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Neil Warren

Tax Devolution and Intergovernmental Transfer Policy Options in a Budgetary Crisis: UK Lessons from Australia

Neil Warren*

Abstract

The new UK Conservative-Liberal Democrat Coalition Government has committed itself to ‘radical devolution’ in a period of unprecedented and protracted budgetary crisis. Commitments include implementing the recommendations of the Scottish Calman Commission, supporting a referendum on further devolution in Wales, promoting further devolution to local government and community groups, and reviewing local government financing. The focus of this paper is on what lessons the UK can learn from Australia’s approach to tax assignment and general grant distribution as it strives for greater devolution in an environment characterised by substantial public sector deficits and debt. On tax assignment, Australian experience is that base sharing of broad based taxes is clearly preferable to revenue sharing arrangements because the latter has proven to be not durable. On grant distribution arrangements (on which UK devolved administrations are almost totally dependent), the UK can benefit considerably from Australia’s experience in allocating general and specific grants to devolved governments. However, the paper recommends that despite support in recent UK reviews for the Australian approach, it should not be implemented without also introducing its accompanying institutional framework. Required is a consultative framework (similar in concept to the Australian COAG) and an independent authority to advise on an alternative grant distribution framework to the Barnett Formula (similar to the Australian Commonwealth Grants Commission). Given Australia’s experience, with these two institutions in place an environment exists in which the nations in the UK union will be able to work cooperatively and responsibly to address the twin objectives of further devolution and the resolution of the current budgetary crisis.

1. DEVOLUTION FUNDING CHALLENGE

In the *Conservative-Liberal Democrat Coalition Agreement* reached on 11 May 2010¹, it was stated that:

We will promote the radical devolution of power and greater financial autonomy to local government and community groups. This will include a review of local government finance. (p11)

We will establish a commission to consider the ‘West Lothian question’. (p27)

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¹ Source of quotations is the *The Coalition: our programme for Government* (HM Government; Cabinet Office, May 2010) at <http://www.cabinetoffice.gov.uk/media/409088/pfg_coalition.pdf>. This document is based on the actual signed agreement - the *Conservative Party-Liberal Democrat Agreement* – which is available at <<http://www.conservatives.com/~media/Files/Downloadable%20Files/agreement.ashx?dl=true>>

We will implement the proposals of the Calman Commission and introduce a referendum on further Welsh devolution. (p28)

We recognise the concerns expressed by the Holtham Commission on the system of devolution funding. However, at this time, the priority must be to reduce the deficit and therefore any change to the system must await the stabilisation of the public finances. (p28)

A central theme in this *Agreement* is maintaining the strength of the union during a period of financial crisis. A key element of their strategy is that 'The constituent parts of the union must have arrangements appropriate to their needs'². Also important is ensuring elected representatives from the nations in the UK are accountable to their constituents for the decisions they make. Put differently, that which elected representatives vote for is that for which they are responsible. This latter issue lies at the heart of the West Lothian Question³ which is focussed on 'ensuring that legislation on devolved issues that only affect England, or England and Wales, can only be passed with the consent of MPs from England, and where applicable Wales'⁴.

For the new UK Government, the challenge is how to match the rhetoric on devolution in the *Agreement* with the substance of governing in an environment characterised by a sizeable national budget shortfall and large public sector debts. When times are bountiful, all can benefit and any perceived unfairness in the distribution of gains is relative. However, when times are tight, many will lose both absolutely and relatively so any deficiencies in established arrangements become heightened and potentially divisive. For the UK Government, its current extremely difficult fiscal situation poses a number of critical threats to the very future of devolution in the UK, let alone to any further moves to greater devolution.

Not surprisingly, the issue of a greater financial contribution from the nations in the UK was not a topic of great focus by any party during the 2010 UK Election. Nor was the impact of cuts in grants or how the Devolved Administrations of Scotland, Wales and Northern Ireland (DA)⁵, and local government (LG) in England (or any new devolved government in England) could assume greater funding responsibility. Even the important 22 June 2010 emergency *UK Budget* did not begin to directly address this issue. However, what it did do was move to constrain funding available to finance current expenditure by DAs and LG (with further real cuts imminent). With a diminishing DA funding pool, the risks to the stability of the union are real. Not surprisingly, in the recently released *Final Report* of the Holtham Commission (2010), division in the union was evident with the Commission's observation that the funding

² See

<http://www.conservatives.com/news/news_stories/2008/07/we_must_act_on_west_lothian_question.aspx?conservativestvtabview=conservatives.tv&ConservativesTvTabView=Conservatives.TV>

³ The West Lothian question centres on the commonly perceived paradox that Scotland, Wales and Northern Ireland have their own governments while England is represented only in the UK Parliament. As a result, the UK Parliament can decide on all issues relating to England, but only on some issues relating to Scotland, Wales and Northern Ireland. Should England then have its own government or should politicians from the regions where DAs exist, be excluded from voting on issues which only relate to England?

⁴ See <http://www.conservatives.com/policy/where_we_stand/cleaning_up_politics.aspx>

⁵ For a brief overview of Devolved Government in the UK see <<http://www.nidirect.gov.uk/index/government-citizens-and-rights/government-1/devolved-government.htm>>

allocation model under funds Wales (by £400 million) and substantially over-funds Scotland (around £4 billion)⁶.

