Ecological Fiscal Transfer (EFT) in Portugal[i]

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Brief summary of the case

The Ecological Fiscal Transfer (EFT) was introduced in 2007, establishing a new form of intergovernmental transfer made to municipalities. This instrument aims to compensate those municipalities that, as a result of the designation of Natura 2000 and other protected areas, may have land-use constraints with potential opportunity costs in terms of economic development (Santos et al., 2012). The implementation of the EFT is too recent to obtain a rigorous evaluation of its effectiveness. However, some constraints and strengths can be identified. These include, respectively, the lack of awareness of the instrument amongst local government authorities and technicians, and the positive relevance for municipalities with a large share of Natura 2000 and protected areas in terms of their total area. It appears that the academic sector and some non-governmental organisations (NGO) have participated in the design and evaluation of this instrument. Nonetheless, it is also considered that broader involvement of civil society has not occurred so far. Finally, several ideas for the revision of this instrument were identified, *inter alia* the promotion of a better perception of the EFT by local stakeholders, and the extension of the principle of positive discrimination to other areas. Although not a market-based instrument, this instrument is included in the set of case studies as an interesting example of a different approach to environmental fiscal and budgetary reform.

1 Description of the design, scope and effectiveness of the instrument

1.1 Design of the instrument

The revision of the Local Finances Law 2/2007 of 15 January (*Lei das Finanças Locais – LFL*) introduced the instrument of ecological fiscal transfer (EFT) in Portugal. The LFL defines the guideline for the transfer of funds from the national government to municipalities (Santos et al., 2012).[1] Three national funds are available for this: the Financial Equilibrium Fund (*Fundo de Equilíbrio Financeiro – FEF*), the Municipal Social Fund (*Fundo Social Municipal – FSM*), and a fund supported by a maximum of 5% obtained from personal income tax (Santos et al., 2012). Moreover, according to article No21 of the LFL, the Financial Equilibrium Fund is equally divided into the General Municipal Fund (*Fundo Geral Municipal – FGM*), and the Municipal Cohesion Fund (*Fundo de Coesão Municipal – FCM*).

Article No6 of the LFL on the "Promotion of local sustainability" establishes the implementation of a "positive discrimination of the municipalities with area allocated to the Natura 2000 network and protected area, in the context of the General Municipal Fund" (*Fundo Geral Municipal – FGM*). The main motivation for the implementation of this transfer corresponds to the compensation of the preservation costs, including opportunity costs, experienced by the municipalities as a result of nature conservation regulations. The instrument represents a financial incentive to municipalities (Santos et al., 2011; 2014). The

[1] There are 308 municipalities in Portugal, including 278 in the mainland, and 30 in the Autonomous Regions of Madeira and Azores.

General Municipal Fund is transferred to the municipalities on the basis of the following criteria:

- 5% is divided equally amongst all the municipalities;
- 65% according to the population size of the municipalities, weighted to benefit municipalities with lower population density;
- 25% transferred in proportion to the area, weighted by a factor measuring the altitude range of the municipality, and 5% in proportion to the area classified as Natura 2000 or protected area in municipalities with less than 70% of their area under the previous classifications (these figures are 20% and 10% respectively for municipalities with more than 70% of their area designated as Natura 2000 or other protected areas) (Santos et al., 2012).[1]

1.2 Drivers and barriers of the instrument

The introduction of the EFT was made in the context of the revision of the LFL, which also involved other changes such as the establishment of new rules for the allocation of the Municipal Cohesion Fund (*Fundo de Coesão Municipal – FCM*) and positive discrimination for low density populations in terms of the transfer of the General Municipal Fund (Santos et al., 2012).

According to Schröter-Schlaack et al. (2014), the design and implementation of the EFT was part of the national policy agenda. The idea was promoted by the Ministry of Environment and accepted by the Ministry of Finance (Santos et al., 2011). This type of instrument had previously been brought up for discussion by the academic sector and NGOs. Moreover, it had support from civil society representatives in meetings with the Portuguese Parliamentary Environment Committee and other members of the Parliament before being implemented (information provided by João Joanaz de Melo, 02/08/2016). The process leading to the introduction of the EFT was complex and shaped by the political and economic context observed in the country at the time, which was influenced by the world economic and financial crisis (information provided by José Alho, 28/07/2016; 26/10/2016). In addition, according to information provided by João Joanaz de Melo (02/08/2016), it is not completely clear if the EFT has been applied in its full extent since its implementation, since some local government authorities have stated that no transfer was received by the corresponding municipalities or that they did not have good knowledge of this instrument.

