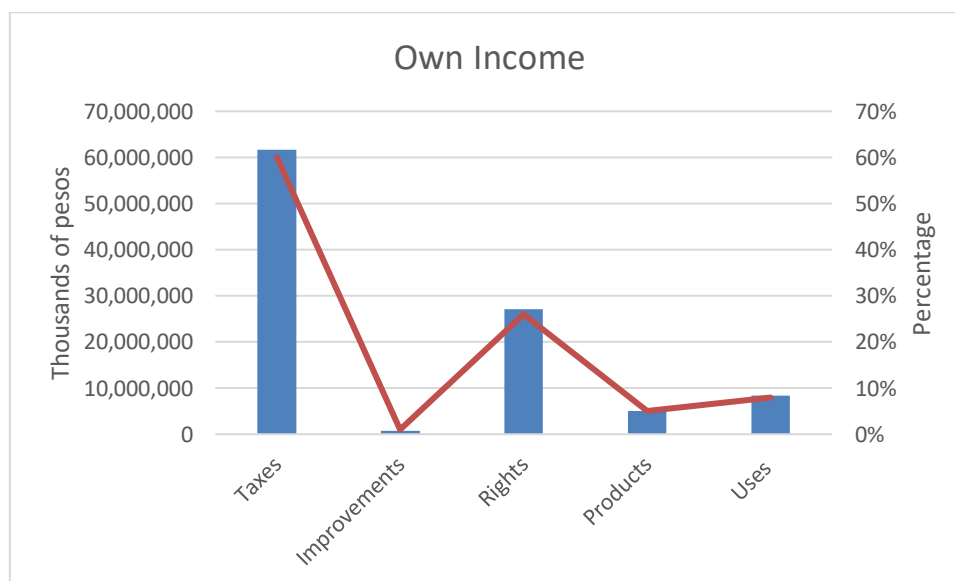
Table 4. Own income, 2018 (Thousands of pesos).

| Municipal Own Income in Mexico, 2018 (Thousands of pesos) | | |
|---|--------------------|-------------|
| Concept | Figure | Percentage |
| Taxes | 61,704,714 | 60% |
| Improvements | 679,785 | 1% |
| Rights | 27,043,353 | 26% |
| Products | 5,049,440 | 5% |
| Uses | 8,297,298 | 8% |
| Total | 102,774,590 | 100% |

Source: Own elaboration based on State and Municipal Public Finances (INEGI, 2020).

Graph 4 shows that local taxes are the most important source of income for the local public treasury, followed by the collection of rights for the use, enjoyment or exploitation of public domain goods. The least productive own income is that of contributions for improvement (1 percent). However, in other countries, such as Colombia, it turns out to be an important source for financing infrastructure and public works. Evidence on the Valuation Contribution (VC) in Colombia (Borrero, 23) says that "it is very old, since its legislation dates back to 1921 and has a history of application throughout the country -practically uninterrupted- for more than 70 years".

Graph 4. Own Income, 2018.



Source: Own elaboration based on data from INEGI (2020).

Regarding the external income to the local public treasury, unconditional transfers were 50.5 percent, the conditional were 48.9 percent and other income was barely 0.6 percent. Since the birth of the SNCF (1980), the importance of strengthening municipal revenue collection has been raised so as not to depend only on fiscal transfers. In this discussion of new formulas and criteria to distribute the transfers, the governors of the 32 federative entities have not reached an agreement. In fact, the states that have decided to leave the National Conference of Governors (CONAGO) are: Chihuahua, Durango, Jalisco, Michoacán, Tamaulipas, Colima, Coahuila, Nuevo León, Guanajuato and Aguascalientes (The Economist, 2020).

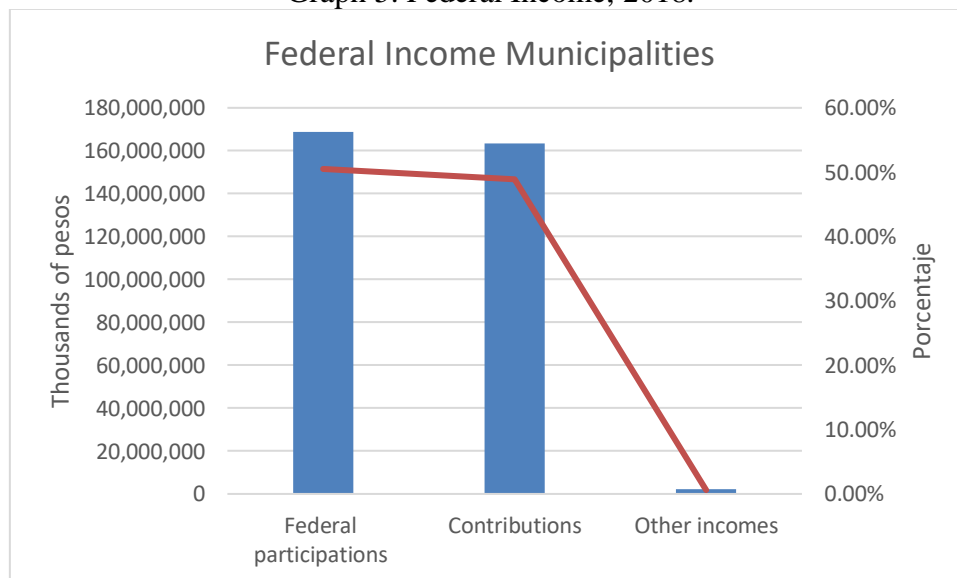
Table 5. Federal income, 2018 (Thousands of pesos).

| Concept | Figure | Percentage |
|------------------------|--------------------|---------------|
| Federal participations | 168,712,238 | 50.5% |
| Contributions | 163,363,077 | 48.9% |
| Other incomes | 2,158,038 | 0.6% |
| Total | 334,233,353 | 100.0% |

Source: Own elaboration based on State and Municipal Public Finances (INEGI, 2020).

