

3 Multi-level governance and subnational finance for service provision

Introduction

In Alentejo, a region with both the largest territory and the lowest population density in Portugal, population decline and ageing pose large challenges for local public service provision, in particular given the ongoing decentralisation reform in Portugal (OECD, 2020^[1]). These demographic developments imply, lower demand for education services and higher demand for health care services, which, in turn, requires changes to local public service provision in the region and better articulation and coordination among levels of government. Ageing and population shrinking also puts strong pressure on municipal governments and parishes, confronted with ensuring access to quality public services while striving to maintain human resource and financial capacities.

To ensure an efficient provision of services in the face of demographic changes, municipalities, inter-municipal communities (IMCs) and parishes have a very important role to play. Joint actions and cooperation may facilitate mutual understanding among different entities and enable them to find solutions to the common challenges they face. The Regional Strategy for Alentejo 2030 (*Estratégia Regional Alentejo 2030*) take over this challenge, by including, for example, digital and shared solutions across municipalities through inter-municipal authorities (CCDR Alentejo, 2020^[2]).

The multi-level governance system in Portugal has been undergoing important structural changes in recent years, and the success of these reforms will depend, to a large extent, on how municipalities can maintain quality public service delivery in the face of a shrinking population and labour force, and the erosion of tax bases. While the creation of inter-municipal communities and the gradual transfer of competences to municipalities support horizontal coordination, municipalities and parishes in Alentejo still face some limitations in effectively collaborating and ensuring efficient service delivery. The current multi-level governance framework and the financing of local authorities in Alentejo need some fine-tuning in order to make sure services are provided efficiently and at the right scale, given the region's sparsely populated areas.

This chapter examines the multi-level governance system in Alentejo, with a particular focus on inter-municipal co-operation for services provision, and the challenges brought by the ongoing decentralisation process. The second part of the chapter focuses on how municipalities, parishes and inter-municipal entities finance service provision and the main challenges they currently faced on this respect. Finally, the last section presents three policy recommendations for Alentejo's consideration, summarised in the following box.

Recommendations on multi-level governance and subnational finance for service provision

This box summarises the main recommendations on multi-level governance and subnational finance detailed in the Recommendations section.

Further pursuing decentralisation and regionalisation reforms to better align service provision and local needs

- At the local level: Accompany the transfer of competences to municipalities with the transfer of adequate financial resources. Incentives could be given to municipalities to take over more responsibilities, including receiving more fiscal resources (from grants) and powers (more own-source revenues).
- At the regional level: Pilot a new governance model in Alentejo, to organise it in a way that coincides with TL2 level, testing, for example, the model of cooperative regions as an alternative to, or an intermediate stage towards full regionalisation.

Strengthening cross-jurisdiction cooperation is necessary to make sure the planning and delivery of services are done at the right scale

- Provide concrete financial incentives to promote inter-municipal collaboration, for example, by directing more transfers to IMCs, instead of municipalities, particularly with respect to public services with important externalities
- Encourage peer-learning building on already successful inter-municipal co-operation mechanisms in the region
- Foster technical capacity through cooperation among parishes to enable them to effectively perform their tasks and deliver local services to residents and encourage parishes co-operation from different municipalities, if appropriate.
- Explore instances of co-operation with neighbouring regions and share knowledge with regions that face similar problems.
- Identify municipalities or groups of municipalities pertaining to the same functional area that could benefit the most from scaling-up the provision of services.

Adjusting fiscal arrangements to ensure municipalities can properly finance service provision and adapt to demographic trends

- Strengthen the municipal own revenue base in a gradual manner to enable municipalities to attract people and investments.
- Guarantee financial means of IMCs to particularly benefit small municipalities that have less capacity to raise own revenues.

The multi-level governance system for service provision in Alentejo

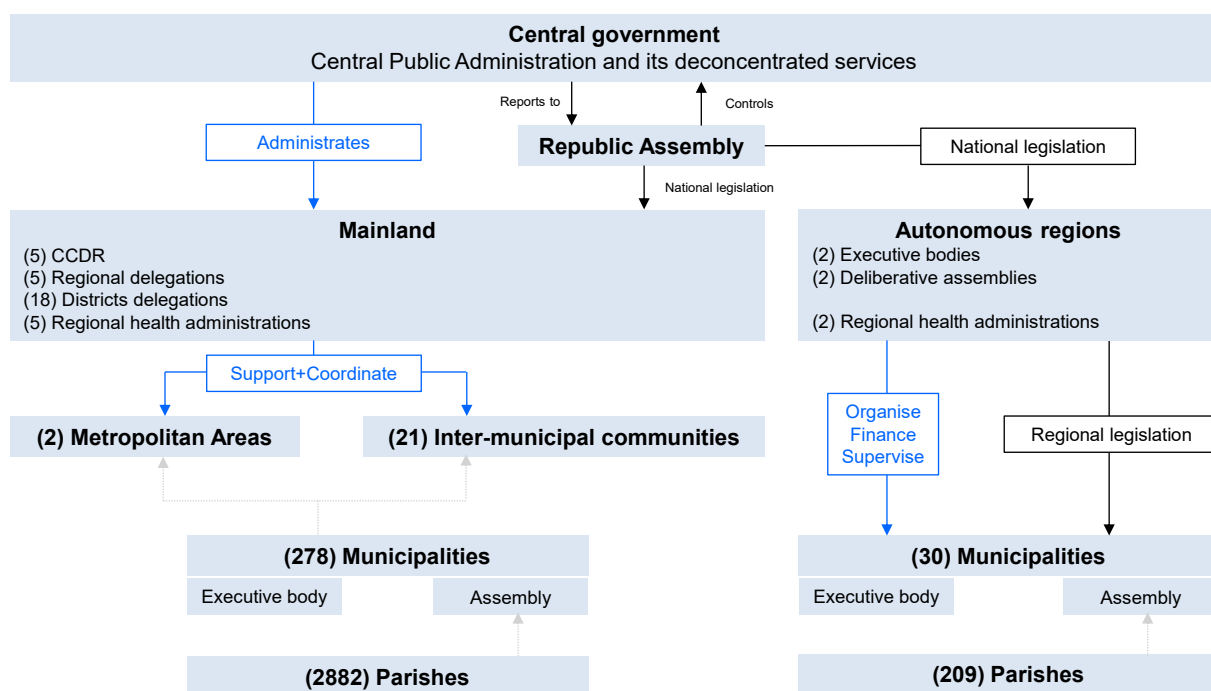
The multi-level governance system in Portugal

Based on the 1976 Constitution, Portugal has a three-tier system of subnational governments, consisting of regions, municipalities and parishes (Figure 3.1). At the local level there are 308 municipalities (*municípios*) – all of which have the same legal status - and 3 091 parishes (*freguesias*). In region of

Alentejo (TL2) there are five inter-municipal communities (*Comunidade inter-municipal*, IMCs) (Alentejo - Alentejo Central, Alentejo Litoral, Alto Alentejo, Baixo Alentejo, Lezíria do Tejo) and 58 municipalities; however, when considering Alentejo's administrative region, it is divided in four sub-regions (Alto Alentejo, Baixo Alentejo, Alentejo Central and Alentejo Litoral) and 47 municipalities. In fact, for statistical purposes Lezíria do Tejo is part of Alentejo, but for administrative purposes it is part of the administrative region of Lisboa e Vele do Tejo.

Portuguese municipalities are large in terms of population compared to other EU countries, with 90% of the population living in municipalities with more than 5 000 inhabitants and 40% with more than 20 000 inhabitants. In addition to the local administrative entities, the local public sector also comprises municipal and inter-municipal enterprises (MIEs), which are legally defined as business-like organisation. Their activities are restricted to general interest services, the management of collective equipment, the provision of services in the areas of education and companies of local and regional development.

Figure 3.1. Multi-level governance system in Portugal



Note: Municipal and inter-municipal enterprises, as well as other organisational forms aimed at inter-institutional co-operation, are not included.

Source: (OECD, 2020^[1])

At the regional level, while regionalisation is enshrined in the 1976 Constitution, mainland Portugal still does not have decentralised regions in place; only the islands of Acores and Madeira constitute autonomous regions in the country. In mainland Portugal, the process of regionalisation, based on the creation of eight elected regional governments (called “administrative regions”), was rejected in a 1998 referendum. Since then, regionalisation has continuously been debated and different models of regional governance have been discussed; however, they have not led to a concrete regional reform.

To manage policies at the regional level and co-ordinate the central government services at the regional scale, Portugal has established deconcentrated regional services, namely the Regional Coordination and Development Committees (*Comissão de Coordenação e Desenvolvimento Regional*, CCDR) (Box 3.1), regional delegations, districts delegations, and Regional Health Administrations. As explained above, in

Alentejo, the CCDR only covers four sub-regions – Lezíria do Tejo that for statistical purposes pertain to the TL2 regional definition, for administrative purposes it is part of the Lisbon region.

Box 3.1. Alentejo Regional Coordination and Development Commission (CCDR-A)

The Alentejo Regional Coordination and Development Commission (CCDR-A) is a deconcentrated service of central government integrated in the Ministry of the Territorial Cohesion and jointly managed by the Ministry of Environment and Climate Action (with regard to matters of environment and land use planning) and the Ministry for the Modernisation of the State and Public Administration (with regard to the relationship with local authorities). Its mission is to promote in an integrated and sustainable way the development of the Alentejo region.