The purpose of this paper is to draw on the Australian experience with funding its devolved (State) governments and what lessons the UK can learn from this experience as it moves towards greater devolution during a period of financial crisis. As background to this discussion, Section 2 provides an overview of the budgetary challenge currently confronting the UK and some of the funding options which might impact on and cause problems for DAs (and England) and the union.

Two options available to the UK Government to shift some of the financial burden of central government to regional governments are then examined. Section 3 reviews the tax-based funding options that could be made available to DAs and the lessons for the UK from the experience in the Australian Federation. Section 4 examines possible changes to the grant design and distribution arrangements focussed on forcing DAs to fund more of their own expenditure commitments. Particular attention is given to grant distribution arrangements and what lessons can be learnt by the UK from Australia's long experience with ensuring the grant distribution framework is a cohesive force in the federation, not a source of division.

Section 5 concludes by noting that based on Australian experience, further devolution in the UK involving the DAs assuming greater expenditure responsibility must be accompanied by them having access to:

1. tax base sharing arrangements based on broad based own-taxes, and
2. grants distribution arrangements which are equitable, transparent and contemporaneous but still flexible enough not to prevent efficiency-improving DA policy reforms.

Unless these two key requirements are met, devolution of greater expenditure and funding responsibility in the UK will fail and be potentially divisive for the union. These conclusions have important implications for the findings of the Scottish Calman Commission (2009), the Welsh Holtham Commission (2010) and the House of Lords Select Committee on the Barnett Formula (July 2009).

⁶ In 2008-09, if the *Total identifiable expenditure* per capita in the UK was 100, in England it was 97, Wales 112, Scotland 115, and Northern Ireland 123 or 100:115:119:127 for England, Wales, Scotland and Northern Ireland <http://www.hmtreasury.gov.uk/d/pesa2010_chapter9_tables.xls>. Ian McLean has estimated that using the Holtham revision to the Barnett Formula, the ratios are 100:115:105:121 respectively <[http://www.nuffield.ox.ac.uk/politics/papers/2010/Calman_and_Holtham_\(2\).pdf](http://www.nuffield.ox.ac.uk/politics/papers/2010/Calman_and_Holtham_(2).pdf)> See also the discussion on this issue in 'Funding the United Kingdom's Devolved Administrations', 2010, Research and Library Service, Briefing Paper 82/10, 30 June 2010 NIAR 206-09 <<http://www.niassembly.gov.uk/researchandlibrary/2010/8210.pdf>>

2. HOW BIG IS THE UK BUDGET CRISIS?

The contagion accompanying the 2007-08 US subprime crisis has few parallels in history – except potentially the financial markets collapse preceding the Great Depression. For the UK, the importance of the City of London as a global financial centre fundamentally linked into the US financial markets and the commoditisation of US debt meant the UK's fortunes were closely linked to those of the US economy. While the subprime crisis had its beginnings in 2007 and had already impacted with the collapse of Northern Rock, what Table 1 illustrates is that in the 12 March 2008 UK Budget, there was still no recognition that this held potentially dire implications for the UK economy. It was not until the collapse of Lehman Brothers in September 2008 that the full extent of the implications of the contagion associated with the US subprime crisis – now universally referred to as the Global Financial Crisis (GFC) – was fully acknowledged. The impact on the UK was swift and profound as is clear from Table 2. Economic growth forecasts for 2009 fell from 2.5% in March 2008 to -3.5% in April 2009 to -4.75% in December 2009, with a final outcome of -4.9%. The collapse in GDP forecast over the 2008 and 2009 Budget period was therefore some 7%.

TABLE 1: SUMMARY OF UK BUDGETS OUTCOME FORECASTS

| Forecast | Date of release | Mar-08 | Mar-08 | Apr-09 | Mar-08 | Apr-09 | Dec-09 |
|-------------------------------------|-----------------|--------------------|---------------------|--------------------|------------------------|---------------------|--------------------|
| | | 2006-07 Outturn | 2007-08 Estimate | 2007-08 Outturn | 2008-09 Projections | 2008-09 Estimate | 2008-09 Outturn |
| Public sector net borrowing (PSNB) | | 2.3 | 2.6 | 2.4 | 2.9 | 6.3 | 6.6 |
| Surplus on current budget | | -0.3 | -0.6 | -0.4 | -0.7 | -3.6 | -3.5 |
| Public sector net debt (PSND) | | 36.6 | 37.1 | 36.5 | 38.5 | 43.0 | 44.0 |
| Budget - June 2010 | | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
| | | Estimate | Projections | | | | 2015-16 |
| Public sector net borrowing (PSNB) | | 11.0 | 10.1 | 7.5 | 5.5 | 3.5 | 2.1 |
| Surplus on current budget | | -7.5 | -7.5 | -5.7 | -4.0 | -2.3 | 0 |
| Public sector net debt (PSND) | | 53.5 | 61.9 | 67.2 | 69.8 | 70.3 | 67.4 |
| Budget - March 2010 | | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
| | | Estimate | Projections | | | | |
| Public sector net borrowing (PSNB) | | 11.8 | 11.1 | 8.5 | 6.8 | 5.2 | 4.0 |
| Surplus on current budget | | -8.3 | -8.4 | -6.6 | -5.2 | -3.9 | -2.8 |
| Public sector net debt (PSND) | | 54.1 | 63.6 | 69.5 | 73.0 | 74.5 | 74.9 |
| Pre-Budget Report - Dec 2009 | | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
| | | Estimate | Projections | | | | |
| Public sector net borrowing (PSNB) | | 12.6 | 12.0 | 9.1 | 7.1 | 5.5 | 4.4 |
| Surplus on current budget | | -9.1 | -9.3 | -7.2 | -5.6 | -4.3 | -3.2 |
| Public sector net debt (PSND) | | 55.6 | 65.4 | 71.7 | 75.4 | 77.1 | 77.7 |
| Budget - March 2008 | | 2009-10 | 2010-11 | 2011-12 | 2012-13 | | |
| | | Projections | | | | | |
| Public sector net borrowing (PSNB) | | 2.5 | 2.0 | 1.6 | 1.3 | | |
| Surplus on current budget | | -0.2 | 0.3 | 0.6 | 1.0 | | |
| Public sector net debt (PSND) | | 39.4 | 39.8 | 39.7 | 39.3 | | |

