

Executive summary and main policy options for Portugal

Overview

At first glance, the Portuguese model of multilevel governance does not seem to differ much from the systems practised in most other countries. However, Portuguese municipalities, parishes (*freguesias*) and intermunicipal co-operative units, which currently form the subnational government in Portugal, have much less spending and revenue powers than most of their peers in other EU countries. Therefore, the Portuguese multilevel governance system appears quite centralised compared with other European and OECD countries.

Another interesting feature of Portuguese multilevel governance is that, at least so far, Portugal has chosen not to establish a regional government level, which is currently in use by many other EU countries with similar population size. This is despite the fact that Portugal has already prepared the legal framework to implement the administrative regions in its 1976 Constitution, which would have elected councils and own budget. Instead, Portugal has established deconcentrated regional governance to tackle regional level issues and co-ordinate central government services at the regional (NUTS 2) level. These agencies are called Commissions for Co ordination and Regional Development (henceforth the Portuguese acronym CCDR). In addition, Portugal has attempted to enhance intermunicipal co-operation by establishing 23 Inter-Municipal Councils (IMC) (CIMs in Portuguese, which correspond to the NUTS 3 level) to take care of tasks which benefit areas that go beyond the borders of single municipalities. Portugal also created metropolitan areas (MAs) for Lisbon and Porto. However, the role of metro and non-metro intermunicipal co-operation remains limited, as only a fraction of local spending has been assigned to the IMCs and MAs so far.

Taking into account the demographic challenges faced by Portugal in the coming decades, due to an ageing and diminishing population, and the growing regional differences in service delivery potential and economic sustainability that will come with it, the need for structural reforms in this area should be a priority for the country. Moreover, there seems to be unused potential in the current implementation of decentralisation.

This executive summary describes in brief the main challenges faced by Portuguese decentralisation and the potential paths forward for more efficient multilevel governance.

Main challenges faced by Portuguese multilevel governance

This study has identified a number of challenges of the current Portuguese model for decentralisation. Below is a summary of the main observations discussed in this paper.

Limited ability to address regional level issues

In Portugal, regional level problems are currently being tackled mainly with deconcentrated central government administration or direct intervention from the central government. While the CCDRs are engaged in co-operation and dialogue with local governments and other relevant stakeholders, the main focus of CCDRs has been on managing the EC structural funds due to their limited financial resources and narrow mandate. Therefore, the ability of CCDRs to deal with issues concerning regional public service provision and regional development is restricted at best. Moreover, due to their role as deconcentrated central government units, the CCDRs lack the status and legitimacy that an elected regional government could have.

Modest spending and revenue decentralisation limit the benefits received from decentralisation

While the legal and administrative autonomy of Portuguese municipalities has been strengthened during the past five to ten years, few important spending assignments have been devolved to local governments in that same period of time. Although the reluctance of Portugal to decentralise important spending tasks to the municipal level during the austerity measures is understandable, the dilemma lies in the fact that without further fiscal decentralisation – i.e. devolving more tasks and revenue to subnational governments – the potential benefits of decentralisation will be missed.

The differences in fiscal capacity between municipalities

Municipalities differ considerably in their capacity to generate own revenues. Lisbon and Porto have the highest levels of own revenues per inhabitant, followed by other municipalities in the coastal area. At the other extreme are the inland municipalities, which are very dependent on intergovernmental transfers. This puts pressure on the transfer system and fiscal equalisation, but also on the subnational government financing system in general.

Tax competition between municipalities may improve efficiency but can also have negative side-effects

The municipalities with lower fiscal capacity, in the use of their freedom to explore legal fiscal limits, tend to adopt lower tax rates in property tax and surcharge tax. While this behaviour is understandable from a single municipality's point of view, as a way to attract private investments and promote local economic development, it may have greater effects which are not all positive. From the positive side, competition between municipalities is beneficial if it enhances the efficiency of public service provision and constrains increase of tax rates. Competition can also be harmful if it leads to “race to the bottom” behaviour of the tax rate setting, for example. In turn, this can erode tax bases and may eventually lead to worse local public services.

Volatile municipal tax bases may create spending risks

Relatively stable local revenues that are predictable over time are usually recommended. Hence, elements of the local revenue system that contribute to the volatility of taxes should be avoided. In 2017, the Municipal Property Purchase Tax (IMT) was the second most important tax for municipalities, forming 26% of total municipal tax revenues. The data on IMT reveals that it has been highly volatile during the past 15 years. While the economic crisis and the subsequent recovery explains part of this development, the volatility of important local tax bases is a cause for concern. Exposure to volatile local tax bases can lead to aggregate efficiency losses if expenditure rises in good times, and governments find it harder to cut spending than raise taxes during a downturn, leading to a ratchet effect.