According to Decree-Law no. 27/2020, of June 17, the CCDRs are headed by a president assisted by two vice presidents, all appointed by resolution of the Council of Ministers. The president is elected by an electoral college made up of several local elected representatives from the geographic area of action of the respective CCDR. A vice-president is appointed by the presidents of the municipal councils that comprise the geographic area covered by the respective CCDR; another vice-president is appointed by the Government, on the proposal of the member of the Government responsible for territorial cohesion, in prior coordination with the members of the Government responsible for the areas of local authorities and the environment, after consulting the already appointed president and vice-president

The CCDR-A has administrative and financial autonomy and is tasked with coordinating and promoting governmental policies regarding regional planning and development, environment, land management, inter-regional and cross-border cooperation. For this, the Commission is a Managing Authority for the Regional Operational Programme funded by the European Union, as well as other regional development financing instruments. The CCDR-A is also in charge of providing technical support to local authorities and their associations.

Source: (CCDR-A, 2021^[3])

The role of the Regional Coordination and Development Committee of Alentejo (*Comissão de Coordenação e Desenvolvimento Regional do Alentejo*, CCDR Alentejo) is crucial. Municipalities do not have the critical mass to operate at the regional level and municipal mergers are not desirable given that municipalities are already large and not densely populated, particularly in Alentejo. IMCs are an adequate level to provide joint services but do not cover the appropriate scale for regional development policies. The CCDR that facilitates a mutual understanding among municipalities and IMCs in order to find a regional-level framework and better take into account challenges identified by IMCs in their strategies, for example regarding the sharing of equipment.

Between the regional and municipal levels, the metropolitan areas (*área metropolitana*) of Lisbon and Porto and the 21 inter-municipal communities (*Comunidade inter-municipal*, IMCs), created by Law 75/2013, constitute the basis of the NUTS3 statistical regions. The IMCs and Metropolitan Areas are constituted by contract and any municipality that is part of a territorial unit where an IMC already exists has the right to adhere to it. Currently, all municipalities are engaged in one of the inter-municipal cooperative associations in Portugal and there are five in Alentejo – Alentejo Central, Alentejo Litoral, Alto Alentejo, Baixo Alentejo, and Lezíria do Tejo. IMCs are governed by the inter-municipal assembly (deliberative power), the inter-municipal council, the Executive Secretariat (executive power), and the Strategic council for inter-municipal development (advisory power). IMCs can only provide services that are assigned to them by municipalities and the central government (OECD, 2020^[1]).

While the CCDR helps in bringing clarity and enabling co-ordination at the regional level, it is still challenging to coordinate sectoral, territorial and regional policies in Alentejo. The multiplicity of sectoral actors at different levels of government make this articulation and co-ordination challenging, having a direct impact in the ability to implement place-based policies. For instance, health services are organised by the central administration around the NUTS2 level (and central healthcare centres) while other services such as home affairs, or social security are organised at the local level. In the case of education, responsibilities are shared between the central and local levels, in particular for the definition of the curricula. While the local level manages up to 25% of the curricula, the Ministry of Education at the central level sets the remaining percentage of the curricula and supervises schools.

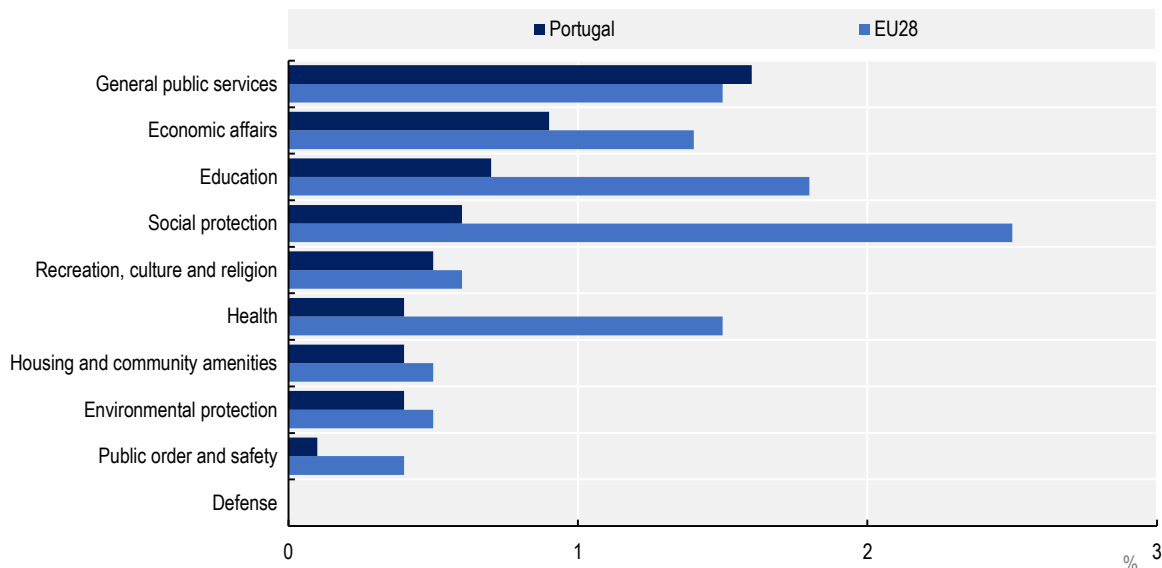
The central level plays an important role in service provision

Despite the ongoing decentralisation reform, the Portuguese central government still plays a strong role in public service provision and has significant responsibilities in education, health, and social services. The spending structure of Portuguese subnational governments contrast with OECD and EU countries. In Portugal, the main subnational sectoral spending categories as a percentage of GDP are general services (1.6%) and economic affairs (0.9%), whereas in the European Union (EU) the main sector spending categories are social protection and education (Figure 3.2). Local government spending as a percentage of GDP in education (0.7%) and health (0.4%) are significantly below EU averages (1.8% and 1.5% respectively).

While municipal responsibilities have been relatively stable over the last 20 years, in 2015, Law 69/2015 expanded their competencies in education, teaching and vocational training. The role of municipalities in education has been growing over the past years. In pre-primary and basic schools, for example, municipalities are responsible for providing extracurricular activities, school meals and transport, and for compensating non-teaching staff (OECD, 2020^[11]). Since 2017, Portugal is implementing a curricula reform process, introducing higher levels of autonomy and flexibility at the local level in order to improve school ability to design and carry out curricula solutions adapted to its own context. Since 2018, the central level is not the only responsible for setting up the curricula and all schools are able to manage up to 25% of it. Moreover, the decentralisation programme approved in 2019 – which will cover all municipalities in 2022, transfers the schools budget to municipalities. This means that former national administration expenses with schools will be transferred to municipalities to be managed locally. Municipalities may also allocate additional funds according to local projects and programmes. The central level is still responsible for setting a part of the curricula, teacher recruitment and setting wages.

Figure 3.2. Local government expenditure by function (COFOG), 2019

As a percentage of GDP



Source: (Eurostat, 2021^[4]), *General government expenditure by function (COFOG)*, https://ec.europa.eu/eurostat/databrowser/view/GOV_10A_EXP/default/table?lang=en (accessed on 30 October 2021).

While the parishes' competences are somewhat limited, they still play a role in service provision as they can act as delegated units of the municipality for service delivery. The decree-law 57/2019, allows, if both parts agree, the possibility of a redistribution of competences and financial resources from the municipality to the parish. These transfers can be agreed for the management and maintenance of green spaces, cleaning of public spaces and maintenance of urban furniture, fairs and markets, and maintenance of school spaces. Still, the delegation of competences from the municipal to the parish level is challenging as parishes do not necessarily have the appropriate means – in terms of human and financial resources - to take over those responsibilities. At the same time, municipalities are struggling with decentralising themselves as more competences are being transferred to them without the necessary additional financial support – while the transfers are significant, they do not necessarily cover all the increasing management costs associated with the transfer of competences (see below). In Alentejo, some municipalities, particularly in the North, declare that they face difficulties in decentralising competencies to parishes in a homogeneous way.

The increasing role of inter-municipal entities in public service provision

The Portuguese law foresees different figures to allow and encourage inter-municipal and inter-parishes associations. Inter-municipal entities (metropolitan areas and inter-municipal communities) enable municipal cooperation in various strategic areas where local service delivery may benefit from increasing scale and improved inter-governmental coordination. The transfer of competences to municipalities in a low-density territory confronted with shrinking and ageing population such as Alentejo needs to come hand in hand with the up-scaling of certain services. This holds true when it comes to minimise the shortcomings related to low and unequal levels of administrative (human and financial) capacities of local administrations.

Municipalities can delegate tasks to IMCs and parishes and can make contractual arrangements with the central government to exercise shared responsibilities (OECD-UCLG, 2019^[5]). IMCs have tasks in regional planning and development, in the provision of essential public services, and in ensuring articulation

between municipalities and central administration services in various domains, such as educational and vocational training networks, public equipment network, mobility and transport (Box 3.2)

Box 3.2. Inter-municipal communities in Portugal

Inter-municipal communities (IMCs), which are organised at the NUTS 3 level, can assume functions and tasks assigned by law to the municipalities. However, IMCs can only provide services that are assigned to them by municipalities and the central government. In the current legal framework, IMCs are designed to pursue the following assignments:

1. Promoting the planning and management of the strategy for economic, social and environmental protection of its territory.
2. Co-ordinating municipal investments of inter-municipal interest.
3. Participating in the management of regional development programmes.
4. Planning the activities of public entities, with a supra-municipal character.

