12

Fiscal decentralisation and autonomy

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Introduction

Fiscal autonomy is defined by Hooghe *et al.* (2016, p. 6) as 'the extent to which a regional government can independently tax its population.' Mangioni (2016) defines the objective of fiscal autonomy as the impost and collection of revenue for the benefit of the community revenue is collected from. While fiscal autonomy is seen as desirable, Shanske (2014, p. 16) states that granting cities fiscal powers is not without risk:

> *The benefit principle requires that each city bear the entire cost of any poor fiscal decisions made by that city, including any choices regarding borrowing. Such a rule is called a 'hard budget constraint.' Hard budget constraints compel local citizens to take full ownership of their local government because they bear the consequences of any local government failures.*

In Australia, fiscal autonomy is an outcome, with decentralisation the process to achieving reform through sharing existing taxes and defining new taxes that would be the domain of metropolitan government. This objective is relevant for Australia, which, in addition to being a low-taxing country, has one of the most centralised tax systems within the OECD. Further, it is a country that has yet to embrace the concept of metropolitan government and how it should be funded.

Fiscal policy that drives decentralisation evokes debate and scrutiny, and is challenged by virtue of the way it is imposed and how revenue is collected, allocated and spent. There are disparate views on the objectives of fiscal policy and its impost in a modern and evolving user-pays economy. The Commonwealth of Australia (2014) expresses challenges confronting government in achieving fiscal reform in the delivery of services and infrastructure. This chapter shows that countries with decentralised tax systems are more successfully able to raise taxes through lower tiers of government that are responsible for delivery of public goods and services.

The chapter commences with a review of the fiscal arrangements and reforms abroad, followed by the existing fiscal arrangements that have served Australia over the past 60 years. It defines how policy has evolved and why it must further evolve. It paves the way for the development of a framework for reform and the case for metropolitan fiscal decentrali-

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sation in moving towards the goal of fiscal autonomy. The change needed to achieve this is driven by the decentralisation of existing tax-raising powers, as well as development of the tax effort of subnational government through new taxes.

It shows that reform will depend on cooperation between tiers of government, with the goals of more efficiently funding public goods and services. Defining which tier of government is responsible for services, in particular, services for which hypothecated taxes may be imposed, is an important component of reform. Further, the practice of cost-shifting by higher to lower tiers of government without allocative means of funding is counterproductive; it requires corresponding fiscal decentralisation or new revenue sources to fund recurrent costs and capital expenditure.

Fiscal decentralisation: the pathway to increased autonomy

The way in which metropolitan areas are governed and funded affects the way in which service delivery is achieved across municipal areas, also known in Australia as local government areas. As cities continue to grow, Westman (2007, p. 87) defines the conceptual economic benefits of this growth as, 'Urbanisation is one of the most powerful irreversible forces of the world … cities make countries rich. Countries that are highly urbanized have higher incomes, more stable economies and stronger institutions'.

What is not addressed to the same extent is the question of how fast-evolving metropolises should be funded and, more specifically, how much autonomy administrators should have in raising own-source revenues. In both unitary and federated structures, the revenues of local government in meeting the needs of metropolitan areas lag behind the financial capacity of their geographic boundaries. The need for greater fiscal capacity coordinated across cities globally has never been greater, with the increasing diversity of cities and demand for infrastructure. Slack (2010, p. 8) emphasises the need for both 'hard services, water transit and roads' as well as 'soft services such as cultural, libraries among other social services'.

In large cities, services that have traditionally been the role of upper tiers of subcentral government (SCG) have progressively been divested to local government. Increasingly, the need to bring essential services closer to the community has resulted in the growth of health, local policing and elementary educational services by lower tiers of government. In other cases, this has been achieved without the requisite forms of funding needed to support services.

The ability of a city to levy its own taxes and determine tax rates, results in more responsibility and accountability to its residents. However, 'First should come the assignment of expenditure responsibility to local government and then the assignment of revenue responsibility should be determined' (Bahl 1999, p. 7). The primary reason for decentralisation of fiscal revenue is defined by Musgrave (1983) as the wish to move government closer to the people, the efficiency gain that most economists agree to be the rationale. If we advocate for fiscal decentralisation, then we must believe that:

> *When preferences among voters are diverse and local government have responsibility for delivering those services that do not have major external effects, the potential benefits include better public services, better accountability on the part of government officials, more willingness to pay for services and hopefully 'development from below (Bahl 1999, p. 2).*

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The ability of a city to determine its objectives is impacted by its self-determined revenues compared with revenues generated through grant funding from higher tiers of government. Grants are one of the largest revenues sources of local government, either in the form of general-purpose grants or specific-purpose grants; the latter may result in higher tiers of government influencing how grant revenue is to be allocated and spent (Warren 2004). Despite the sentiment towards fiscal autonomy and measures to decentralise fiscal revenue sources, central government transfers are in the top two sources of revenue for many cities: in London they comprise 74%, in Berlin 26%, in Madrid 37%, in New York 31%, in Paris 18% and in Tokyo 8% (Slack and Cote 2014).