Source: UK Budget 2008, Table 2.2 (March 2008), UK Budget 2009, Table 2.1 (April 2009), UK Pre-Budget report 2009, Table 2.2 (Dec 2009), Table 1.1 (March 2010), Table C1 (June 2010) <<http://www.hm-treasury.gov.uk/budget2010.htm>>

With a collapsing economy and rising unemployment, the impact on the UK Government budget was rapid and dramatic. From a deficit equal to 0.4% of GDP in 2007-08, it was estimated in the June 2010 Budget to rise to 7.5% of GDP and not decline from this level until 2011-12 (Table 1). In 2009-10, this budget deficit is equivalent to twice the revenue from the VAT or almost as much as current personal income taxes. Put more simply, by the end of 2009-10, the UK was estimated to raise 25% less revenue than it needs to fund its spending. A direct result of these ongoing high budget deficits is a doubling in public sector net debt (PSND) from 36.5% of GDP in 2007-08 to an estimated 53.5% in 2009-10. Prior to the June 2010 Budget, PSND was forecast to be 74.5% of GDP by 2013-14. Even after the changes introduced in the June 2010 Budget, it was still forecast to be 70.3% (Table 1).

In responding to this budgetary crisis and the deteriorating economic position, the UK Government has been canvassing all possibilities. What Table 1 shows is that the actions taken by the new coalition Government in the emergency 2010 UK Budget (June 22) might have reduced government expenditure and increased taxes (such as raising the VAT rate from 17.5% to 20%), but that the Budget will not be balanced until 2015-16 and by then, PSND will be 67.4%, up from 35.5% in 2007-08.

TABLE 2: SUMMARY OF UK FISCAL PROJECTIONS: PSNB, BUDGET SURPLUS AND PUBLIC SECTOR NET DEBT (% OF GDP)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|----------------------------|------|----------|----------|---------|---------|----------|
| Budget 2010 (June 2010) | | | | | | |
| GDP growth (per cent) | | | -4.9 | 1.2 | 2.3 | 2.8 |
| CPI inflation | | | 2.1 | 2.7 | 2.4 | 1.9 |
| Budget 2010 (March 2010) | | | | | | |
| GDP growth (per cent) | | ½ | -5 | 1 to 1½ | 3 to 3½ | 3¼ to 3¾ |
| CPI inflation | | 4 | 2 | 2 | 1½ | 2 |
| Pre-Budget 2009 (Dec 2009) | | | | | | |
| GDP growth (per cent) | | ½ | -4¾ | 1¼ | 3½ | 3½ |
| CPI inflation | | 4 | 2 | 1¾ | 1½ | 2 |
| RPI inflation | | 2¾ | ½ | 2½ | 3½ | 3½ |
| Budget 2009 (April 2009) | | | | | | |
| GDP growth (per cent) | 3 | ¾ | -3½ | 1¼ | 3½ | |
| CPI inflation | 2 | 4 | 1 | 1 | 2¼ | |
| RPI inflation | 4¼ | 2¾ | -1¼ | 2½ | 4 | |
| Budget 2008 (Mar 2008) | | | | | | |
| GDP growth (per cent) | 3 | 1¾ to 2¼ | 2¼ to 2¾ | 2½ to 3 | | |
| CPI inflation | 1 | 2½ | 2 | 2 | | |

Source: UK Budget 2008, Table 2.2 (March 2008), UK Budget 2009, Table 2.1 (April 2009), UK Pre-Budget report 2009, Table 2.2 (Dec 2009), UK Budget 2010, p5
<<http://www.hm-treasury.gov.uk/budget2010.htm>>

Reducing PSND will require sustained budget surpluses. While a strong and sustained economic recovery could play a large part in bringing about such surpluses, Table 2 indicates that only modest growth is forecast over the coming years. Any near-term turnaround in PSND must therefore come from a combination of reduced government expenditure and increased taxes. The UK Government has itself acknowledged that further action will be needed to reduce PSND. With a devolved system of government and significant transfers from the central to the sub-central and local governments, attention must inevitably shift in the UK to the scope for transferring a larger share of the responsibility for reducing PSND to DA and local governments.

3. TAX ASSIGNMENT

Seven basic options are available to the UK Government in their dealings with Devolved Administrations (and England) if they are intent on exacting from them a greater contribution to reducing PSND:

1. change expenditure assignment;
2. change tax assignment;
3. encourage (or force) own-tax increases;
4. reduce general grants;
5. transition from general to specific grants;
6. change the method of distributing general grants; and
7. change the method of managing specific grants.