It is also the responsibility of the IMC to ensure the co-ordination of actions between municipalities and central government in the following areas:

1. Public supply networks, basic sanitation infrastructures, treatment of wastewater and municipal waste
2. Network of health equipment
3. Educational and vocational training network
4. Spatial planning, nature conservation and natural resources
5. Security and civil protection
6. Mobility and transport
7. Public equipment networks
8. Promotion of economic, social and cultural development
9. Network of cultural, sports and leisure equipment

Source: (OECD, 2020^[11])

In Portugal, the EU Cohesion Policy has reinforced the financial and strategic capacities of IMCs. They currently manage European Cohesion Policy funding as intermediate bodies and their strategic role for service provision is one of the key objectives of the current programming period. In addition, as intermediate bodies, they are also key for territorial investment; the programming of integrated territorial investments by IMCs and metropolitan areas through the Pacts for Development and Territorial Cohesion (PDCT) within the framework of Portugal 2020 (Forum das Cidades, 2020^[6]). In this framework, some IMCs conduct projects that are key to promote regional development. The IMC of Alentejo Litoral for example, is carrying out an inter-municipal climate change adaptation plan and five urban resilience plans, one for each Municipality of Alentejo Litoral. They are also in the process of mapping social, health and educational services within its territory. IMCs have also served to ensure that municipalities co-operate to develop the specific strategies within their territory responding to specific territorial needs. This is the case, for example, of co-ordination of vocational programmes, for which the national level aims at ensuring this co-ordination happens. This is what happens in the project involving Almodovar, Mértola, Castro Verde, Aljustrel and Ourique municipality that have developed a vocational training offer to match the labour market needs and to articulate the students' mobility services, as a mean of preventing both desertification and students' dropout.

Municipalities can also pursue their tasks through other organisational forms aimed at inter-institutional cooperation and involve public, private and social partners (OECD, 2020^[1]), namely cooperatives and foundations, or associations. For example, Lezíria do Tejo has established two inter-municipal companies a water utility company and a waste treatment company. This allowed rationalising public services provision in these areas. The water utility company is profitable and municipalities have decided to promote further investments instead of collecting the dividends. The associations of parishes and municipalities with specific purposes are created to promote certain projects of common interest to their members, such as the *Associação de municípios do Alentejo Central* or the *Associação de municípios para a gestão da água pública no Alentejo* which aims at guaranteeing the quality, continuity and efficiency of public services of water collection treatment and supply for public consumption and the collection, treatment and disposal of urban waste water (ANMP, 2021^[7]).

Alentejo also benefits from cross-border co-operation enhanced by the EU. The cooperation programme Interreg V-A Spain Portugal (POCTEP) aims at tackling cross-border challenges and promoting smart and sustainable growth. It also seeks to foster territorial cohesion by developing and improving cross-border public services along the Spanish – Portuguese border. Alentejo, Algarve, Centro and Norte NUTS2 regions (Portugal) and Andalucía, Castilla y León, Extremadura and Galicia Autonomous Communities (Spain) participate in this project financed by Regional Development Fund (ERDF, EUR 365 million).

The current multi-level governance framework does not allow to deliver services with region-wide benefits, such healthcare or transport – the latter being provided at the IMC level. Moreover, while IMCs have proven to be essential for the functioning of the multi-level governance system, in some cases it has been difficult to stimulate participation of municipalities in IMCs projects as they do not necessarily see the advantages of supra-municipal coordination. In addition, since decision making by inter-municipal communities requires unanimity among municipalities, the line of actions and investment by IMCs remains limited.

Although today Portugal does not envisage providing municipalities or municipal associations new taxing powers, the French experience is an example of innovative ways of promoting IMCs. The French government has persistently supported inter-municipal co-operation by giving some Public Establishments for Inter-municipal Cooperation (EPCI, *Établissement Public de Coopération Intercommunale*) – a form of IMC created in 1992- their own sources of revenues and taxing powers to exercise some of their mandatory municipal competences or some other voluntary tasks agreed by all the municipalities involved (OECD, 2017^[8]). Reflecting on this experience, Alentejo could find ways to give IMCs more powers or flexibility to carry out their functions. Indeed, while the local autonomy on taxation is bounded by the Portuguese Constitution, there is an ongoing process of sharing taxes between different administration levels and a growing level of flexibility for municipalities to use a % of key national taxes, as IRS, IMI, IVA. Providing with more flexibility to the IMCs on this regard could also be envisaged.

Opportunities and challenges of the ongoing decentralisation process

Since 2018, Portugal has embarked in an important decentralisation process (Law No. 50/2018) which stipulates the transfer of responsibilities to local authorities and inter-municipal entities between 2019 and 2022. Municipalities have gradually adhered to this Law since 2019 and those that have not adhered yet will have to do so by 2022. In the field of education, all competences that refer to non-tertiary education, except the management of teaching staff and the definition of curricular contents, is being transferred to municipalities.

Box 3.3. The ongoing decentralisation reform in Portugal

In order to clarify the assignments and responsibilities, and to take steps for further decentralisation, Law no. 50/2018 of 16 August defined the framework for the transfers of new additional competencies to local authorities. The transfer of competencies started in 2019 for the local authorities that did not declare, until 15 September, that they were not willing to implement them.

The decentralisation Law has two main axes:

1. The reorganisation of the state at the regional and sub-regional levels, only in the continental part of the country.
2. The transfer of new competencies from the government to the municipalities, a transfer that in some cases can be for the IMC, aiming to strengthen inter-municipal structures.

Regarding the first dimension, the political decision has no fixed schedule. Regarding the competencies to be transferred to the municipalities, Law no. 50/2018 defined a wide range of new competencies to be transferred until January 2021. For education, health and social action, the deadline has been extended to March 2022. The specific conditions of these transfers, namely financial conditions, are currently being clarified. In general terms, the areas transferred to municipalities are:

1. Education, all that refers to non-tertiary education, except management of teaching staff and definition of curricular contents.
2. Social action at the local level, especially in the fight against poverty.
3. Justice: "Julgados de Paz" network (volunteer commitment court), social reintegration and support for victims of crimes.
4. Health, local equipment and management of non-clinical personnel.
5. Municipal civil protection.
6. Culture, local heritage and museums not classified as national.
7. State unused real estate assets.
8. Housing, housing of the state and management of urban rental and rehabilitation programmes.
9. Management of port-maritime areas: secondary fishing ports, recreational boating and urban areas for tourism development.
10. Tourism (inter-municipal entities): management of investment funds, planning and subregional tourism promotion.
11. Investment attraction and management of community funds (intermunicipal entities): definition of the territorial strategy for development and management of local development programmes with community funding.
12. Beaches: licensing, management and equipment of sea, river and lake beaches integrated in the public domain of the state.
13. Management of forests and protected areas.
14. Transport: infrastructures and equipment within urban perimeters.
15. Citizen service: citizen's shops.
16. Proximity policing, participation in the definition of a policing model.
17. Protection and animal health.
18. Food safety.
19. Fire safety in buildings.

20. Public parking: regulation, supervision and management of administrative misconduct.

21. Licensing games of chance and fortune at a local level.

Source: (OECD, 2020^[1])

The transfer of competences from the central level to municipalities has represented an opportunity for local governments, who have been able to reorganise, to a certain extent, the provision of public services. In Alentejo, for example, decentralising tasks associated with transport services permitted to facilitate the reorganisation of the network, and in some cases, to close small schools and reorganise the delivery of school transportation and education services in a more rational way with one school providing education services for different places.

However, the transfer of competences has also been somewhat burdensome for local governments. As is the case in many OECD countries, the transfers of funds do not necessarily follow the transfers of competences and funding remains below what is needed by municipalities to efficiently deliver on their new tasks. Certainly, by Law, the funds directly associated with the tasks being transferred need to be reallocated to the local level. However, these funds do not consider the additional administrative costs that municipalities need to incur when dealing with new tasks, including adjustments in functions in order to deliver new tasks and new, often onerous, administrative procedures, for example, requiring adjusting municipal contracts with electricity providers.

In addition, the incomplete decentralisation process, and in particular the lack of a regional level, also affects the efficient provision of services in Alentejo. The lack of a regional level of government may hinder the provision of certain services as the central government might be too large and municipalities too small to deliver services effectively. This situation contrasts, for example, with the neighbouring regions in Spain, where the regional-level has a significant amount of autonomous decision making capacity in education and health care service provision and investment.

Financing local public services in Alentejo

While the fiscal framework of local authorities has undergone reforms in recent years (2007, 2013, 2018) to strengthen municipal finance and improve its sustainability, the fiscal situation of Portuguese municipalities, in particular in Alentejo, is challenging. First, the transition from a centrally financed model to a model which is based on greater self-reliance at the subnational government level has been slow. In addition, while direct and shared tax revenues represent a significant share of municipal revenues, municipal tax bases in Alentejo tend to be below the national average. In addition, central government transfers to municipalities, in particular capital transfers, have decreased after 2010 (OECD, 2020^[1]), resulting from national fiscal consolidation measures. Finally, ageing and shrinking population put at stake the current funding models of local public services in Portugal.