Even though in Mexico it is difficult for most of the income to be generated locally, this can give freedom to mobilize the application of these public monies towards items that seem to be priorities, which do not have to be subject to national tax laws in the country.

Graph 5. Federal Income, 2018.



Source: Own elaboration based on data from INEGI (2020).

Regarding the fiscal effort, the municipalities of Mexico had the capacity to collect 23 percent of the 455 billion pesos spent in 2018; conditional and unconditional transfers (federal income)

contributed a 73 percent; while through financing (public debt) 4 percent of the resources spent by the local public treasury were contracted.

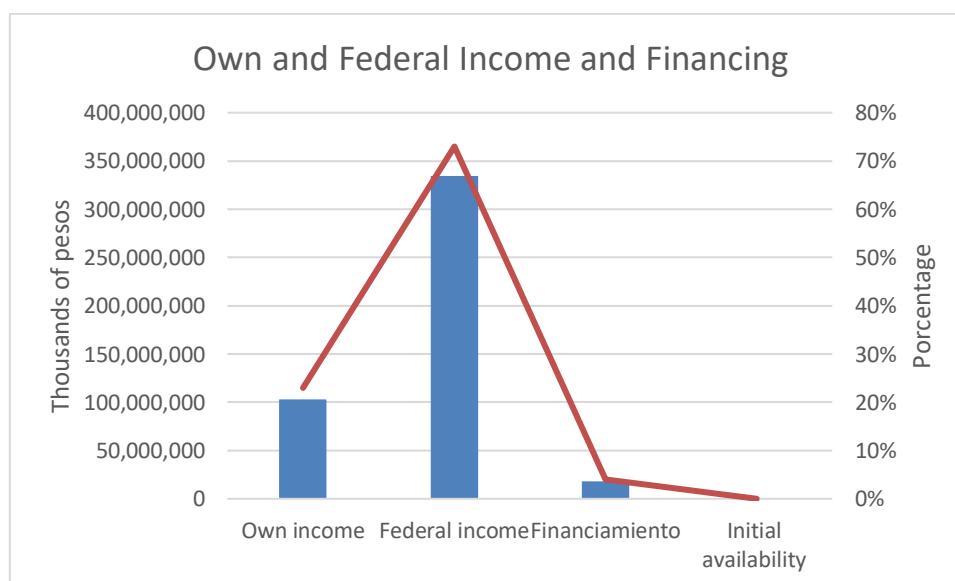
6. Own and federal income and financing, 2018 (Thousands of pesos).

| Own and Federal Incomes and Financing, 2018 (Thousand of pesos) | | |
|--|--------------------|-------------|
| Concept | Figure | Percentage |
| Own income | 102,774,590 | 23% |
| Federal income | 334,233,353 | 73% |
| Financiamiento | 17,976,317 | 4% |
| Initial availability | 105,795 | 0% |
| Total | 455,090,055 | 100% |

Source: Own elaboration based on State and Municipal Public Finances (INEGI, 2020).

Graph 6 shows the strong dependence that the local public treasury has on the income shared by the SHCP, in accordance with the Adherence Agreement to the National Federal Fiscal Coordination System, where the municipalities are represented by the states.

Graph 6. Own and federal income and financing.



Source: Own elaboration based on data from INEGI (2020).

Conclusions

The municipal governments of Mexico have not found or designed the mechanism for the property tax to work better and increase their income. It is necessary that the level of collection reaches at least one point of GDP for the next decade. It will have to be worked on because the COVID-19 pandemic affected transfers and the municipalities will receive fewer federal resources and now face fiscal stress.

It is difficult to say whether or not the local public treasury in Mexico should be granted greater freedoms to administer its fiscal instruments. Doing so, it would become a laboratory for tax and spending initiatives that could be successful or misguided; they have the right to make mistakes, in an effort to improve the performance of local public treasure instruments. But I think it would be worth it and that the local public treasury should not be relegated by the historical practices of fiscal centralism that makes it lazy and conformist, which today was made more evident by the COVID-19 health pandemic.

Given this, questions arise such as: Will municipal governments and citizens be able to establish a social contract to pay their taxes with certainty and that these be applied for the benefit of the population that lives in the municipality? Will local public spending stop being a barrel of pork⁵ and focus on the production of goods and services that have a real impact on the territory? These are questions that can be brought to the debate table among the voters who participate in the next electoral process of 2024 to elect the mayors who manage local public finances. This could be an exercise that generates many challenges for all those who in one way or another have permanent contact with the municipal public treasury.

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⁵ Pork barrel refers to acts of corruption to divert public resources, affecting the health of the public treasury and the quality of life of residents living in the municipality

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