1.3 Revenue collection and use

Scale of revenues (total/annual)

On average, around 60% of municipal budgets are made up of fiscal transfers from the national government, with minimum and maximum values ranging from 25% in Lisbon to 95% in Barrancos in 2008 (Santos et al., 2012; Schröter-Schlaack et al., 2014). According to

Table 1, total fiscal transfers ranged from EUR 2,251 million to 2,407 million between 2004 and 2008, respectively. The latter value already includes the EFT, which represented 2.2% of total fiscal transfers in 2008, i.e. approximately EUR 53 million (Santos et al., 2012).

Table 1. Total fiscal transfers to municipalities between 2004 and 2008 (in million EUR)

Old Local Finances Law				New Local Finances Law
2004	2005	2006	2007	2008
2,251	2,298	2,298	2,298	2,407

Source: Santos et al. (2012).

Use of the revenues

The revenues obtained with the EFT are not earmarked, meaning that the municipalities receive a lump-sum transfer, and are free to decide how to use the money received (Santos et al, 2014).

Who pays and collects

As mentioned in the previous sections, the EFT is a fiscal transfer made from the national Government to local governments.

1.4 Environmental impacts and effectiveness

The implementation of the EFT is too recent to evaluate its ecological effectiveness in terms of its impact on the management of protected areas, the conservation of biodiversity, and the provision of ecosystem services (Santos et al., 2012; Schröter-Schlaack et al., 2014). Nevertheless, Schröter-Schlaack et al. (2014) refers to the efforts that are being made by academics together with other authorities (e.g. conservation organisations, municipal and private land users) to evaluate the effect of the EFT and suggest options for its improvement (e.g. Santos et al., 2012; 2014).

According to Santos et al. (2014), it is hard to measure the effectiveness of the EFT due to the fact that its general purpose relies on the compensation of opportunity and management costs associated with the designation of protected areas. The instrument lacks visibility and it is not considered to be as well-known as it should be by local government authorities and technicians. This does not allow the important role of protected areas for economic development to be demonstrated (information provided by José Alho, 28/07/2016). Moreover, the substantial number of changes implemented with the revision of the LFL made it difficult for municipal authorities to understand the part related to the EFT, weakening the incentive towards conservation (Santos et al., 2012; Schröter-Schlaack et al., 2014).

Moreover, the fact that the revenues obtained with the EFT are not earmarked for the management of Natura 2000 sites means that this instrument cannot be considered an incentive towards conservation. As a result, it is not fully appropriate to assess the effectiveness of this instrument in terms of its conservation impacts.

Nonetheless, the positive discrimination in favour of municipalities with Natura 2000 and other protected areas is considered as a breakthrough due to the recognition of the contribution of those areas for economic development (information provided by José Alho, 28/07/2016 and 26/10/2016). The EFT is therefore considered to be a significant step in changing the mind-set of decision makers (Schröter-Schlaack et al., 2014).

1.5 Other impacts

Despite representing only 2.2% of total fiscal transfers in 2008, the EFT represents an important contribution to the local budgets of some municipalities that have a significant area of their territory classified as Natura 2000 or protected areas (e.g. Campo Maior, Freixo de Espada à Cinta, and Castro Verde) (Santos et al., 2012). Some of these municipalities are located inland, where there are often more socio-economic constraints than in coastal areas (e.g. ageing population, less access to public services). Accordingly, the EFT may represent a positive discrimination for these areas.