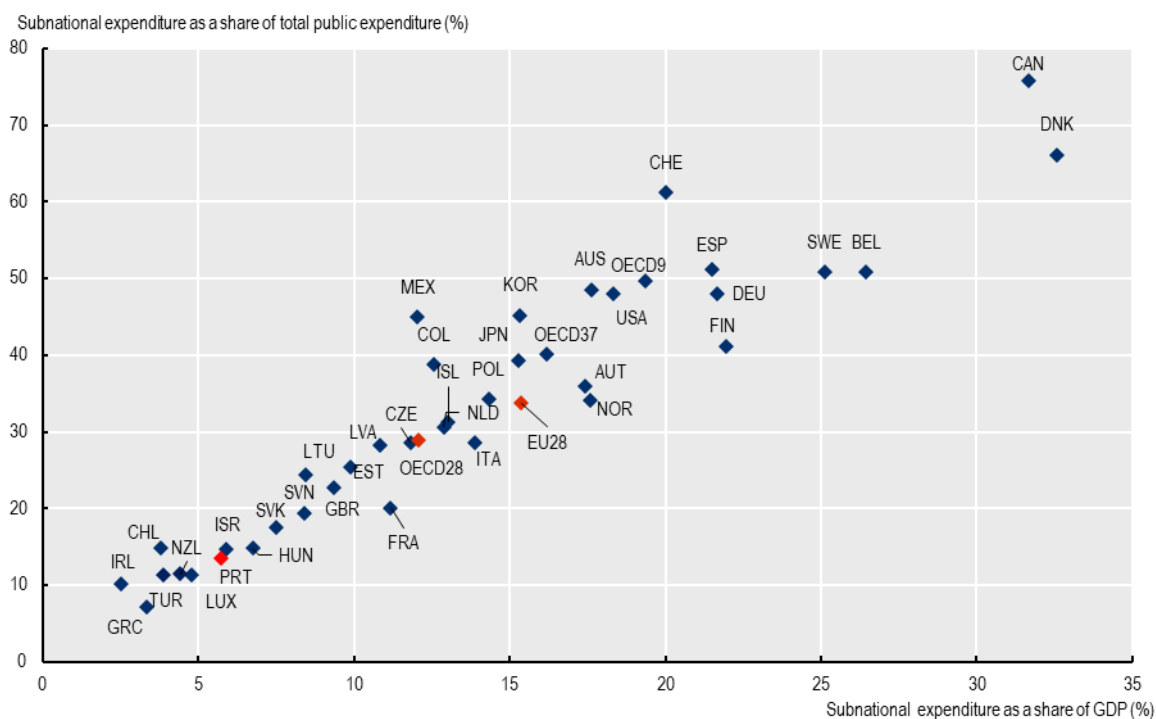
To address challenges facing local public service delivery in Alentejo, the funding model of sub-regional and local authorities should give more room for local initiatives and fiscal incentives fostering the attractiveness of rural areas.

Portugal is one of the most centralised countries of the OECD

Portugal is one of the most centralised countries in the OECD. The strong role of the central government in public service provision is reflected in the responsibilities devolved to subnational governments. In 2019, subnational governments expenditure accounted for 13,5% of total public spending, compared with 40,2% on average in OECD countries, and 33,6% on average in the EU (see Figure 3.3). In education, health

services and social services, the central government bears the main responsibility in Portugal (OECD, 2020^[11]). As was pointed before, compared with the EU average, the spending assignments of Portuguese subnational governments differ markedly. While in the EU, the three largest sectoral spending categories are social protection, education and general services, in Portugal the main local services comprise general services, economic affairs and other services (see Figure 3.2).

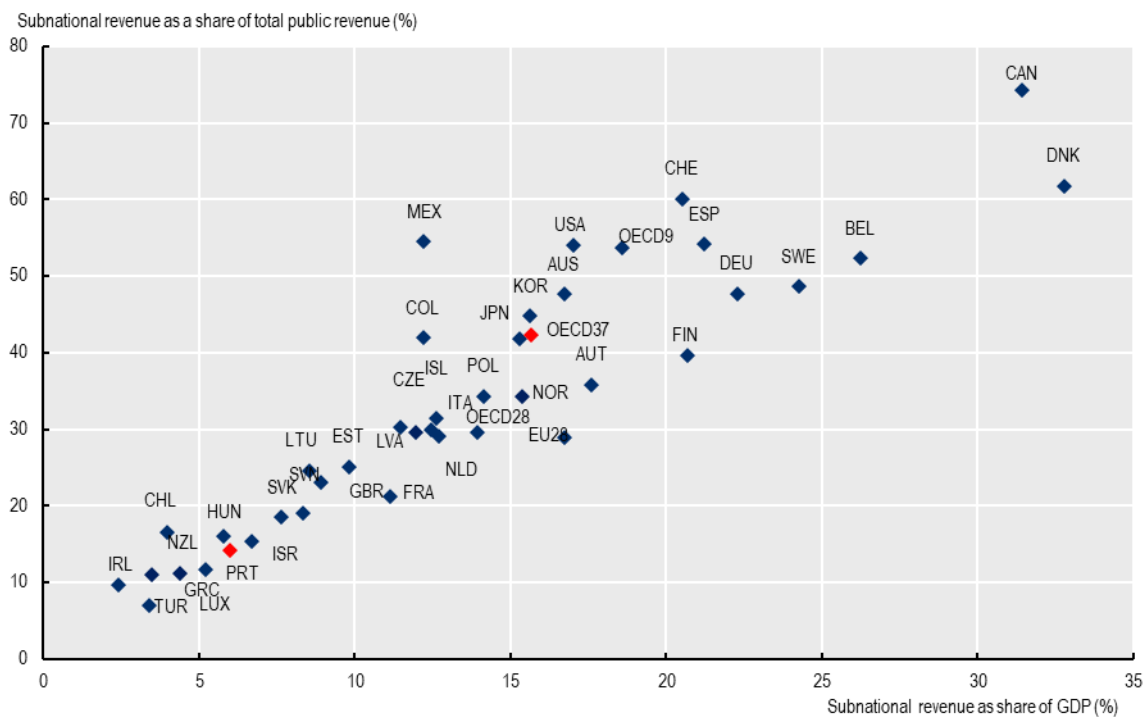
Figure 3.3. Subnational government expenditure as a percentage of GDP and total public expenditure, 2019



Note: Australia, Chile and Colombia: estimates from IMF Government Finance Statistics. 2018 data for Chile, Japan, New Zealand, Turkey
 Source: (OECD, 2021^[9])

Subnational government revenue is also below the OECD average. In 2019, Portuguese subnational government revenue represented 14.1% of total public revenue and 6% of GDP, below the OECD average (42.2% and 15.7% respectively) and the EU average (34.2% and 15.4% respectively).

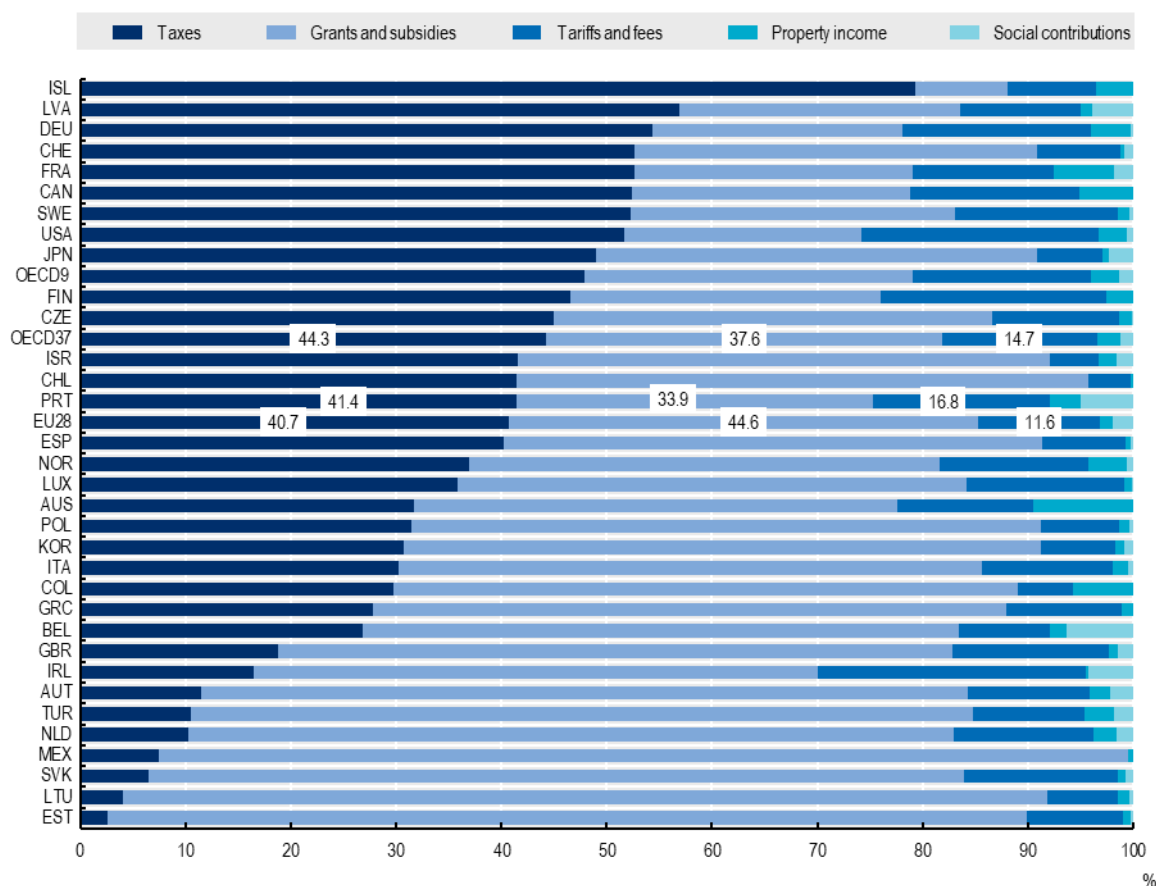
Figure 3.4. Subnational government revenue as a percentage of GDP and total public revenue, 2019



Note: Australia, Chile and Colombia: estimates from IMF Government Finance Statistics. 2018 data for Chile, Japan, New Zealand, Turkey
Source: (OECD, 2021^[9])

Although the share of tax revenues in subnational revenue is at the same level of the EU average (41% in 2019) and the share of grants lower than the EU average (34% vs 45%) thanks to a high share of revenues from user charges and tariffs, they have little fiscal autonomy. In Alentejo, municipalities have even weaker fiscal space. They rely significantly on central government transfers and their tax revenues is not necessarily optimised.