Since Federation in 1901 Australian States have experienced all seven options as a result of their changing and evolving relationship with the Australian Government. In fact, in the past two years alone, all options have found application and debate. On 1 January 2009, the Australian Government and States agreed on a new approach to allocating specific grants which involved introducing fewer specific grants (from over 90 to just 5 payments) accompanied by a greater focus on performance monitoring and the availability of reward payments for the achievement of agreed objectives (option 7). On 28 February 2010, the Commonwealth Grants Commission (CGC) introduced, following a five year review, a new system used when advising the Australian Government on how to allocate general grants (option 6). At the 19 April 2010 meeting of the Council of Australian Governments (COAG), the Commonwealth moved to assume effective control of health funding from the States (option 1) accompanied by substantial cuts in intergovernmental transfers (options 4 and 5). And on 2 May 2010 the Henry Review (*Australia's Future Tax System, 2010*) proposed a number of major changes to State and local taxation (affecting options 2 and 3 above)⁷.

While changes to expenditure assignment between tiers of government in the UK is an option available to the UK Government as it addresses its budget crisis, such changes will not be the focus of this paper. However, Table 3 highlights the already important role devolved governments have in the UK. Factoring in the critical role of DAs in funding Local Government (LG), then DAs have a greater role in the UK than States and local government in the Australian Federation. However, this paper will not consider expenditure reassignment but focus only on what lessons the UK can learn from Australia's approach to tax assignment and intergovernmental transfers as it attempts to address its budget crisis.

⁷ These recommendations are outlined in Warren(2010a).

TABLE 3: SUMMARY OF EXPENDITURE ASSIGNMENT IN THE UK AND AUSTRALIA: 2008-09

| | Population Share | Local Government excluding Social Protection (a) | Devolved Administration | UK Government including All Social Protection (a) | Total Expenditure |
|--------------------------|------------------|--|-------------------------|---|-------------------|
| 2007-08 | | | | | |
| Scotland | 8.4% | 20.1% | 40.7% | 39.2% | 100.0% |
| Wales | 4.9% | 20.4% | 35.0% | 44.7% | 100.0% |
| Ireland | 2.9% | 3.6% | 89.8% | 6.6% | 100.0% |
| England | 83.9% | 22.1% | 0.0% | 77.9% | 100.0% |
| <i>Total Expenditure</i> | <i>100.0%</i> | <i>21.2%</i> | <i>9.2%</i> | <i>69.7%</i> | <i>100.0%</i> |
| 2008-09 | | Local | States and Territories | Commonwealth | Total Expenditure |
| Australia | | 5.9% | 39.3% | 54.8% | 100.0% |

(a) Local Expenditure on "Social Protection" is added back to "UK Government" as it largely determined by the UK Government
Source:
UK National Statistical Office, Public Expenditure Statistical Analyses (PESA) 2009, Table
Australian Bureau of Statistics, Cat No 5512, Government Financial Statistics 2009-10

TABLE 4: SUMMARY OF SUB-CENTRAL TAX ASSIGNMENT IN THE UK AND AUSTRALIA

| Australian States and Territories | United Kingdom |
|--|---|
| Current State Own-Source Revenue Employers payroll taxes Land Taxes Developer and other property levies Stamp duties on property conveyances Gambling taxes Insurance taxes Motor vehicle taxes | Collected by Local Government (and retained) Council Tax Collected from Local Government (Pooled by Devolved Administration and redistributed) Non Domestic Rate Income (NDRI) (or National Non-Domestic Rate (NNDR)) Collected and distributed by Central Government to Devolved Administrations Scotland: <i>Current (February 2010)</i> <i>After UK Government response to Calman Commission</i> 3p to personal income tax basic rate (but while available, it was not enacted) 10p of Income tax basic and higher rates assigned to Scotland with scope for Scotland to increase or decrease this rate - Stamp Duty Land Tax - Aggregates Levy - Landfill Tax - Air Passenger Duty |
| Australia: Local Government | |
| Municipal Rates | |

How the UK and Australia go about funding their devolved governments is very different. Table 4 details tax assignment in the UK and Australia. In 2008-09, this saw the central government in Australia raise 82% of tax revenue, States 14.8% and local government 3.2%. In the UK, the comparable figures for 2007 were 94.8%, 0% and 4.7% respectively, with supra-national government levies (for EU) being 0.5%⁸. UK DAs therefore have an almost total dependence on the central government for their funding. The option available to Scotland (Table 4) of imposing an additional 3p on the basic rate has not been exploited despite being available since the sitting of the first Scottish Parliament on 1 July 1999.

While Australian States have borrowing and bond issuing powers, this borrowing is regulated through the Loan Council which was formed early in the Federation to prevent States competing for scarce funds in the then limited capital market. Today, the Loans Council exists in name only and is a formality in annual Commonwealth-State negotiations over funding arrangements. In contrast, DAs in the UK have no substantive borrowing or bond issuing capacity – which is not unreasonable as they have no revenue capacity with which to fund any repayments. Where borrowing is permitted but tightly regulated is to fund expenditure made ahead of its funding. The UK DAs therefore have what Bird and Smart (2002, 2010) term ‘hard budget constraints’ while Australian States have ‘soft budget constraints’. The combination of a soft budget constraint and high levels of intergovernmental transfers poses a real challenge to the efficient and equitable operation of the Australian federation.