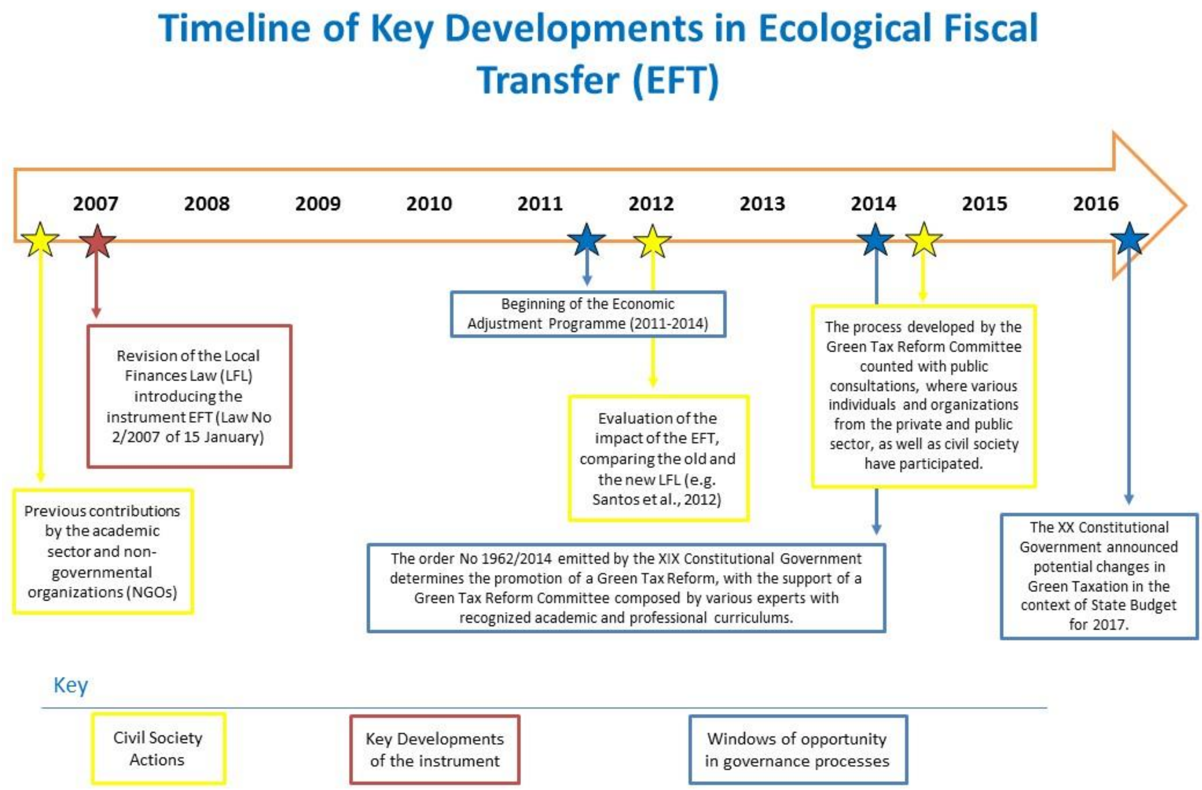
2 Stakeholder engagement

The introduction of the EFT in 2007 did not follow a methodology that allowed the views of the actors involved to be captured. This resulted in a lower quality and limited scope of the process (information provided by José Alho, 28/07/2016; 26/10/2016). There is a lack of involvement of civil society in the discussion of economic instruments likely to be applied in the promotion of nature conservation, involving private land owners and municipalities (information provided by João Joanaz de Melo, 02/08/2016). Since the implementation of the EFT, the main participation of civil society was with academic-led work on the evaluation of the instrument's impact (e.g. Santos et al., 2012) and with the Green Tax Reform (GTR) in 2014. The latter initiative included the creation of a GTR committee composed of both academic and professional experts. This committee coordinated the public consultation process for the GTR. In terms of the EFT, it was not considered necessary to make changes in the sections of the LFL dealing with the criteria established for the transfer of the General Municipal Fund to the municipalities (see Section 1.1). However, the GTR committee suggested some changes on other aspects, *inter alia*:

- the evaluation of the potential use of a percentage of the EFT for actions that promote nature and biodiversity conservation, without affecting the autonomy of the municipalities in terms of spending;
- the reinforcement of the value of the ETR, which was considered as low, in order to represent a real incentive for the municipalities, while guaranteeing the balance with other criteria for the fiscal transfers;
- and the need to establish the EFT as an independent component of the structure of the funds, allowing the magnitude of the transfers being made to be clearly identified (Green Tax Reform Committee, 2014).

These suggestions were, however, not adopted by the national Government. The Law No 82-D/2014 of 31 December embodied the results of the GTR, including various measures in other fields such as waste management and water pricing.