Figure 3.5. Structure of subnational revenue, 2019 (%)



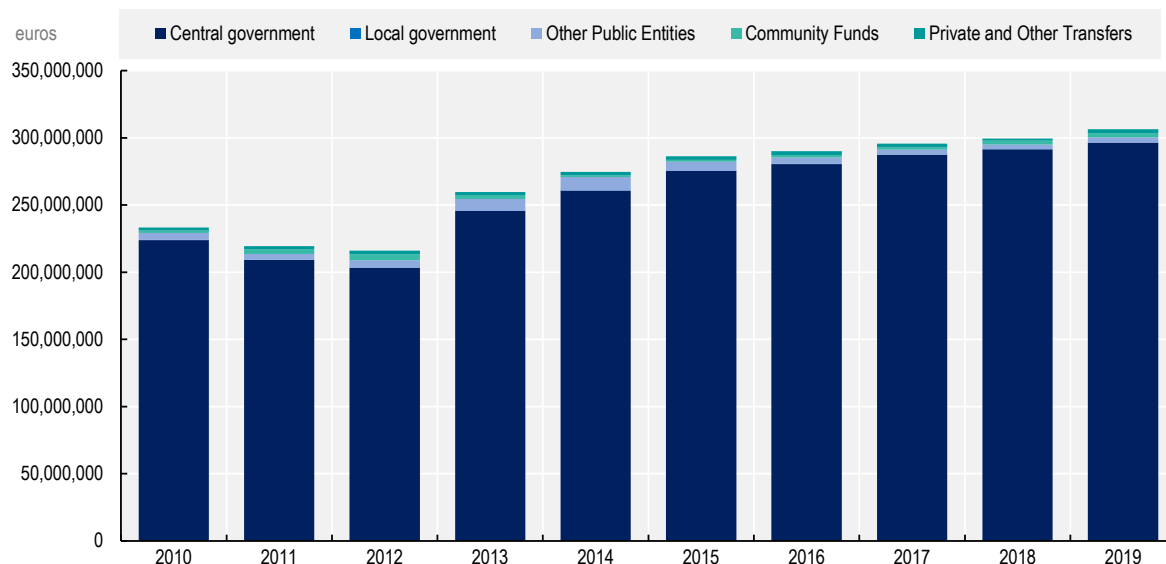
Note: Australia, Chile and Colombia: estimates from IMF Government Finance Statistics. 2018 data for Chile, Japan, New Zealand, Turkey
Source: (OECD, 2021^[9])

Municipalities in Alentejo strongly rely on central government transfers

In Alentejo, intergovernmental transfers are the main source of revenues for municipalities. In 2019, on average, current transfers represented 47.3% of total revenues for municipalities and capital transfers were about 12.8% of total revenues. Among these transfers, 88.2% corresponded to transfers from the central government, 9.8% were Community Funds (EU transfers) and the remaining 2% to other transfers from other public entities and private transfers. Interestingly, since 2010, the composition of municipal revenues has changed. The share of current transfers increased from 37.8% to 47.3% between 2010 and 2019, while the share of capital transfers decreased from 26.5% to 12.7%. The decline in capital transfers is mainly the result of lower capital transfers from the Financial Equilibrium Fund (FEF) and Participation in Community co-financed projects, with implications on municipalities' investment capacity.

Figure 3.6. Composition of municipal revenue from current transfers, Alentejo

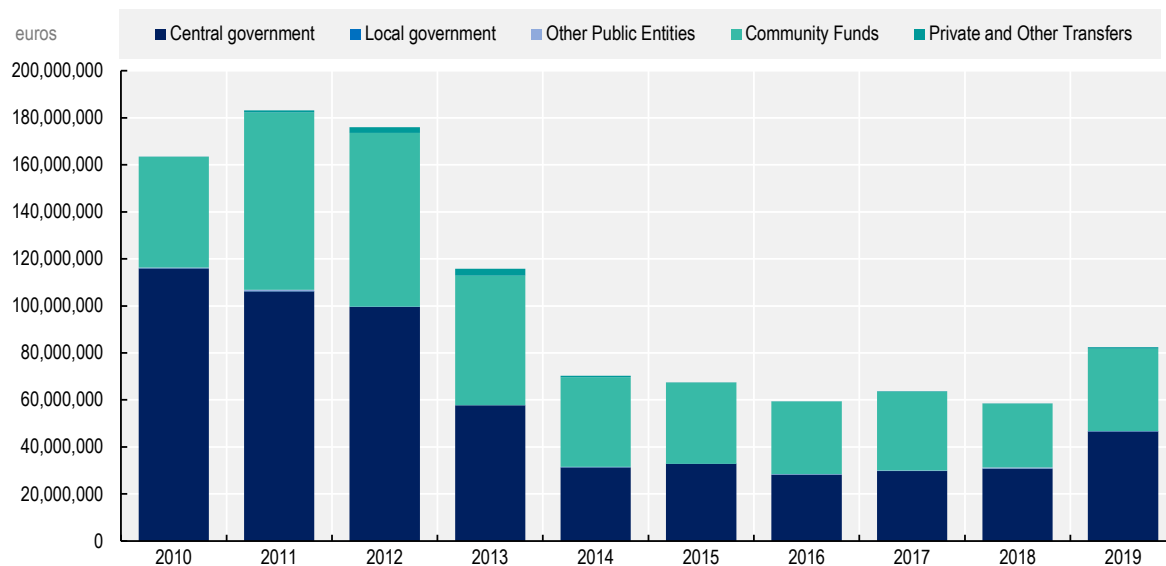
By counterpart, in Euros, 2010-2019



Source: (DGAL, 2021^[10]), *Regime financeiro das autarquias locais*, <http://www.portalautarquico.dgal.gov.pt/pt-PT/financas-locais/> (accessed on 30 October 2021).

Figure 3.7. Composition of municipal revenue from capital transfers, Alentejo

By counterpart, in Euros, 2010-2019

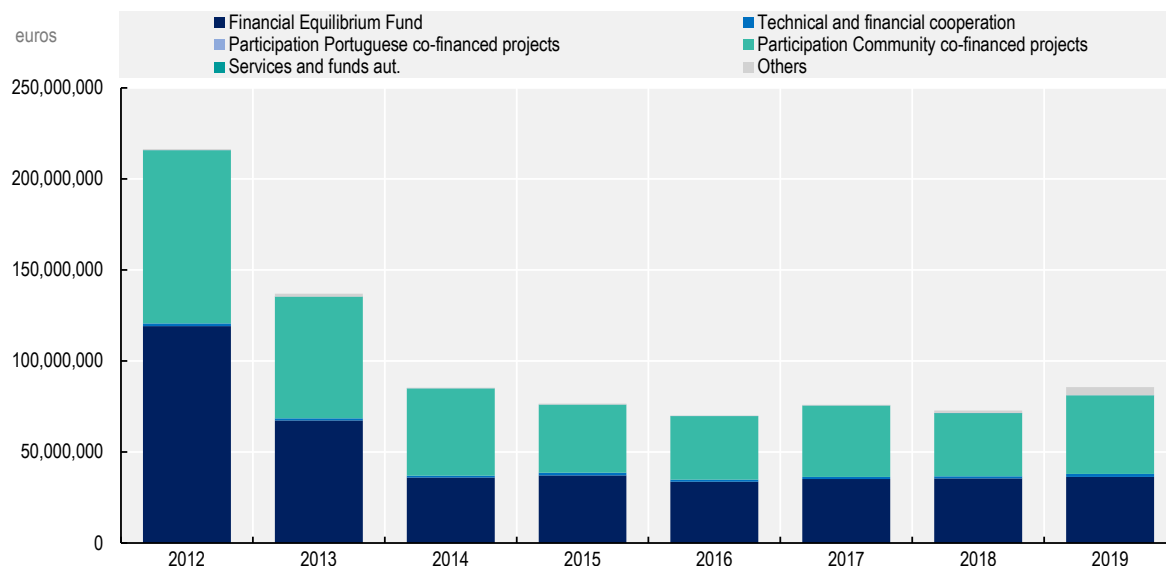


Note: Central government capital transfers mostly consist of the Financial Equilibrium Fund.

Source: (DGAL, 2021^[10]), *Regime financeiro das autarquias locais*, <http://www.portalautarquico.dgal.gov.pt/pt-PT/financas-locais/> (accessed on 30 October 2021).