As Freebairn (2010, p59) has argued, with high vertical fiscal gap (VFG⁹) and no hard budget constraints, there will be:

1. Lack of accountability for funding own expenditure from own sources because of a dependence on intergovernmental transfers;
2. Shifting of responsibility for policy failure to other governments (on same or different tier) based on claims of overall under funding;
3. Additional administrative costs arising from States managing a process of blame shifting in relation to policy failure; and
4. Externalities arising from States shifting the cost of their deficit inducing policies to non-residents, and the costs arising from funding based on average rather than State specific marginal costs.

Evidence exists in the Australian federation of all four occurrences amongst States. The generally accepted solution (Bird and Smart 2010 and Freebairn 2010) is for Australian States to have access to revenue from taxes levied on broad tax bases and for transfers to be inframarginal with the latter focussed on addressing fiscal equalisation issues. In this way, not only would States be responsible for the funding of the majority of expenditure, any increased funding would be a State responsibility. The additional benefit would be that States would have a greater benefit to build their

⁸ See Tables B (p19) and E (p28) of *OECD Revenue Statistics 1965-2008* (2009).

⁹ The gap (or revenue deficiency) between a State’s own-revenue means and their expenditure needs is the vertical fiscal gap (or VFG). The differing capacities of individual States to raise revenue from own-sources (such as lower average wages of employees) or disabilities which impact on their ability to make expenditure (such as higher wage costs) is referred to as horizontal fiscal gap (HFG). The challenge for any federation is how then to address VFG through a framework which acknowledges HFG. This is the objective of the horizontal fiscal equalisation (HFE) principle found applied when allocating central government transfers between sub-central governments.

own economies because they have direct access to revenue from taxes levied on broad bases. What is critical though, is that States have some discretion over the taxation of their own base.

In the UK, the lack of any substantive tax assignment to DAs must be changed if there is to be any genuine move to further devolve government. The recent recommendation by the Calman Commission (2009, p111) to assign greater revenue raising powers to the Scottish Government through assigning 10p of the basic and upper personal income tax rates (with scope for additional imposts), is a positive move in this direction. So too is the Holtham Commission (2010, p72) recommendation for the revenue from 10p, 20p and 25p of the basic and higher rate bands (Table 5) to be assigned to the Welsh Government. However, there are important lessons to be learnt from the Australian experience with tax assignment to States, including the assigning and reassigning of numerous taxes during the period since Federation in 1901.

The current tax assignment to States in the Australian federation, as shown in Table 6, is the product of two forces driven by sections of the Australian Constitution. Firstly, s90¹⁰ of the Constitution prohibits States from imposing duties of customs and excise. The High Court has interpreted this section as excluding States from imposing all forms of sales tax. Secondly, s96¹¹ of the Constitution has been interpreted by the Commonwealth (supported by High Court judgements) as enabling it to allocate grants to States at its discretion. As a result, the Commonwealth has been able to deny States the right to impose taxes within their powers by threatening to reduce their grants equal to any revenue they might raise from such taxes¹².

TABLE 5: SCOTTISH AND WELSH OWN INCOME TAX RATES

| 2010-11 Income Ranges | Description | Current Rates | Calman Commission: Scottish Income Tax Rates | Holtham Commission: Welsh Income Tax Rates* |
|--------------------------|-----------------|------------------|--|---|
| £0-£37,400 | Basic rate | 20% | 10% | 10% |
| £37,401-£150,000 | Higher rate | 40% | 10% | 20% |
| £150,001 and over | Additional rate | 50% | 10% | 25% |

* The rate for each band would be able to be changed by Wales but any variance from rates in England would be limited to 3p.
Source: Calman Commission (2009), Holtham Commission (2010), HMRC
<<http://www.hmrc.gov.uk/rates/it.htm>>

¹⁰ s90 of the Australian Constitution states that: 'On the imposition of uniform duties of customs the power of the Parliament to impose duties of customs and of excise, and to grant bounties on the production or export of goods, shall become exclusive.'

¹¹ s96 of the Australian Constitution states that 'During a period of ten years after the establishment of the Commonwealth and thereafter until the Parliament otherwise provides, the Parliament may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit.'

¹² For an outline of the design of each Commonwealth tax, see *Pocket Guide to the Australian Commonwealth Tax System* <<http://www.treasury.gov.au/contentitem.asp?NavId=&ContentID=866>>. A description of the taxes imposed by States is available in the NSW Treasury Publication, *Interstate Comparison of Taxes 2009-10* <http://www.treasury.nsw.gov.au/_data/assets/pdf_file/0005/17780/TRP10-01_dnd.pdf>

