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Acknowledgements


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## Integrating local ecological services into intergovernmental fiscal transfers: The case of the ecological ICMS in Brazil

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<http://dx.doi.org/10.1016/j.landusepol.2007.11.001>, How to Cite or Link Using DOI

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### Abstract

Local conservation efforts are often related to benefits at higher governmental levels. On the one hand, these efforts are strongly connected to local land-use decisions. On the other hand, activities such as sustainable water management or biodiversity conservation are associated with regional, national or even global public goods. Therefore, spatial externalities or spillovers exist, which—if not adequately compensated for—lead to an underprovision of the public goods and services concerned. This article investigates intergovernmental fiscal transfers as an innovative instrument for compensating local jurisdictions for the ecological goods and services they provide across local boundaries. From a public finance perspective, fiscal transfers are a suitable instrument for internalising spatial externalities. However, most federal states use this instrument predominantly for social and economic public sector functions rather than for ecological ones. This article investigates the case of the ecological "ICMS" that was first introduced by a few states in Brazil during the 1990s. Part of the revenue from this value-added tax is redistributed to the local level on the basis of ecological indicators. In this way, the state level uses fiscal transfers to compensate municipalities for the existence of protected areas and other ecological services provided within their territories. The Brazilian experience illustrates that such fiscal transfers can represent both a compensation for land-use restrictions and an incentive to value and engage in more conservation activities at the local level.

### Keywords

Fiscal transfers; Environmental federalism; Conservation benefits; Spillover effects; Local ecological