Figure 3.8. Composition of municipal revenue from capital transfers, Alentejo

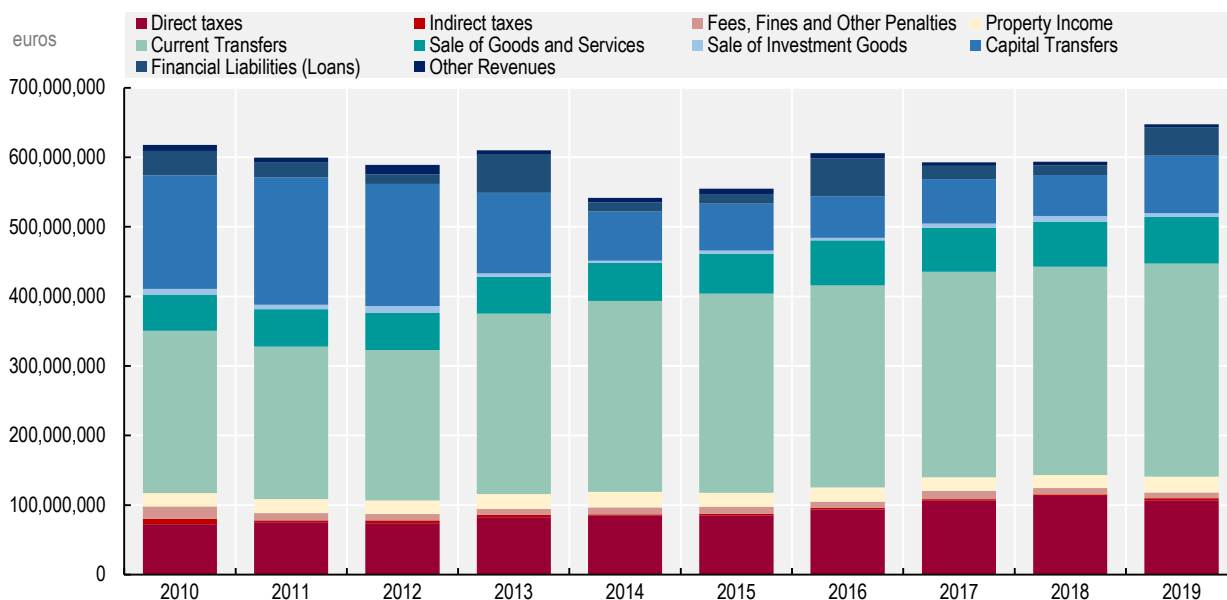
By type, in Euros, 2010-2019



Source: (DGAL, 2021_[10]), *Regime financeiro das autarquias locais*, <http://www.portalautarquico.dgal.gov.pt/pt-PT/financas-locais/> (accessed on 30 October 2021).

Figure 3.9. Composition of municipal revenue, Alentejo

In Euros, 2010-2019



Source: (DGAL, 2021_[10]), *Regime financeiro das autarquias locais*, <http://www.portalautarquico.dgal.gov.pt/pt-PT/financas-locais/> (accessed on 30 October 2021).

The most important component of intergovernmental transfers are transfers resulting from tax sharing, which are particularly important for inland municipalities. On average, inland municipalities receive higher

values of tax sharing transfers than those from the coastline. Since 2007, pursuing the objectives of horizontal and vertical financial balance, tax sharing transfers include:

- A general-purpose grant, the Financial Equilibrium Fund (FEF), whose value is equal to 19.5% of the simple arithmetic average of income from personal income tax (IRS), the corporate income tax and value added tax (VAT). This fund is then divided into two sub-funds with different purposes and subsequently redistributed among municipalities with different criteria:
 - Municipal General Fund – to finance their legal assignments. It is distributed according to population, surface area, and other cost factors.
 - Municipal Cohesion Fund – with the objective of correcting asymmetries among municipalities, particularly with respect to fiscal capacity and unbalance of opportunities. Its allocation is based on municipal tax capacity and an index of municipal social development.
- A specific subsidy (earmarked grant), the Municipal Social Fund (FSM), whose value corresponds to the expenses related to the attributions and competences transferred from the central administration to the municipalities. It is a conditional transfer from the national budget designed to adjust to the transfer of additional assignments related to social functions such as health, education, and social assistance.
- A 7.5% share of VAT revenue collected in the accommodation, catering, communications, electricity, water and gas sectors.
- A Decentralisation Financing Fund (*Fundo de Financiamento de Descentralização*) to finance the new powers of local authorities (Law no. 73/2013 and Law no. 51/2018).

Municipal tax revenue comes from both shared taxation and own-sources taxes

Fiscal revenues are the most important component of municipal own revenues, besides user charges and fees. The main taxes that municipalities collect are the following:

- Municipal Property Tax (*Imposto Municipal sobre Imóveis*, IMI), that was established in 2003 and replaced the Municipal Contribution. The IMI's rates are set annually by the municipalities in the area where properties are located within the following range: between 0.3% and 0.45% for urban buildings (up to 0.5% in specific circumstances), and 0.8% for rural properties. The importance of IMI has been increasing over time as a result of the real estate tax reform implemented to increase local government's revenues. The reform led to a reduction of the temporary exemptions applicable to own housing and to a revaluation of urban real estate assets for taxation purposes, approximating it to the market value. The value revaluation has only concerned urban properties that is, rural properties have not yet been revaluated. This has impacted the differences in the capacity to generate own revenues from urban and rural municipalities.
- Municipal Property Purchase Tax (*Imposto Municipal sobre Transmissões Onerosas de Imóveis* - IMT) that entered into force on January 1, 2004 to replace the Municipal Sisa Tax. The rate is variable, and depends on the type of property (primary residence versus rental or holiday residence) and the value of the property. Since 2014, the IMT has been rising steadily.
- Surcharge tax (*Derrama*), a municipal tax on corporate income that is taxable by the national corporate income tax. This tax decreased considerably during the 2009 financial crisis, but since 2016 it has been increasing.
- Circulation Unique Tax (*Imposto Único de Circulação* – IUC), which revenues are shared among the central government and local governments. The IUC is a yearly tax that is calculated considering the engine cubic capacity (displacement) and the CO2 emissions.
- A variable participation of 5% in the IRS, determined under the terms of article 26, of taxable persons with tax domicile in the respective territorial area, calculated on the respective collection net of the deductions.

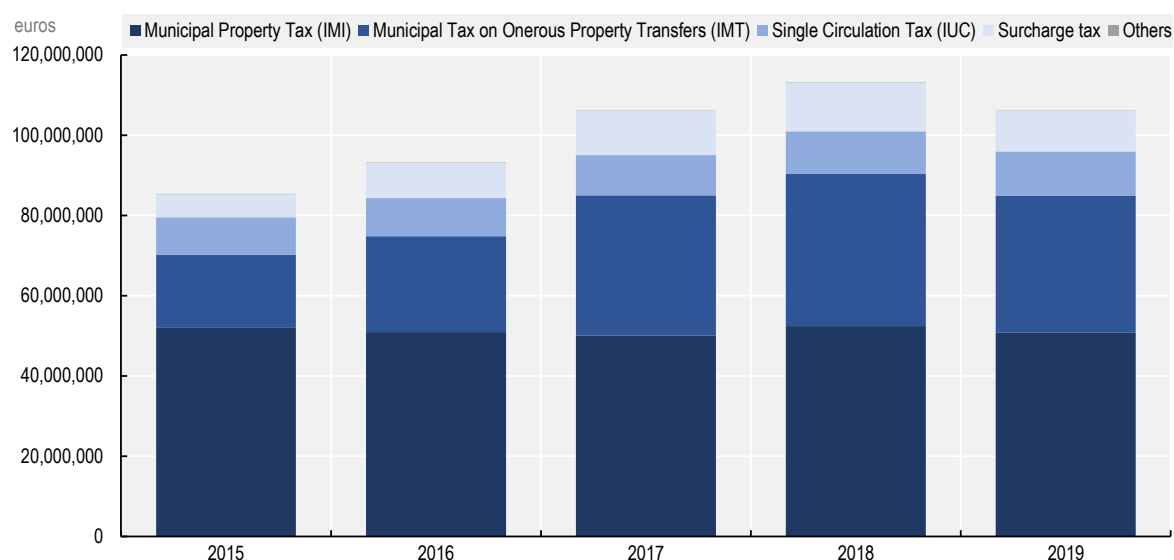
Municipalities scope for setting tax rates is restricted at best, but some municipalities, particularly those with lower fiscal capacity, tend to adopt lower tax rates in the Property Tax (IMI) and Surcharge Tax (OECD, 2020^[11]), in the use of their freedom to explore legal fiscal limits. While this behaviour can be understood as a way to attract private investments and promote economic development, it also creates greater disparities on the fiscal capacity of municipalities within the region and Portugal, making those with lower fiscal capacity even more dependent on central transfers. In Alentejo, municipal direct tax revenue mainly comes from the Municipal Property Tax (IMI) and the Municipal Tax on Onerous Property Transfers (IMT) (Figure 3.10).

Table 3.1. Municipal direct taxes, charged by the central administration

Tax Name	Tax base	Scope for setting tax rates	Weight in municipal tax revenue (%)	Weight in total municipal revenue (%)
Municipal Property Tax (IMI)	The municipal property tax (IMI) is levied on the taxable patrimonial value of rural and urban properties located in Portuguese territory.	Restricted	51.44	8.57
Municipal Tax on Onerous Property Transfers (IMT)	The IMT is levied on the transfers, for consideration, of the property right or partial figures of this right, on immovable property located in the national territory.	No room for manoeuvre	29.05	4.97
Single Circulation Tax (IUC)	The single circulation tax is levied on vehicles registered or registered in Portugal	No room for manoeuvre	10.08	1.69
Surcharge tax	The Surcharge is translated into the application of a tax on taxable income subject to Corporate Income Tax.	Restricted	9.39	1.6
IRS - Personal Income Tax	Personal income	0%-5% variable Some leeway		

Figure 3.10. Detailed composition of municipal direct tax revenue, Alentejo

In Euros, 2015-2019



Source: (DGAL, 2021^[10]), *Regime financeiro das autarquias locais*, <http://www.portalautarquico.dgal.gov.pt/pt-PT/financas-locais/> (accessed on 30 October 2021).