TABLE 6: TOTAL TAXATION REVENUE 2008-09

| | Commonwealth | | States | | Local | | Total | |
|--|----------------|---------------|---------------|---------------|---------------|---------------|----------------|---------------|
| | \$m | % | \$m | % | \$m | % | \$m | % |
| Taxes on income | | | | | | | | |
| Income taxes levied on individuals | | | | | | | | |
| Personal income tax | 124,029 | 44.6% | | | | | 124,029 | 36.6% |
| Fringe benefits tax | 3,581 | 1.3% | | | | | 3,581 | 1.1% |
| Total | 127,610 | 45.9% | | | | | 127,610 | 37.7% |
| Income taxes levied on enterprises | | | | | | | | |
| Company income tax | 62,784 | 22.6% | | | | | 62,784 | 18.5% |
| Income tax paid by superannuation funds | 9,201 | 3.3% | | | | | 9,201 | 2.7% |
| Total | 71,986 | 25.9% | | | | | 71,986 | 21.2% |
| Income levied on non-residents | | | | | | | | |
| Dividend withholding tax | 303 | 0.1% | | | | | 303 | 0.1% |
| Interest withholding tax | 1,035 | 0.4% | | | | | 1,035 | 0.3% |
| Other income taxes levied on non-residents | 436 | 0.2% | | | | | 436 | 0.1% |
| Total | 1,774 | 0.6% | | | | | 1,774 | 0.5% |
| Total | 201,369 | 72.4% | | | | | 201,369 | 59.4% |
| Taxes on employers payroll and labour force | | | | | | | | |
| Employers payroll taxes | | | 16,402 | 32.7% | | | 16,402 | 4.8% |
| Other employers labour force taxes | | | | | | | | |
| Superannuation guarantee charge | 377 | 0.1% | | | | | 377 | 0.1% |
| Total | 377 | 0.1% | 16,402 | 32.7% | | | 16,779 | 5.0% |
| Taxes on property | | | | | | | | |
| Taxes on immovable property | | | | | | | | |
| Land taxes | | | 5,565 | 11.1% | | | 5,565 | 1.6% |
| Municipal rates | | | 179 | 0.4% | 10,758 | 100.0% | 10,946 | 3.2% |
| Other | | | 1,017 | 2.0% | | | 1,017 | 0.3% |
| Total | | | 6,761 | 13.5% | 10,758 | 100.0% | 17,519 | 5.2% |
| Taxes on financial and capital transactions | | | | | | | | |
| Financial institutions transactions taxes | | | | | | | | |
| Government borrowing guarantee levies | 16 | 0.0% | 386 | 0.8% | | | 402 | 0.1% |
| Stamp duties on conveyances | | | 9,534 | 19.0% | | | 9,534 | 2.8% |
| Other stamp duties | | | 304 | 0.6% | | | 305 | 0.1% |
| Total | | | 10,225 | 20.4% | | | 10,225 | 3.0% |
| Total | 16 | 0.0% | 16,986 | 33.9% | 10,832 | 100.7% | 27,834 | 8.2% |
| Taxes on the provision of goods and services | | | | | | | | |
| General taxes (sales taxes) | 1,090 | 0.4% | | | | | 1,090 | 0.3% |
| Goods and services tax (GST) | 42,626 | 15.3% | | | | | 42,626 | 12.6% |
| Excises and levies | | | | | | | | |
| Crude oil and LPG | 15,592 | 5.6% | | | | | 15,592 | 4.6% |
| Other excises | 8,727 | 3.1% | | | | | 8,727 | 2.6% |
| Agricultural production taxes | 608 | 0.2% | | | | | 608 | 0.2% |
| Levies on statutory corporations | 210 | 0.1% | 69 | 0.1% | | | 279 | 0.1% |
| Total | 25,137 | 9.0% | 69 | 0.1% | | | 25,206 | 7.4% |
| Taxes on gambling | | | | | | | | |
| Taxes on government lotteries | | | 746 | 1.5% | | | 746 | 0.2% |
| Taxes on private lotteries | | | 438 | 0.9% | | | 438 | 0.1% |
| Taxes on gambling machines | | | 3,034 | 6.1% | | | 3,034 | 0.9% |
| Casino taxes | | | 413 | 0.8% | | | 413 | 0.1% |
| Race betting taxes | | | 381 | 0.8% | | | 381 | 0.1% |
| Taxes on gambling n.e.c. | | | 15 | 0.0% | | | 15 | 0.0% |
| Total | | | 5,028 | 10.0% | | | 5,028 | 1.5% |
| Taxes on insurance | | | | | | | | |
| Insurance companies contributions to fire brigades | | | 1,028 | 2.1% | | | 1,028 | 0.3% |
| Third party insurance taxes | | | 371 | 0.7% | | | 371 | 0.1% |
| Taxes on insurance n.e.c. | | | 3,106 | 6.2% | | | 3,106 | 0.9% |
| Total | | | 4,505 | 9.0% | | | 4,505 | 1.3% |
| Taxes on international trade | 6,289 | 2.3% | | | | | 6,289 | 1.9% |
| Total | 75,141 | 27.0% | 9,602 | 19.2% | | | 84,743 | 25.0% |
| Taxes on the use of goods and performance of activities | | | | | | | | |
| Motor vehicle taxes | | | | | | | | |
| Stamp duty on vehicle registration | | | 2,026 | 4.0% | | | 2,026 | 0.6% |
| Other | | | 4,432 | 8.8% | | | 4,432 | 1.3% |
| Total | | | 6,458 | 12.9% | | | 6,458 | 1.9% |
| Franchise taxes | | | | | | | | |
| Gas taxes | | | 2 | 0.0% | | | 2 | 0.0% |
| Petroleum products taxes | | | | | | | | |
| Tobacco taxes | | | | | | | | |
| Liquor taxes | | | 1 | 0.0% | | | 1 | 0.0% |
| Total | | | 4 | 0.0% | | | 4 | 0.0% |
| Other | 1,098 | 0.4% | 596 | 1.2% | | | 1,694 | 0.5% |
| Total | 1,098 | 0.4% | 7,058 | 14.1% | | | 8,156 | 2.4% |
| Total | 278,002 | 100.0% | 50,118 | 100.0% | 10,758 | 100.0% | 338,878 | 100.0% |
| Taxes received from public corporations | 420 | 0.2% | 1,985 | 4.0% | 121 | 1.1% | 2,526 | 0.7% |
| Taxes received from other levels of government | 4 | 0.0% | 753 | 1.5% | -136 | -1.3% | 621 | 0.2% |