It is apt at this point to briefly define the differences between the two main structures of government in supporting the fiscal split between taxes shared by more than one tier of government. In distinguishing the fiscal powers of federated and unitary structures:

> *A unitary structure of government, or unitary state, is a sovereign state governed as a single entity. The central government is sole authority, and the administrative divisions exercise only powers that the central government has delegated to them. Subdivisional units are created and abolished, and their powers may be broadened and narrowed by central government. Federated structures of governments include the USA, Canada and Australia, while England, New Zealand and Denmark are unitary structures (Mangioni 2016, p. 336).*

In contrast to unitary states, under a federated structure, power is shared between federal and SCG tiers of government. The SCGs themselves are unitary in nature in their relationship and administration of local government or metropolitan government (Mangioni 2016). In a federation the component states are in some sense sovereign, insofar as certain powers are reserved to them that may not be exercised by central government (OECD 2009).

In industrial countries, the revenue split at subnational government is approximately one-third of total tax revenue collected (Bahl 1999). In contrast, in Australia the share is less than 20% and is unsustainable under the current collection ratio. In increasing this share, the questions best asked, are how decentralisation is to be achieved, how revenue should be decentralised and, given the low tax-take in Australia, how and which tier of government is best placed to recalibrate this revenue disparity. Australia is ideally fiscally placed to commence decentralisation through the funding of a metropolitan structure of government.

Table 12.1 sets out the disparity of own-source revenue as a percentage of total tax between central and local government in unitary and federated structures. It shows that local government in Australia collects less than half the OECD average for federated countries, and one-third when compared with the USA and Canada. There are significant limitations in the funding of local government in Australia, but there is also the opening for fiscal reforms to encompass potential opportunity for funding to be decentralised and allocated to an evolving metropolitan government across Australia. In Table 12.1, the difference between the percentage of revenue collected by central and local government in federated structures is the revenue collected by the upper tier of SCG, defined as states or provinces.

We now examine the options for reforming fiscal sharing and restructuring the tiers of government, with metropolitan government in mind. This is followed by the review undertaken in the progressive metropolitan development of Toronto and restructuring operational and fiscal arrangements in Denmark, which moved to a quasi-metropolitan/regional

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Table 12.1. Tax collection percentage, central v. local government

Country	Central	Local	Structure
Australia	80.0	3.5	Federation
Germany	31.2	8.2	Federation
USA	42.1	14.1	Federation
Canada	41.4	10.3	Federation
Federated OECD average	**53.4**	**7.6**	
Denmark	75	25	Unitary
UK	75.8	5	Unitary
New Zealand	93.7	6.7	Unitary
Unitary OECD average	**63.5**	**11.7**	

Source data: OECD (2016).

government structure during the 1990/2000s. Each example highlights potential reforms of fiscal arrangements in Australia.

Fiscal reformation: sharing tax revenues by tiers of government

In defining the taxonomy of power between tiers of government, the OECD (2009, p. 4) incrementally distinguishes the levels of fiscal autonomy applied to SCG in the following broad categories:

- SCG sets tax rate without the need to consult a higher tier of government;
- SCG initially sets the tax rate, with higher tier of government setting upper or lower limits;
- a tax-sharing arrangement between SCG and central government, in which SCG determines the split;
- a tax-sharing arrangement between SCG and central government, with central government determining the split;
- a tax-sharing arrangement between SCG and central government, in which the split is set out in legislation,
- central government sets the rate and the base of the SCG tax or taxes.

A study of 17 OECD countries demonstrates the evolution of fiscal autonomy in Europe through own-source revenues shared between central government and SCG that embrace these options (Blochliger and King 2006). This study shows that 36% of revenue is collected from highly mobile income taxes, 21% from consumption taxes and 19% from immobile property taxes. It is apparent that sharing the same tax base with cohesive agreements between jurisdictions is progressively becoming a successful decentralisation option in European countries. While an option, many metropolitan areas including London are at different phases in the decentralisation process, with London's primary source of revenue after grants being the council tax, which accounts for 8–9% of its revenue.

While in principle tax-sharing arrangements appear to demonstrate a collaborative approach to bridging revenues across tiers of government, a more granular analysis is needed in determining their success at the operational level. In Australia, the sole tax imposed at the local government level is council rates, and even so the states increasingly govern the increase and amount of revenue that may be collected by local government. A

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similar regime exists in the UK in relation to the council tax. In these two countries, this tax is the only fiscal impost applied at the local level excluding user charges, yet increases in revenue from that source is regulated or determined by central government in London and state government in Australia.

The above study, referred to by Blochliger and King (2006), was primarily conducted on unitary countries, where revenue splits were more amicably agreed. The only source of tax revenue collected by local government in Australia and the UK results in their split of local revenue being among the lowest in the OECD. In the case of Australia, this will be addressed further in the following section. We now review two cases where fiscal reforms over the past decade have involved decentralisation and restructuring of the functions and fiscal responsibilities of government. The studies demonstrate that reforms may be achieved through incremental fiscal decentralisation as shown in Toronto, or in sweeping reforms in restructuring government as implemented in Denmark.