The financing of parishes and inter-municipal entities is limited

The parishes and IMCs financing models limit their capacity to effectively provide services to the local community. On the one hand, parishes' own-revenues are based on a small fraction of property tax (IMI) and user charges related to some public services they provide. Parishes are also entitled to a general-purpose grant, the Financial Fund of Parishes, which corresponds to 2% of the average of the amount collected with personal income tax, corporate tax, and value-added tax (OECD, 2020^[11]). Parishes have also limited access to EU funds; while leasing is allowed, they can only access short-term debt to face treasury difficulties (to be repaid at the year-end) and have no access to debt instruments for investment. However, as highlighted during the study mission, these source of financing remain limited and are at risk given the demographic changes of many municipalities in the region. This also means that parishes' investment depends on their ability to generate savings.

Similarly, IMCs across Portugal have only a restricted capacity to raise own revenues and are mainly financed by municipalities that are part of the community and transfers from the Financial Equilibrium Fund (FEF) which represent only 0.5% of the total FEF transfers. The limited financial means of these entities puts pressure on their capacity to be effective service providers. Diversifying funding sources of IMCs, as well as increasing the amount of transfer they perceive are crucial to enhance their functioning and expand their areas of intervention – which, in Alentejo, are mostly focused on transportation issues. This is also a way of encouraging municipalities to delegate tasks to IMCs.

An ageing and shrinking population jeopardises service delivery funding in Alentejo

As explained in detail in Chapter 2, Alentejo faces ageing and shrinking population, which impact directly (i) the type of services that local governments need to finance, as well as (ii) the local governments' capacity to finance the provision of services. The ongoing change of Alentejo's demographic structure will have a strong impact on education, health and long-term care services, but also on public infrastructure. Given the ageing trend, it is expected that public spending on age-related programs will increase. At the same time, the declining population is likely to have a negative effect on economic activity, resulting in a slowdown in public revenue growth. Shrinking population also means shrinking municipal tax bases. This represents an important challenge for services financing in Alentejo, where direct and shared taxes revenue account for a large share of total subnational government's revenue. Given the design of the transfer system, declining population also means a reduction of the transfers received from the central level.

Local governments across the OECD have adopted different strategies to face shrinking population. In Finland, for example, where rural and remote municipalities have suffered from shrinking population for many decades the state grant system has protected municipalities from a financial collapse. This has been despite the fact the grants are based on per capita calculations, and therefore the transfers decline as the population declines. However, the equalisation of the tax base and the spending needs calculations, which are largely based on the demographic structure of municipalities, have ensured that municipalities with shrinking population have not faced radical changes in revenue. Municipalities have also adjusted their spending and increased their income and property tax rates and used more debt funding. The central government has encouraged municipalities to improve efficiency in welfare services, especially by promoting voluntary municipal mergers and inter-municipal cooperation (OECD, forthcoming^[11]). This is what has been partially done since 2013 in Portugal (Law 73/2013) which also protects municipalities of minimum growth and redistribution to municipalities with the lowest local tax rate). In Sweden, where the municipalities also have important service responsibilities, municipalities have responded to population decline by cutbacks in spending and increased efficiency, especially by school closures, as well as inter-municipal collaboration (Syssner, 2016).

Box 3.4. Shrinking population: five types of policy responses

A traditional way to address population shrinkage at the regional and local government level has been the “going for growth” policy, in other words, to try to reverse shrinking trends and stimulate population growth (ESPON, 2017). However, a completely different approach has received a lot of attention recently. It has been argued by some researchers that a “coping with decline” strategy would form a more realistic way forward for declining population regions and municipalities. This strategy, also called “smart shrinking”, means that shrinkage is accepted and the focus is on measures to adapt to its economic and social consequences (Haase, Hospers, Pekelsma, & Rink, 2012).

In practice, it is possible to identify five types of practical policy responses at the subnational level:

1. Trivialising shrinkage: situation where the local policymakers are presented demographic projections showing that the local jurisdiction will shrink in the coming years or decades. The data is however challenged by policymakers, leading to no response. This approach is likely to lead to budget deficits and indebtedness.
2. Countering shrinkage: policymakers define a strategy to counter shrinkage by attracting new residents and firms to the local jurisdiction. To be successful, this strategy requires realistic growth prospects and is likely to need strong financial support from the central government.
3. Accepting or managing shrinkage: policymakers actively define a strategy to improve the quality of life for the residents that decide to stay, instead of focusing on how to attract people from outside. It is perhaps the most realistic strategy, especially in a situation where the population has already declined for a long time and where there are no prospects for growth policy in the foreseeable future
4. Utilising shrinkage: policy that sees shrinking municipalities as societal laboratories where new methods are tested. The argument is that a municipality’s quality of life does not depend on population density. This policy can work only if the local residents are able and willing to pay higher taxes for the local public services, or there is enough private service capacity to replace the public service provision.
5. Generalising shrinkage: combination of the “countering”, “managing” and “utilising” approaches. In this alternative, reasonable growth prospects are utilised with support from the higher level of governments. In this policy alternative, it makes sense to focus more on current residents than on newcomers (Hospers & Reverda, 2015). The “generalising” policy is challenging from financing aspect and requires skilled local government management as well as active and engaged local decision-makers

Source: (OECD, forthcoming^[11]), *Financing local public services and infrastructure in Estonia: challenges and ways forward*.

Recommendations

The mismatch between jurisdictions borders and the optimal public service benefit areas in Portugal affects the provision and delivery of public services in Alentejo. In the context of low population density, depopulation, and ageing, services can be redesigned in a manner that considers the functionality of the territory. In some cases, it is impossible for each entity to provide all services, rather, reorganising services delivery in a coordinated manner could improve access to services. Furthermore, financial constraints and the need for infrastructure call for more cooperation.

Alentejo could be a laboratory for using public policies to better align demographic trends with public service delivery. Regionalisation reforms, joint municipal authorities or formal co-operation between local governments, specific transfers from the central government could be used to better ensure that services are delivered efficiently and benefit all population.

Further pursuing decentralisation and regionalisation reforms to better align service provision and local needs

The regionalisation and decentralisation process may allow better serving the population. Decentralisation and regionalisation can spur accountability and good governance at the regional and local levels, in particular by aligning service provision to actual local needs. For this, Portugal needs to pursue regionalisation and decentralisation reforms. For this, key avenues are:

- At the local level, the transfer of competences to municipalities needs to be accompanied with the transfer of adequate financial resources as the capacity of municipalities to take over more responsibilities depend to a large extent on the transfer of resources. Incentives could be given to municipalities to take over more responsibilities, including receiving more fiscal resources (from grants) and powers (more own-source revenues). As a reference, Table 3.2 summarises the appropriate subnational government revenues for different expenditure categories. Beyond the transfer of resources it is important to ensure that municipalities have adequate human resources and equipment to undertake the new tasks that have been assigned.

Table 3.2 Appropriate subnational government revenue by category of expenditure

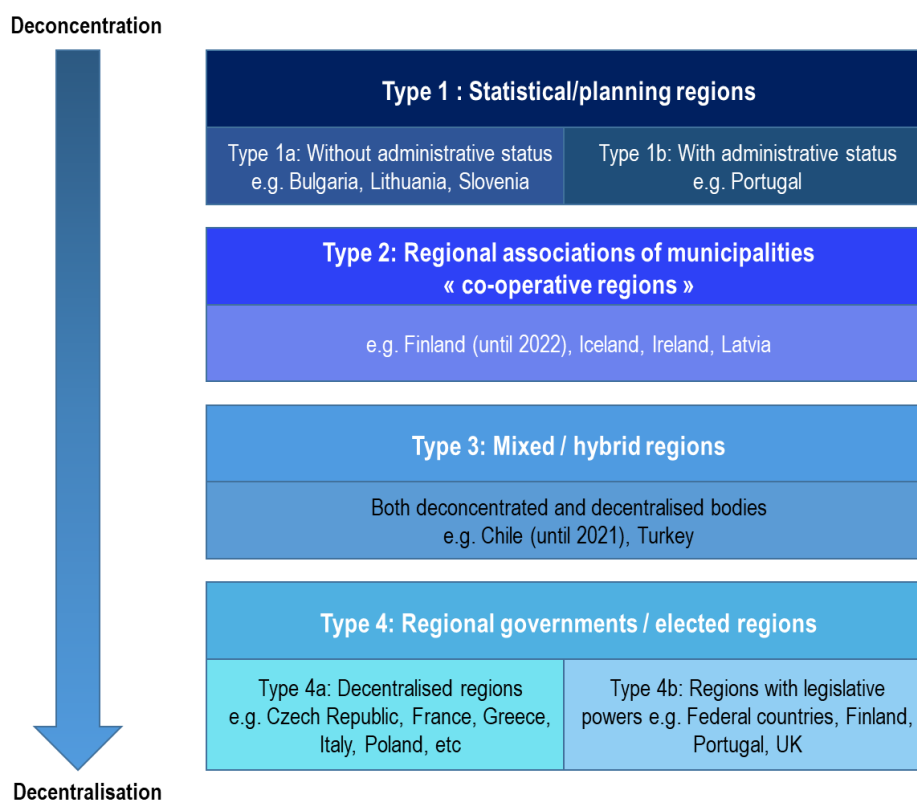
Service	Local taxes	User charges	Transfers	Borrowing
General administration	P	-	-	-
Education	P	S	P	(A)
Health	S	S	P	(A)
Welfare	S	-	P	-
Water supply	S	P*	-	A
Sewerage	S	P*	-	A
Drainage	P	P*	-	A
Markets and abattoirs	S	P*	-	(A)
Housing	S	P	S	A
Land development	-	P*	-	A
Streets	P	S*	-	A
Motorways	S	P*	P	A
Public transportation	S	P	-	A
Garbage collection	P	P	-	(A)
Garbage disposal	S	P	S	A
Parks and recreation	P	-	-	(A)
Fire protection	P	-	-	(A)
Police	P	-	-	-

Note: P= Primary source funding; S = Secondary source; A = Borrowing appropriate for major capital expenditures; (A) = Borrowing appropriate for capital expenditures but likely to account for a small share of spending. * = Development charges (special assessments, valorisation charges, etc.) are appropriate where benefits are spatially well defined within a jurisdiction. ** Transfers may be from regional or central government.