Unclear role of intermunicipal co-operation

Metropolitan areas (MAs) and intermunicipal councils (IMCs) still play a marginal role in the public sector, notably due to the modest level of decentralisation in general. While this may change in the coming years, as more responsibilities will be decentralised to municipalities, the challenge is to enlarge the role of intermunicipal organisations and guarantee their financial means.

Overlapping assignments between deconcentrated central government units may be a source of inefficiency

The deconcentrated regional departments of the Portuguese line ministries are currently fragmented, forming a complex web of central government services. There are currently deconcentrated central government departments in agriculture, education, employment, economy, social security, health and transport. The five CCDRs are responsible for the territorial co-ordination of central government services in each region. However, there seem to be several organisational and legitimacy challenges which may impede the CCDRs in the co-ordination and catalysis of a truly cross-sector, strategic approach to regional development.

The slow economic growth in Lisbon and Porto areas

It is worrying to note that the growth in the Portuguese metropolitan areas, notably in the Lisbon area, has not picked up as in other regions in Portugal. Operational metropolitan governance can form a favourable environment for economic growth and well-being. Therefore, enhanced metropolitan governance could be part of the solution to this problem. Currently, the Lisbon and Porto Metropolitan Areas are organised as compulsory one-tier co-operative associations (MAs). The real decision-making authority in metropolitan areas is however largely held by the municipalities of these areas, together with central government. As a result, the current MAs lack both political and financial authority to truly influence the metropolitan-wide challenges.

Ways forward in the process of decentralisation in Portugal

Prerequisites for a successful territorial and institutional restructuring

There are preconditions for any successful decentralisation reform. Among these requirements, focusing on clear responsibilities and functions assigned to government levels, funding the responsibilities that are transferred adequately, as well as strengthening subnational capacities and the overall co-ordination mechanisms are fundamental. Other preconditions include allowing for territorially-specific policies and the possibility for asymmetric decentralisation, with differentiated sets of responsibilities given to different types of regions/cities, and metropolitan areas in particular. Such mechanisms are critical to providing institutional and fiscal arrangements that best respond to local needs. Such measures would be useful for Portugal irrespective of the type of decentralisation reform.

Portugal could consider adopting experimenting and sequencing practices when implementing major multilevel governance reforms. While this kind of reforming is slower than a “big bang” reform, it enables learning-by-doing and revising decisions during the reform process, if need be.

Portugal could also consider intensifying and developing the data collection processes as well as setting up new databases on subnational government finances and service provision. High-quality information on Portugal’s subnational governments would enable enhanced steering and monitoring of subnational governments, both by central government and citizens/taxpayers. Although the data collection processes and database setup would require additional resources, savings gained over time from reduced administrative work would be likely to exceed the costs of the initial investment.

It must be also emphasised that decentralisation should be seen as an entity and not as a collection of separate policies. Therefore, reforms on particular areas of governance and decentralised system are likely to affect other policy areas as well. Establishing a regional government level is therefore bound to affect the central government, municipalities, intermunicipal units and parishes, etc. In order to secure a successful decentralisation reform, all major components of multilevel governance should be on the table.

Three scenarios for enhanced decentralisation in Portugal

Three approaches for regionalisation in Portugal are presented in this report, in the broader decentralisation context. These options are based on models that are most often observed in other European countries. They can also be progressively adjusted as more information on reform needs will become available. The options presented in this report are not mutually exclusive and are actually complementary, in particular the options to strengthen the metropolitan areas and the IMCs that can go hand in hand with the creation of administrative regions.

In general, the options presented here would improve the implementation of decentralisation in Portugal. In the longer time frame, it is also likely that the proposed measures would contribute to enhanced efficiency of public services and to slower growth of public expenditure. Provided that subnational governments will be assigned also own revenues which will cover a considerable share of their service expenditures, decentralisation together with fiscal rules can also support fiscal responsibility of subnational governments. Decentralising spending without decentralising revenues would be a risk for public finances because a high reliance on central transfers can incentivise subnational governments to overspend and to incur debt, especially if subnational governments operate under soft budget constraints.

The following alternative ways forward are provided as a basis for further discussion and possible further investigation.

(i) Decentralisation and strengthened deconcentration without empowerment of the regional level

If Portugal decides not to establish administrative regions at this stage and maintain the deconcentrated model, there are still several ways Portugal could strengthen the current system of regional governance. Such measures are summarised below:

- **Aligning the regional networks of deconcentrated central government departments with the CCDRs**
The deconcentrated central government services could be better co-ordinated by making the regional organisational structures more alike and compatible. Such reorganisation should also include the various consultative entities promoting vertical and horizontal co-ordination at the regional level. Furthermore, the role of presidents of the CCDRs should be strengthened in relation to the heads of sectoral deconcentrated government departments. These measures would improve the effectiveness of CCDRs.
- **Strengthening the capacity and fiscal autonomy of municipalities for enhanced service delivery**
The decentralisation process started in August 2018 should be continued and followed through. However, partial decentralisation such as only assigning responsibility for service delivery, may not lead to the full benefits of decentralisation. Spending responsibilities should also be accompanied by local financing responsibility to secure the right incentives for subnational governments.
- **Clarifying the role of intermunicipal co-operation**
Currently, IMCs and MAs play only a marginal role in local public service delivery. While this situation may change as more tasks are decentralised to municipalities during the coming years, the central government could nevertheless accelerate the process with financial incentives. One way to accomplish this could be to use the transfer system, for example by directing more transfers to IMCs instead of municipalities, in case of public services with important externalities.
- **Intensifying the metropolitan governance in Lisbon and Porto areas**