Metropolitan fiscal reform in Toronto

Canada is a federated structure with a central government, 10 provinces and three territories. As Canada federated, central government allowed its provinces to retain the right to impose similar tax bases but it has adopted varying degrees of disincentives in attempting to minimise tax competition across its provinces. With a highly urbanised population, among the latest raft of tax reforms is the funding and revenue sources collected by Canada's cities. In taking steps to building fiscal autonomy through decentralisation in Toronto, the *City of Toronto Act* was introduced in 2006.

Toronto is the largest (most populous) city of Canada, with 6 242 300 residents (Statistics Canada 2016). The objectives of the *City of Toronto Act* are to provide a level of metropolitan self-governance and financial capacity in meeting the specific needs of the city. The objectives of the Act are set out under Part 1 – Interpretation of the Act. These highlight the need to balance province and city interests; points 6 and 7 focus on the need to meet the city's fiscal objectives:

> *The purpose of this Act is to create a framework of broad powers for the City which balances the interests of the Province and the City and which recognizes that the City must be able to do the following things in order to provide good government:*
> 1. *Determine what is in the public interest for the City.*
> 2. *Respond to the needs of the City.*
> 3. *Determine the appropriate structure for governing the City.*
> 4. *Ensure that the City is accountable to the public and that the process for making decisions is transparent.*
> 5. *Determine the appropriate mechanisms for delivering municipal services in the City.*
> 6. *Determine the appropriate levels of municipal spending and municipal taxation for the City.*
> 7. *Use fiscal tools to support the activities of the City. 2006, c. 11, Sched. A, s. 2.*

The City of Toronto has a relatively narrow but expanding tax base, primarily derived from recurrent property taxation (50% of revenue), followed by municipal land transfer tax (7%) and a third-party sign tax (0.1%). The signage tax is a potential revenue source for Australia's cities. The balance of Toronto's revenues is derived from user fees, which account for 43% of revenue (City of Toronto 2016). That review of revenues collected by the

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City of Toronto defined further tax sources that would assist in funding the city until 2021. Two additional tax options are available – a personal vehicle tax and an alcohol beverage tax. The latter requires provincial regulatory changes before it can be enacted.

Significantly higher revenue may be collected through the recently introduced third-party sign tax (City of Toronto 2016). This tax has been a solid revenue source in international cities including New York and Tokyo under the enterprise tax. Further tax reforms under review require provincial support for introduction as metropolitan taxes; they include hotel, municipal income and municipal sales taxes. The City of Toronto has delegated power under its governing Act to establish budgets and to operate many of its services through boards, agencies and corporations, some of which facilitate user or fee-related charges. There are over 30 instrumentalities in operation across Toronto City, including policing, public health and transit commissions. The key objectives of these instrumentalities as defined by the City of Toronto (2016) are to:

- meet legal requirements;
- operate in a commercial environment;
- focus on delivering a specific policy objective or service;
- enable independent decision-making;
- engage citizens in board decision-making, bring expertise, involve funders or fundraisers and use volunteer capacity.

Fiscal reformation in Denmark

The Danish local government reform comprises three reform elements – a territorial reform (merging of municipalities), a reallocation of tasks across levels of government, and a financing and equalisation system of reform. This allows compensating costs and benefits to carry over from one reform element to the other (Jenson and Jacobson 2009). The municipal reform was presented by the government as a solution for reinforcing decentralisation, both functionally and fiscally.

Until 1970 Denmark consisted of 1389 urban and rural municipalities, which were amalgamated into 275 municipalities. The 24 counties were merged into 14. In 2007 a further wave of reform was implemented by central government. It abolished the counties, replacing them with five regions and merging the 275 municipalities into 98. The restructuring of subnational government as of 1 January 2007 resulted in two levels of government: level 1 the state (central) government and level 2 comprising regions and municipalities. There is no subordination between regional and municipal government as they have different tasks and responsibilities (Local Government Denmark 2009).

One of the main elements of the Danish reform was the increase of power and funding at the local and metropolitan levels which resulted from the dissolution of the county level. Several tasks were transferred from the counties, leaving the municipalities responsible for handling most welfare tasks including compulsory education and special education for adults, rehabilitation and long-term care for the elderly, preventive health care, nature and environmental planning, participation in regional transport companies and maintenance of the local road network (Blöchliger and Vammalle 2012).

The number of taxation levels was reduced from three to two, since the regions, unlike the counties, no longer had the authority to impose taxes. The revenues of regional government consist of block grants and activity-based funding from the central government and local government (Falk-Rasmussen and Muller 2010). In addition, local government reform does not result in changes in the distribution of the cost burden between the municipali-

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ties. A reform of the grant and equalisation system was carried out, which takes into account the new distribution of tasks (Blöchliger and Vammalle 2012).