Source: Adapted and modified from (Bahl and Bird, 2018^[12]), *Fiscal Decentralization and Local Finance in Developing Countries*, Edward Elgar Publishing, <https://doi.org/10.4337/9781786435309>.

- At the regional level, Alentejo could be a pilot region to organise the administration in a way that coincides with NUTS2. Alentejo could serve as a pilot to experiment a new model of regional governance. Within a country, there can be several forms of regionalisation depending on the challenges faced by the country and its particular needs. Different options are available (see Figure 3.11); one option would be, for example, to test the model of cooperative regions (association of municipalities at the regional TL2 level) as it is the case in Finland, Iceland, Ireland and Latvia. Across EU Member States and the OECD, regional associations of municipalities have different organisational structures, responsibilities and funding systems. The tasks of the co-operative regional governments are often limited to regional development and spatial planning, EU funds management and some other tasks with clear region-wide benefits such as environmental protection or regional roads. However, as an inter-municipal organisation, they can also execute tasks that are delegated by their members (e.g. waste collection or management of school offices in Iceland, and support co-operation and co-ordination between municipalities). They enjoy some decision-making autonomy on matters of regional jurisdiction. They have their own budget and are funded by municipal member fees. They can also receive central government transfers and EU funding. Co-operative regionalisation can be seen as an alternative to full regionalisation but also as an intermediate stage towards full regionalisation, such as in Finland and Latvia.

Figure 3.11. Four different models of regional organisation in the OECD and the EU



Source: (OECD, forthcoming^[13]), *Regionalisation reforms in OECD countries and around the world*.

Encouraging cross-jurisdiction cooperation through concrete incentives

Further encouraging inter-municipal association to provide decentralised services could improve service provision in education, health care and social support. The central government needs to adopt a proactive role in promoting and stimulating inter-municipal cooperation in the provision of decentralised services.

Municipalities are stronger and more competitive when they join forces and take advantage of economies of scale. IMCs are also better positioned to identify investment and relevant actions with supra-municipal benefits. To encourage collaboration the following actions could be beneficial:

- The central government could accelerate the process of inter-municipal cooperation with financial incentives. To stimulate collaboration among municipalities, it is helpful to design programmes fostering cooperation rather than competition across jurisdictions. One way to accomplish this could be to use the transfer system, for example by directing more transfers to IMCs, instead of municipalities, particularly with respect to public services with important externalities (OECD, 2020^[11]). Along the same lines, EU funds could be directed to inter-municipal projects conducted by inter-municipal communities.
- Build on already successful inter-municipal co-operation mechanisms in the region (or in other regions in Portugal) and to adopt a strategy to actively promote them and encourage peer-learning.
- Leverage inter-municipal companies for the delivery of basic services at the inter-municipal level could also bring important benefits, as it is the case of the water utility company and a waste treatment company in Lezíria do Tejo. Further developing joint-procurement might be also useful to reduce costs as scale increases, for instance to finance telecommunications and school meals.
- Fostering technical capacity through cooperation among parishes could enable them to effectively perform their tasks and deliver local services to residents. Parishes can play an important role in articulating service delivery in very low-density areas. In some cases, however, parishes would benefit from cooperating with adjacent parishes in another municipality. Cross-jurisdiction cooperation could even extend to cross-border. For example, in the case of the municipality of Barrancos and its surroundings, cross-border co-operation could increase service quality to the level of Elvas' and lower territorial disparities in access and use of public services.
- Take better advantage of the conditions established by the current regulatory framework on IMCs for Alentejo to explore instances of co-operation with neighbouring regions and knowledge sharing with regions that face similar problems. This would permit Alentejo to take advantage of peer experiences in facing the challenges brought by a shrinking and ageing population. This peer learning, while promoted by the central level, could, for example, be conducted with regions in Spain that are currently facing similar challenges.
- Identify municipalities or groups of municipalities pertaining to the same functional area– which are not necessarily the ones grouped in IMCs - that could benefit the most from scaling-up the provision of services. Ensuring that services are provided at the functional allows benefitting from spill-overs and economies of scale. Some IMCs have already started to develop maps of public services and this task should be extended to the entire Alentejo's territory. This mapping needs to identify which services may benefit from joint-provision considering functional areas, and not necessarily the administrative divisions of IMCs currently in place.

Strengthening the financing of service provision at the subnational level

Current fiscal arrangements in Portugal do not always take into account territorial, social and economic specificities, and, ultimately, the changing needs of each territory resulting from demographic changes. This means that many municipalities in Alentejo especially those that are smaller and scarcely populated –and which are ultimately the most affected by the demographic challenge-, face large difficulties in providing access to quality services in a sustainable way. Fiscal arrangements need to be gradually reformed in order to ensure that municipalities will still be able to properly finance service provision and ensure citizen's well-being over time. For this, some of the measures that could be taken are the following:

- Strengthening the municipal own revenue base in a gradual manner. A high reliance on transfers and a low taxing power may have a negative effect on the efficiency of municipal service delivery. This can be done by exploring the possibility of increasing the leverage that municipalities have on

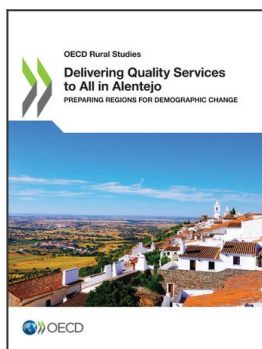
to tax rates (i.e. on the Property Tax and the Surcharge Tax), and the proportion of the personal income tax that stays with municipalities. With this, municipalities can make a more efficient use of these instruments to attract people and investments. This needs to be accompanied with proper accountability measures so that citizens have a clear idea which are the taxes that are managed by municipalities.

- Guarantee financial means of IMCs to particularly benefit small municipalities that have less capacity to raise own revenues. IMCs currently receive only a marginal amount of transfers (0.5% of the FEF) and have a very restricted capacity to raise own revenues. To enlarge the role of IMCs and make them less dependent on the municipal will of delegating task, it would be important to increase the amount of transfers. This increment can be subject to particular outputs that can be previously defined between the central level and the concerned IMCs (see above).

References

- ANMP (2021), *Associations of Special Purpose Municipalities*, [7]
<https://www.anmp.pt/municipios/associacoes-de-municipios-de-fins-especificos/> (accessed on 2021).
- Bahl, R. and R. Bird (2018), *Fiscal Decentralization and Local Finance in Developing Countries*, Edward Elgar Publishing, <https://doi.org/10.4337/9781786435309>. [12]
- CCDR Alentejo (2020), *Alentejo 2030: regional strategy*, <https://www.ccdr-a.gov.pt/docs/ccdra/gestao/ER2030.pdf>. [2]
- CCDR-A (2021), *Comissão de Coordenação e Desenvolvimento Regional do Alentejo*, <https://www.ccdr-a.gov.pt/>. [3]
- DGAL (2021), *Regime financeiro das autarquias locais*, [10]
<http://www.portalautarquico.dgal.gov.pt/pt-PT/financas-locais/> (accessed on 30 October 2021).
- Eurostat (2021), *General government expenditure by function (COFOG)*, [4]
https://ec.europa.eu/eurostat/databrowser/view/GOV_10A_EXP/default/table?lang=en
 (accessed on 30 October 2021).
- Forum das Cidades (2020), *Pacts for Development and Territorial Cohesion*, [6]
<https://www.forumdascidades.pt/content/pactos-para-o-desenvolvimento-e-coesao-territorial>.
- OECD (2021), *Subnational governments in OECD countries: key data*, [9]
<https://stats.oecd.org/Index.aspx?DataSetCode=SNGF>.
- OECD (2020), *Decentralisation and Regionalisation in Portugal*, OECD, [1]
<https://doi.org/10.1787/fea62108-en> (accessed on May 2021).
- OECD (2017), *Multi-level Governance Reforms: Overview of OECD Country Experiences*, [8]
 OECD Publishing.

- OECD (forthcoming), *Financing local public services and infrastructure in Estonia: challenges and ways forward*. [11]
- OECD (forthcoming), *Regionalisation reforms in OECD countries and around the world*. [13]
- OECD-UCLG (2019), *World Observatory on Subnational Government Finance and Investment*, <https://www.sng-wofi.org/>. [5]



From:
Delivering Quality Services to All in Alentejo
Preparing Regions for Demographic Change

Access the complete publication at:

<https://doi.org/10.1787/63ffb4d7-en>

Please cite this chapter as:

OECD (2022), “Multi-level governance and subnational finance for service provision”, in *Delivering Quality Services to All in Alentejo: Preparing Regions for Demographic Change*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/13240a11-en>

This work is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries.

This document, as well as any data and map included herein, are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area. Extracts from publications may be subject to additional disclaimers, which are set out in the complete version of the publication, available at the link provided.

The use of this work, whether digital or print, is governed by the Terms and Conditions to be found at <http://www.oecd.org/termsandconditions>.