The ability of MAs to engage in real decision-making and financing of the metropolitan areas should be improved. Metropolitan authorities should also have adequate capacity to take responsibility for development in the region.

One option could be to alter MAs into subnational government units with elected councils and with sufficient fiscal autonomy, by granting them taxation rights (for example property tax) for example, as well as giving them important tasks of regionwide importance such as transport, environment, housing, land use and planning. Another possibility could be to merge the municipalities of the metropolitan region to form large metropolitan cities.

- Rethinking the task assignments between levels of multilevel government

There seems to be room for rethinking the service assignments between central government, municipalities, parishes, IMCs and MAs. A nationwide plan could be prepared for reorganising the tasks and responsibilities as well as resources. All main stakeholders (e.g. line ministries, representatives of municipalities, IMCs, central government agencies, research institutes) should be engaged in the process.

(ii) Decentralisation without full regionalisation by reinforced municipal and intermunicipal levels

The second alternative policy strategy for Portugal could be to establish a compulsory regionwide intermunicipal association, which could take over the tasks of the CCDRs.

Such a co-operative regional body could also take over the responsibility for some of the tasks that are currently organised by IMCs or by municipalities, but only if this can be justified by externalities that could be internalised by the regional government.

The responsibility of metropolitan governance could be focused on special metropolitan authorities as regionwide authorities would be too big and heterogeneous to be effective in solving metropolitan problems.

The regional councils in this alternative would consist of members elected by municipalities in the region. The tasks of the co-operative regional governments could be limited to regional planning, managing EU funds and other tasks with clear regionwide benefit areas such as environmental protection and regional roads. The financing of the regions could be based on central government transfers and municipal member fees.

(iii) Decentralisation through complementary regionalisation and intermunicipal co-operation reforms

Establishing a full-scale, elected, self-governing regional government level as described in the Portuguese Constitution, i.e. administrative regions, is the third alternative path. Establishing administrative regions would solve many issues that the other two alternatives presented in this section are not able to solve or only partially. Compared with other potential alternatives, the elected self-governing regions provide advantages in terms of local democracy, legitimacy and accountability. Administrative regions could also bring additional allocative efficiency, depending on the eventual tasks assigned to the regions.

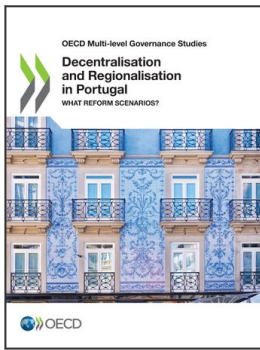
It should be noted that establishing administrative regions would not exclude policies to strengthen decentralisation at the local level. Therefore, the proposals to empower municipalities and IMCs would still be valid as they would complement the measures to establish administrative regions.

Regional councils could have two main functions: regional development and territorial cohesion planning. The councils could be responsible for the EU Structural Funds programmes and their implementation. The financing of administrative regions should be based on central government transfers and own revenues. Administrative regions should also have budgetary and financial autonomy in service areas devolved to them.

It should also be noted that establishing administrative regions does not exclude the possibility of having a deconcentrated regional administration for purely central government services. However, the representatives of deconcentrated central government administration should not interfere with the decision-making of the regional governments. Instead, the deconcentrated central government administration could focus on ensuring that the subnational governments obey the law and that the quality of local public services does not deviate too much from the national standards.

Intermunicipal co-operation and administrative regions complement each other and hence should be promoted together as a driving force to improve local public services. Intermunicipal co-operation and regionalisation are two key mechanisms to both rationalise public expenditure and improve the quality of public services throughout the country. The metropolitan regions should have a special administrative solution since the administrative regions would be too big to focus effectively on metropolitan issues.

The regionalisation alternative described here could be the first step in a series of public sector reforms. The next phase could be to reform deconcentrated central government departments and to extend the service menu of administrative regions. Such reforms should be implemented sequentially, sector by sector for example, with careful planning and impact evaluation to avoid unwanted effects.



From:
Decentralisation and Regionalisation in Portugal
What Reform Scenarios?

Access the complete publication at:
<https://doi.org/10.1787/fea62108-en>

Please cite this chapter as:

OECD (2020), "Executive summary and main policy options for Portugal", in *Decentralisation and Regionalisation in Portugal: What Reform Scenarios?*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/0ff9c231-en>

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