In terms of the total cost of public services and their allocation across government levels, the reform was conceived as a zero-sum game, on the principle that 'the funds follow the tasks'. Apart from one-off transition costs, the reform was neutral with respect to the overall spending of the central and subcentral levels. In addressing cost-shifting higher grants; on the one hand, municipalities receive new grants from the central government for the services transferred to them and, on the other hand, the newly created regions have no taxing power and are funded by grants from the central government and the municipalities (Blöchliger and Vammalle 2012).

At the municipality level, the tax revenue collection is spread across several sources, of which income tax comprises the largest portion at ~70% (Falk-Rasmussen and Muller 2010). User payment charges and fees are the second largest source at 10%, with property tax the third largest income source at 8%. Grants from central government account for 7%, with the rest of the tax revenue derived from loans, company tax and interest (Local Government Denmark 2009).

Case for fiscal decentralisation in Australia

The Toronto and Danish reforms assist in conceptualising the construct of metropolitan government in Australia. While it is useful to make international comparisons of fiscal policy and arrangements between the various tiers of government, it would be remiss not to acknowledge that each system has been shaped by the jurisdiction's political, economic, demographic and temporal circumstances. With this in mind, some of the evolving international reforms inspire the opportunity to decentralise fiscal control and further develop own-source revenues at the metropolitan level in Australia. In this section we examine Australia's tax system, the need for decentralisation and the recommendations of Australia's major tax reviews of the past 40 years. This provides the foundation for the case to fund services at the metropolitan level and addresses corresponding capital outlays now defined as infrastructure development.

It was shown above (in Table 12.1) that Australia has one of the most centralised tax systems in the world, with local government own-source revenue accounting for little more than 3% of total tax revenue collected across all three tiers of government. Two further observations are made about Australia's taxes: the overall tax collected in Australia is well below the OECD average, and the tax mix varies across the broad tax categories. In summary, consumption taxes are below the OECD average as a percentage of Gross Domestic Product (GDP), while income taxes are above the average. This brings to the fore, the need to reform the tax mix as well as the overall tax effort in Australia, while improving fiscal revenues that are generated at the local and potentially at the metropolitan level.

To put these points into context, we examine the evolution of Australia's taxes since Federation, the role of the Grants Commission and the key tax reforms of the past four decades that have shaped the dominance of central government as Australia's fiscal gatekeeper. This provides a background for the fiscal decentralisation discussion that follows.

Australia's fiscal evolution post-Federation

The stability of the Australian Federation has been tested since its creation: in 1933 there was a Western Australian referendum on secession, which resulted in 68% of voters opting for that state to leave the Commonwealth. This action was prompted by the financial and

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fiscal circumstances that impacted Western Australia, and prompted the creation of the Commonwealth Grants Commission. One of the Commission's first tasks was to develop equalisation of centrally collected revenue for allocation to the smaller populous states of Australia. The initiative to secede was not actioned by Western Australia, but it emphasised the impact of Australia's fiscal federalism on the states close to a century ago.

The challenge of fiscal federalism was again emphasised in the early 1940s, when the Commonwealth took control of income and company taxes from the states under the *Uniform Taxation Act 1942*, to fund the war effort. The Commonwealth placed conditions on the states' reimbursement grants, which resulted in a High Court challenge by the states, a challenge that was won by the Commonwealth. While the states were still able to impose incomes taxes, the Commonwealth had the power to offset grant revenue corresponding to the amount of income tax collected by the states (Warren 2004).

The rationale for the primary function of the Commonwealth Grants Commission is the equalisation of fiscal revenues across the states:

> *State governments should receive funding from the Commonwealth such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standard (Commonwealth of Australia 2009).*

While an important mechanism in achieving this objective, in Canada and Germany equalisation is tempered to increase the efficiency of provinces and lander (the equivalent mid-tier of government) and to stimulate growth in more dependent jurisdictions. It is recognised by the Commonwealth Grants Commission that the current formula used to distribute revenue, may reduce the incentive for states to promote economic growth and development. This is the catalyst to consider alternative options and sources of revenue that may be imposed by subnational government, through encouragement and incentives from the Commonwealth.

It is clear that the Commonwealth Grants Commission has a role to play in equalising centrally collected revenues across disparate regions of Australia. This chapter also argues that it has a role in incentivising the sharing of centrally collected revenues and the evolution of own-source revenues at the local and metropolitan levels of the Australian Federation. In essence, its charter needs to progress to incentivise and support the fiscal development of metropolitan government.

Tax reforms after the Asprey and Henry reviews

The 1980s were an important period of fiscal reform resulting from the Asprey Review of Australia's tax system a decade earlier. The high rates applied to income tax became a disincentive for employees in higher tax brackets in excess of 60c/$. The review canvassed the need for a consumption tax, which took a quarter of a century to introduce. The revenue from consumption was to replace income tax revenues resulting from the progressive reductions in income tax revenue.