Source: ABS 55060do001_200809.xls

TABLE 7: TAXES CEDED BY AUSTRALIAN GOVERNMENT TO STATES AND STATES TO THE AUSTRALIAN GOVERNMENT

| State 'piggyback' Base Sharing with Australian Government | |
|--|---|
| 1978-1989 | States were permitted to impose a flat % surcharge on Australian Government collections from the personal income tax. This was repealed in 1989 when several States took interest in this tax, primarily with the intention to provide an income tax rebate. |
| State Base Sharing with Australian Government | |
| 1901-1952 | Land tax (Australian Government abandoned in 1952) |
| <1976 | Entertainments tax, a minor tax which was initially shared, then solely applied by the Australian Government, and subsequently solely applied by the States who abandoned it in 1976. |
| <1981 | Death duties, abandoned by all jurisdictions by 1981 |
| 1915 – 1942 | Income tax was initially imposed prior to Federation in 2001. It remained solely a State tax until 1915 and was then jointly levied by both the Australian Government and States between 1915 and 1942. It was then taken over by the Australian Government in 1942. |
| 1997 | Taxes on fuel, liquor and tobacco, which were levied by both the Australian Government (as excise duty) and States (as Franchise Fees) until the State taxes were successfully challenged in the High Court as contravening s90 of the Constitution which prevented States from levying duties of customs and excise. |
| Australian Government Revenue Sharing with States | |
| 1976 – 1985 | Personal Income Tax: <i>New Federalism</i> was introduced in 1976 and saw States received a fixed share of Australian Government personal income taxes during its first 5 years (until 1981-82). However, by the early 1980s, the Australian Government was confronting substantial Budget deficit and since income taxes were a major growth tax, the <i>New Federalism</i> arrangements were changed. After a transitional year (1981-82), they opted (from 1982-83) for the less generous arrangement, giving States a fixed share of Australian Government total taxation. In 1985-86, this revenue sharing arrangement was permanently abandoned as the Australian Government felt even these arrangements were too generous to States. |
| 1997-2000 | Franchise Fees: The State Franchise Fees which were declared unconstitutional in 1997 were replaced with a revenue sharing arrangement where the Australian Government increased its own taxes on fuel, alcohol and tobacco and passed on the proceeds to the States. While States originally imposed different Franchise Fees, the Constitution prevented the Australian Government imposing taxes which discriminated between States. Consequently, the new tax surcharges were uniform across all States and States were then free to use this revenue to finance differential subsidies so as to leave consumers in each State approximately in the same position they were before the Franchise Fees were declared unconstitutional. |
| 2000+ | GST: Since the introduction of the GST in June 2000, its revenue has been allocated to States as a block grant and distributed on fiscal equalisation principles by the Australian Government on the basis of advice from the Commonwealth Grants Commission. |

Source: Langoulant(1999), Warren(2004)

What the current distribution of taxing powers (Tables 4 and 6) does not reveal is a history of taxes at one level of government in Australia being ceded to another, either cooperatively or through coercion. Table 7 outlines the major changes to tax assignment and to base and revenue sharing arrangements since Federation.

Cooperation is what characterised the Commonwealth ceding the Payroll Tax to States in 1971 and the Commonwealth collecting the (unconstitutional) State Franchise Tax between 1997 and 2000.

Cooperation is also what led to the Commonwealth assigning revenue from its taxes to States as the basis for determining general grants. In 1976, income tax sharing arrangements were introduced but following a budget crisis the Commonwealth replaced this arrangement with a less generous sharing of 'total' tax revenue, before abandoning even this arrangement in 1985. In 2000, the Commonwealth assigned 100% of the revenue from the newly introduced GST to States as a general grant, in part response to States agreeing to repeal various taxes. However, from 2011-12, this arrangement will also change, with States set to receive only two thirds of the GST

revenue following their agreement to cede to the Australian Government responsibility for funding 60% of all health expenditure¹³.

Cooperation has also extended to the Commonwealth facilitating the introduction of own-State taxes collected by the Commonwealth on behalf of States. Between 1978 and 1989, the Commonwealth offered States the opportunity to share the base of the personal income tax by providing enabling legislation where States could impose a 'piggyback' State personal income tax (in the form of a surcharge, administered by the Australian Tax Office). With the Australian Government making no room, no State moved to introduce such a tax and in 1989, the Commonwealth repealed the relevant provisions.