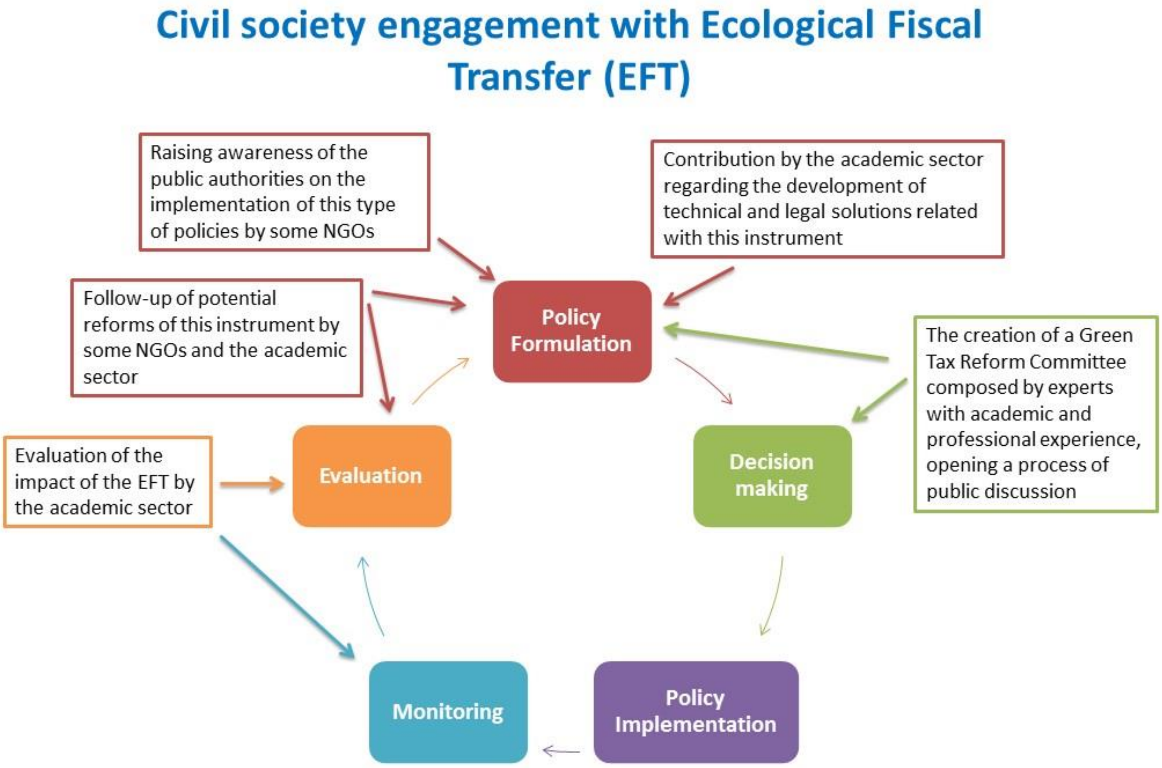
Figure 1. Schematic view of the involvement of civil society (in yellow) and policy-makers (in blue) in the introduction and implementation of the Ecological Fiscal Transfer (EFT) (in red)



3 Windows of opportunity

Figure 2 aims to capture civil society engagement in the context of the EFT. The main actions were associated with the policy formulation and evaluation stages, with some involvement in the decision making and monitoring stages. Civil society was mainly represented by the academic sector and some environmental NGOs, including GEOTA.

Figure 2. *Schematic overview of windows of opportunity throughout the policy cycle of the* Ecological Fiscal Transfer (EFT)



4 Insights into future potential/reform

4.1 Actual Planned reforms and stakeholder engagement

It is not completely clear if reforms are currently being considered. The interviewees for this case study considered that such reform was not planned (José Alho, 29/07/2016), and that the current Portuguese Government intends to implement a future GTR reform which may address the EFT, but the process is not yet clear (João Joanaz de Melo, 02/08/2016).

4.2 Suggestions for future reforms – instrument design and civil society engagement

- Increase awareness of the EFT by the local stakeholders (based on information provided by José Alho, 28/07/16);
- Consider other typologies of sites (e.g. UNESCO World Heritage Sites) to assess eligibility for the EFT (based on information provided by José Alho, 28/07/16). However, broadening the scope by integrating other typologies may weaken the potential positive effects on Natura 2000 sites due to the limited resources available;
- Launch an awareness campaign aimed at promoting the importance and role of protected areas (based on the information provided by José Alho, 28/07/16);
- Extend the positive discrimination approach not only to municipalities but also to private land owners of Natura 2000 areas (based on information provided by João Joanaz de Melo, 02/08/2016);
- Improve knowledge on the ecosystem services provided by the natural territory (based on information provided by João Joanaz de Melo, 02/08/2016);

- Introduce another criterion for the EFT associated with the conservation value and quality of protected areas (based on Santos et al., 2012);
- Apply part of the revenue obtained from the EFT to management and restoration actions within Natura 2000 sites.

4.3 Suggestions for replicability

- Promote the application of the positive discrimination approach in territories that preserve natural and cultural resources beyond their obligation of being classified as Natura 2000 or protected areas (based on information provided by José Alho, 28/07/16);
- Promote the application of the positive discrimination approach in other fields such as the efficient use of natural resources and the response to environmental problems, notably adaptation to climate change (based on information provided by José Alho, 28/07/16);
- Promote the application of the positive discrimination approach in other fiscal instruments such as the Municipal Property Tax (*Imposto Municipal sobre Imóveis – IMI*) (based on information provided by José Alho, 28/07/16).

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