However as in most tax reviews, time passes before recommendations are adopted, with many reforms adopted out of necessity. Hewson (2014, p. 591) highlights that the time between review and reform of fiscal policy is gradual and progressive, with key reforms taking up to 20 years to implement:

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Asprey's recommendations received little attention from the Whitlam and Fraser governments … the issues it raised did not disappear. Indeed, the major reforms of the 1980s – capital gains tax, fringe benefits tax, dividend imputation, large cuts to personal and business income tax rates – the taxation of foreign-sourced income in 1990, and a broad-based consumption tax in 1998, were all stimulated by Asprey. They sought to broaden the base and, to the extent possible, cut the statutory rates of tax.

In the absence of a much-needed consumption tax, in 1985 the Commonwealth introduced a capital gains tax, which replaced revenue resulting from the progressive reductions in income tax and company tax rates. The capital gains tax was introduced with one significant carve-out, i.e. the principal place of residence. This was one major asset class that central government could not build a compelling rationale to tax. In 1992 a retirement levy in the form of mandated superannuation, known as the superannuation guarantee charge (SGC), was introduced with the long-term view of reducing the redistribution of tax revenue through aged pensions in the decades ahead.

A goods and services tax commenced in 2000 and was one of the most important reforms of the 21st century – Australia formally introduced a consumption tax. This reform was tax re-centralisation as it replaced many of the wholesale sales taxes that were fractured into subcategories according to the goods to which the tax was applied. While these are important reforms, they were mandated by central government in Australia, which collects and controls over 80% of tax revenue. There has been less fiscal reform at the subnational level of government. Between 1976 and 1981 the states progressively abolished death duties. The lost revenue from inter-generational wealth transfers through willing of assets, including the family home, was replaced with increases in stamp duty over the same period.

In stark contrast to the increases in stamp duty on property since the Asprey Review, the recommendations of the 2010 Henry Review addressed the reforms needed to increase revenues by subnational government. Key among them were recommendations to expand state land tax to include the family home, which is the single largest expenditure of this tax. Figure 12.1 shows that recurrent land tax collected from the combination of state land tax and local government rating is the fourth largest source of revenue in Australia, yielding marginally more revenue than payroll tax, which is the fifth largest revenue source.

The 10 taxes shown in Fig. 12.1 account for ~90% of total tax revenue in Australia. The remaining 10% of tax revenue is derived from 115 different taxes. Figure 12.1 also shows that the top three tax revenue sources are collected by central government, none of them shared with SCG. Income tax is the largest source of tax revenue in Australia, and is above the OECD average. The importance of maintaining competitive labour taxes moves the tax pendulum towards increasing taxes on consumption and capital. This raises questions as to how Australia's tax system may be reformed in building fiscal capacity, deriving tax revenues that would fund metropolitan government and sharing existing tax sources with central government.

The previous section showed that most fiscal reforms over the past five decades were driven by central government as the primary tax collection tier of government. We now consider several potential fiscal measures for funding a metropolitan structure across the cities and emerging urban agglomerations of Australia. These measures are categorised into the groupings of expanding existing fiscal sources, inter-governmental sharing of

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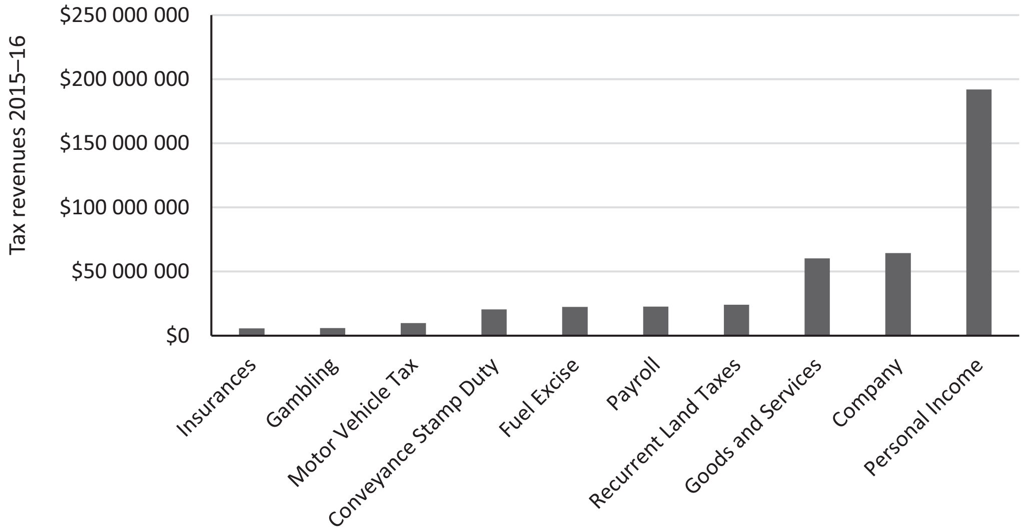

Fig. 12.1. Sources of tax revenue in Australia. Source data: Australian Bureau of Statistics (2016)

similar tax bases, and the proposed introduction of new taxes that would be the sole domain of a metropolitan government.

The mix of options indicates that there is no single answer for tax reform and funding of any one tier of government. This is supported by the variety of taxes that operate at the metropolitan and local levels internationally. What emerges in Australia, resulting from the challenges of fiscal federalism, is the low level of total tax revenue collected and the limited tax mix from which revenue is derived. These factors precipitate the need for fiscal evolution and new substantial tax revenue sources, in which Australia's cities are important facilitators in driving tax reform.

Table 12.2 demonstrates the need for fiscal reform through decentralisation at the metropolitan level in Australia. Pertinent is the narrow revenue imposts by local government in Australia in contrast to the evolved revenues collected in New York and Toronto (both federations) and Tokyo and Paris (unitary structures). The residence tax in Paris and property tax in New York and Toronto are significantly higher than the revenue collected from this tax in the cities of Australia. This is due to restrictive rate-pegging and capping imposed on local government by the states – the exact opposite to the revenue-sharing opportunities that should exist in Australia.

Further noted in Table 12.2 are automobile and vehicle taxes imposed in Tokyo and soon to be imposed in Toronto. The largest capital expense of local and potentially metropolitan government is road maintenance and capital works. This revenue is easily hypothecated to roads and transport by local or metropolitan government and would replace the Roads to Recovery funding granted by the Commonwealth directly to many local government areas in the capital cities of Australia. While this revenue would remain important financial assistance for many regional local government areas, its equivalence at a metropolitan level would be best funded through an automobile impost.

Table 12.2 shows many of the opportunities for funding goods and services that are successfully applied in metropolises internationally. It demonstrates how cities may contribute to expanding tax revenue and the fiscal reform agenda in Australia. In the next sections we elaborate on the direction of reform, through new revenues that may be intro-

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Table 12.2. Own-source and shared taxes in international cities

Cities of Australia	London	Copenhagen	Paris (unitary)	Tokyo	New York	Toronto
Local taxes	**Local taxes**	**Local taxes**	**Local/metro taxes**	**Local/metro taxes**	**Local taxes**	**Local/metro tax**
Council rates	Council tax	Local income tax	Property tax	Metro inhabitant tax	Property tax	Property tax
	Shared tax	Service tax	Residence tax	Enterprise tax	Sales and use tax (various)	**Shared tax**
	Uniform business rate*	Land tax	Economic contribution tax	Acquisition tax	**Other local/ metro**	Property transfer tax
		Property value tax	Garbage tax	Golf-links tax	Hotel occupancy tax	**Proposed metropolitan taxes under review**
			Front-walk cleaning tax	Automobile tax	Liquor licence	Alcohol beverage tax
			Parking tax	Light-oil delivery tax	Taxi transfer	Personal vehicle tax
			Power consumption tax	Urban planning tax	Betting tax	Third-party sign tax
			Transfer tax	Accommodation tax	Billboard taxes	
				Shared taxes	**Shared taxes**	
				Consumption tax	Income (various)	
				Tobacco tax	Liquor excise	
				Local transfer tax		
Federated govt	**Unitary govt**	**Unitary govt**	**Unitary govt**	**Unitary govt**	**Federated govt**	**Federated govt**
Local govt share of national tax	**Local govt share of national tax**	**Local govt share of national tax**	**Local govt share of national tax**	**Local govt share of national tax**	**Local govt share of national tax**	**Local govt share of national tax**
3.5%	5%	25%	13%	23.5%	14.1%	10.3%

* Reforms underway in the UK.
Sources: Slack and Cote (2014); Mangioni (2016); OECD (2016); City of Toronto (2016).

duced and the expansion of existing revenues through sharing of the tax base across tiers of government in Australia.

Defining the objectives and rationale for funding metropolitan government

It was pointed out earlier in this chapter, that tax revenues and funding by higher tiers of government should follow the tasks and responsibilities of government. In contextualising fiscal priorities, Tomlinson (2016) defines two significant points that would be the domain of metropolitan government, i.e. subsidiarity of infrastructure services (stated as best provided at the metropolitan level) and devolution of responsibility for funding such projects. In the capital cities of Australia, addressing housing and the transport mobility of rapidly expanding populations requires fiscal measures at the metropolitan coalface. The primary focus of this section is the initial and recurrent funding needed to develop and maintain new and regenerated infrastructure across metropolitan locations, although some operational responsibilities may be shared across tiers of government.

Several options exist for expanding and creating alternative sources of revenue that are well-defined as the domain of metropolitan government. The first source is income tax revenue forgone by the Commonwealth on property that benefits from increases in value generated from public services and infrastructure. The second source is land tax revenue forgone by the states in the form of tax expended through the land tax threshold and the principal place of residence exemption (Mangioni 2016). The latter revenue source was the subject of review by Commonwealth of Australia (2008) and is still working its way through the current tax reforms needed at the subcentral level.

A further revenue source under review is that of value capture taxation generated by the uplift in value through the announcement and delivery of infrastructure. We now discuss each of these taxes and why they would apply at the metropolitan government level as a key source of revenue. It is demonstrated that fiscal decentralisation and sharing of tax bases across existing and new tiers of government is a progressive means of developing the taxonomy of power from revenue sources that are undertaxed in Australia. In summary, these tax sources are untapped by central government as it is nearly impossible to impose and collect them as consolidated revenue. The potential success of their introduction is against visible public goods and services that contribute to the value of the source from which the tax is collected.

Income and property or land taxes are the two senior revenue sources for metropolitan government that would be shared with central or state government in Australia. Neither tax is imposed by either of those tiers in the form they would be imposed by metropolitan government. The Henry (2008) and Asprey (1975) reviews both defined the need for SCG to increase sources of revenue and improve overall tax effort, while reforming inefficient taxes that contributed to social deadweight loss. We examine these two taxes and why they are suited to metropolitan government, and briefly canvass two additional taxes.

While central government collects higher percentages of tax revenues and grant some to lower tiers of government, much of this revenue is far less visible to the taxpayer. That is, consumption taxes that are subsumed into the cost of goods and services are spent on much of the visual goods used by the community, which includes public infrastructure. This does not necessarily mean that revenue is being misallocated, but that it may be better matched against the goods and services it is allocated to. Most of the tax revenue collected by central government is near-invisible to taxpayers, as employers collect and remit income

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taxes and businesses remit revenues collected from goods and services consumption taxes (Mangioni 2016).

Fiscal decentralisation: shared tax bases

Metropolitan land tax

In comparison to the federations of Canada and the USA, Australia collects approximately one-third of revenue from recurrent land tax, known as the property tax. Similarly, in contrast to New Zealand, Australia collects ~65% of the revenue that New Zealand collects from this tax as a percentage of GDP, and collects less than half the revenue of that tax in the UK. While debate has recently centred on constitutional recognition of local government, the greater imperative should be directed at managing the limitations that the states impose on local government revenue-raising capacity from council rating. At present the states are unable to evolve and reform their own recurrent land tax due to its visibility, while revenue from this source at the local government level varies significantly across capital cities.

The first reform to be addressed should be the uniform abolition of the land tax threshold in each capital city of Australia (Mangioni 2016, pp. 236–237). This revenue would be collected by metropolitan government through a system similar to the local government rating system. The second land tax source for metropolitan government would be a recurrent land tax on the principal place of residence in the capital cities. Mangioni (2016) discusses that fact that council rates in Australia are on average one-third of the same tax in the USA and Canada. This source of revenue cannot be readily captured as a consolidated revenue tax by the states as it cannot be clearly tied to any particular expenditure.

A progressive phase-in of this tax over a five-year period as metropolitan government evolves, would provide an important revenue source on which the states are unable to capitalise. In Table 12.2, this revenue is earmarked for capital expenditure on utilities. The tax could also be spread across capital outlay earmarked for transport infrastructure.

Metropolitan land gain tax

Close to a decade after the Asprey tax review, capital gains tax was formalised as a subset of income tax under the provisions of the *Income Tax and Assessment Tax 1936*. The government of the day, in maintaining the competitiveness of income tax, formalised the income capital gains tax, i.e. income from gains generated from increases in unearned increments of value. But the principal place of residence has largely remained exempt. A land gain tax, specifically derived from revenue forgone by the Commonwealth from capital gains on residential property, is an important fiscal void that would be filled by metropolitan government.

Similar to land tax, this would be a visible tax remitted directly by the taxpayer on their single largest source of wealth and investment. The residence does not generate cash-flow income, the primary return on investment is the capital growth. This source of revenue, if imposed by central government, would not likely be acceptable as a consolidated revenue tax source. It is, however, ripe for impost by metropolitan government which would earmark the revenue for capital expenditure of infrastructure projects, both new and regenerated. The introduction of this tax by central government in 1985 was the first step in taxing capital value. The second phase of implementing this tax at the metropolitan level in Australia needs to be supported by central government and the upper tiers of SCG. The reality is that this is not a revenue source that these higher tiers of government could successfully impose.

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Decentralisation: new tax bases

Value capture taxation

The sourcing of metropolitan revenue through value capture taxation takes several forms, which include tax increment financing and betterment taxation and levies. These are not new concepts but have made a resurgence over the past decade and are used to partially fund several national and international projects. Locally, these projects include the Gold Coast Light Rail and Melbourne City Loop, while internationally value capture has been successful in partially funding the London Cross rail, New York Hudson Yards Rail Project and Hong Kong Rail and Property Development. This form of financing may contribute up to 30% of the project cost. It is usually levied incrementally on the surrounding property that benefits from the project, separately from user charges which are levied to use the infrastructure.

Value capture taxes, unlike land tax, are hypothecated imposts specifically earmarked for defined projects, but the rationales for the impost and allocation of funds are not always clearly understood by taxpayers. In the broader scheme of these projects, the impost would be best aligned with metropolitan government which would deliver such projects in conjunction with the private sector through private–public partnerships in co-funding projects.

Signage tax

Signage and billboard taxes are established revenue sources in the largest cities of the world, including Tokyo, New York and Toronto. They are generally classified as enterprise taxes and the revenue collected from this source is not usually defined as a benefits-received tax, but as consolidated revenue unless specifically defined. This is a potential revenue source for Australian cities, particularly in the central business districts and high-profile transport corridors, where private land, stratum and government land is used and leased for advertising purposes.

Review of equalisation and reform incentives

Equalisation remains an important mechanism in federated and unitary structures of government internationally, particularly following the global financial crisis, where regional Australia was doubly impacted by the coinciding end of the commodities boom. Equalisation may be used to target support through the incentivised fiscal reforms of subcentral and metropolitan government. In contrast to granting excess revenue, expanding allocation through co-funding projects at the metropolitan level would transition to more fiscal independence at the metropolitan level.

In metropolitan locations where central government revenues exceed expenditure, the option exists for central government to support the impost of metropolitan taxes and levies. These imposts may be assessed on the value of land and collected by metropolitan government for infrastructure projects. In addition to revenue collected by metropolitan government, the Commonwealth (through the Grants Commission) would initially directly subsidise metropolitan government for metropolitan revenue raised and spent on earmarked projects. This would commence fiscal decentralisation and build a pathway for metropolitan government to progressively become fiscally independent.

Table 12.3 sets out the potential taxes identified for impost by metropolitan government and the inter-governmental arrangements that could be applied for sharing the exempt portions of the tax forgone by central government. The responsibilities and expense classification are aligned with the potential revenues that are best suited to this

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Table 12.3. Fiscal responsibility and tax assignment of metropolitan government

Metropolitan responsibility	Expense classification	Metropolitan tax	Tax category
Metropolitan transport (roadways, tunnels and light rail)	Capital outlay	Value capture Land taxes Capital gains tax	Consolidated/benefits received revenue
	Recurrent maintenance and expenditure	Automobile tax User charges	Benefits received
Hard (utility) services	Capital outlay	Land tax	Consolidated revenue
	Recurrent expenditure	User utility charges	Benefits received
Environmental and waste management		Billboard tax	Consolidated/benefits received
Equalisation transition incentive scheme			

tier of government. This match is determined by the tax category, particularly in the case of consolidated revenue where the goods and services benefit the community and the value of property from which the revenue is derived. In the case of metropolitan transport, for example, the initial capital outlay is derived from revenues generated from increases in the value of land that has resulted or will result from the capital works. This fits within the consolidated revenue category, as revenue is initially collected in the lead-up to the commencement of the works.

As a way of incentivising metropolitan government in developing fiscal capacity, the revenue that is traditionally passed down through block grants would be targeted as co-incentive payments made for the delivery of metropolitan goods and services. This co-funding is defined as an equalisation transition incentive scheme, as shown in Table 12.3, and is a more efficient and targeted strategy than are block grants. In Australia, central government tax revenues forgone in the form of capital gains are a potentially important source of revenue for local and metropolitan government in paying for goods and services within defined locations.

Conclusion

This chapter supports the idea that the ongoing urbanisation of Australia's cities necessitates the reform of fiscal policy, to recognise and fund metropolitan governments in bringing services closer to the communities they serve. This reform includes sharing existing tax bases that have traditionally been the domain of central government, and supports the introduction of new tax sources. An international review of revenues collected by local and metropolitan government shows that several new taxes should be supported by government at the metropolitan level in Australia. The approach of fiscal decentralisation would be more acceptable to taxpayers where taxes are imposed at the local or metropolitan level of government.

In supporting a metropolitan government structure, a clearer distinction is needed in defining the roles and functions of SCG. International examples show that metropolitan government roles must be clearly defined across local and state government, particularly in federated structures. In federated structures, lower tiers of government are not as well-resourced as those in unitary structures. In unitary structures there is clearer distinction

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of fiscal responsibility; in Denmark, fiscal capacity was devolved to local government. Its capital cities have evolved to become metropolitan in raising revenue and the assignment of responsibility. Similarly, the City of Toronto has begun sharing taxes with the provinces and central government.

The review of Australia's taxes shows options for local or metropolitan government to share existing tax bases. It further shows that these imposts would be more acceptable to taxpayers when hypothecated against local goods and services, which in turn contribute to the value of the land the imposts are raised against. In achieving progressive fiscal decentralisation, the ability to bring metropolitan goods and services, particularly infrastructure, closer to the community, will result in the ability of SCG to contribute to increasing overall tax revenue.

To engender fiscal autonomous reform, central government, in contrast to granting consolidated revenue to lower tiers of government, should reorient its role in partnering with metropolitan government. As the objective of fiscal decentralisation is progressively achieved, greater autonomy responsibility and accountability will transfer to local and metropolitan government. In federated countries where significant tax revenue is expended in the tax base of central and upper SCG, metropolitan government is well-positioned in imposing and collecting revenues from the sources discussed in this chapter. In modernising the tax system in Australia, fiscal recognition through decentralisation of taxes to local and metropolitan government is a priority in addressing the needs of Australians.

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