In practice, coercion rather than cooperation characterises the relationship between the Commonwealth and the States. This was the case when the Commonwealth assumed exclusive responsibility for imposing income taxes in 1942, threatening States with a loss of grant funding equivalent to any revenue they might raise from their own taxes on this base. Sometimes this coercion arises from budgetary crisis, which saw income tax sharing arrangements between the Commonwealth and States replaced with 'total' tax sharing arrangements in the early 1980s, and at other times, to encourage State tax reform (as with the GST revenue sharing arrangements in 2000).

On 2 May 2010, the Australian Government released the Final Report of a review into *Australia's Future Tax System* (Henry Review) along with its response¹⁴. The Henry Review continues a long tradition of governments, both Federal and State, reviewing State taxes¹⁵. However, major tax reform has been slow to come to the States. The benefit of the Henry Review has been that its recommendations have served to bring together a disparate debate on the future of State taxation and proffer a 10 to 20 year strategy for its reform. Table 8 summarises its proposed State tax reforms which centre on three major changes to State taxation. The first is a State Cash Flow Tax (CFT) whose base is a business's cash flow where wages and salaries are not a deductible outflow but where exports are a deduction. In the case of imports, they would be taxable as they enter the country. In effect, the CFT is just another form of GST – this time administered not on the subtractive-indirect (or invoice) method as with the GST but on the subtractive-direct method. The advantage of the CFT over the GST is that it has no exemptions and therefore has a broad base. However, the CFT would need to be centrally administered if only because States are not permitted under the Constitution¹⁶ to impose taxes on interstate flows and it would not be possible for States to choose their own CFT rate.

The second major State tax reform recommended by the Henry Review was a significant expanding of the land tax base to include the owner-occupied residence

¹³ At the time of writing this paper (November 2010), a formal agreement has not been finalized with States. Moreover, Western Australia has indicated that it will not be party to any such agreement and other States are showing reluctance to act on their initial agreement to cooperate with the Commonwealth.

¹⁴ See <http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/pubs_reports.htm>. The Government's response is available from <<http://www.futuretax.gov.au/pages/default.aspx>>

¹⁵ The most recent example of a State sponsored review is the NSW *Review of State Taxation* in 2007-08 undertaken by Independent Pricing and Regulatory Authority (IPART, 2008).

¹⁶ s92 of the Australian Constitution states that 'On the imposition of uniform duties of customs, trade, commerce, and intercourse among the States, whether by means of internal carriage or ocean navigation, shall be absolutely free.'

(akin to the base of the local government rates). In fact, the proposal does consider the scope for the State land tax to be administered by local government as part of their local government rates. The third major reform was to the taxation of transport related services and in particular, a move toward congestion charges and market based road pricing. At the same time, State Payroll Tax, property conveyancing duties and insurance and other stamp duties would be repealed, while gambling taxes would be reformed to ensure they are more uniform and capture rents.

While there is broad acceptance that the current tax assignment in the Australian federation is less than ideal (Freebairn 2010, Warren 2010a, Henry Review 2010), there is less agreement on the direction of necessary reform. What is agreed however is that States must have access to their own broad-based tax bases and discretion over the rates applied.

When devolution was introduced in the UK in the late 1990s, it was essentially a delegation of expenditure responsibility from the UK Parliament to Scotland, Wales and Northern Ireland – rather than of taxing powers. The basic objective was to enable DAs to use their pool of funding to fund programs which better reflected local preferences. Funding for DAs came primarily through grants and for local government through a combination of grants, (domestic) Council Tax¹⁷, and a National Non Domestic Rate (NNDR)¹⁸. In the case of NNDR, the revenue collected is contributed to a central pool which is then redistributed amongst authorities on the basis of population¹⁹ and equalisation principles. With the Council Tax, each DA can set rate-capping conditions on local councils which gives them effective control over the collections from this tax.

¹⁷ ‘Most dwellings are subject to the Council Tax. There is one bill per dwelling, whether it is a house, bungalow, flat, maisonette, mobile home, or houseboat, and whether it is owned or rented. The value of your home has been assessed by the Listing Officer of the Valuation Office Agency (part of HM Revenue & Customs). Each dwelling has been allocated to one of eight bands based on its estimated open market capital value at 1 April 1991. The band for your dwelling is shown on your bill and you will be in one of eight bands. You should bear in mind that all Council Tax valuations are based on the price a property would have fetched if it had been sold on 1 April 1991. Any increase or fall in a dwelling’s value which results from general changes in the housing market since then will not affect its valuation. Such movements in general prices will not be a reason for changing your Council Tax band.’ Source <http://www.bedford.gov.uk/advice_and_benefits/council_tax/explanatory_notes.aspx>.

‘Local authorities are responsible for setting their budgets for the year and determining how much will be met through council tax. In each area, one local authority (‘the billing authority’) sends out council tax bills which include council tax charges (‘precepts’) set by other authorities in the area. For example, a council tax bill issued by a district council could include precepts for the county council, the parish council, the police authority and, in some cases, the fire authority. However, the Devolved Governments have powers to cap excessive increases.’ Source: <<http://www.communities.gov.uk/localgovernment/localgovernmentfinance/counciltax/counciltaxfacts/>>

¹⁸ ‘The local authority works out the Business Rates (National Non-Domestic Rate or NNDR) bill by multiplying the rateable value of the property by the appropriate multiplier. There are two multipliers; the standard non-domestic rating multiplier and the small business non-domestic rating multiplier. The former is higher to pay for small business rate relief. The various Governments set the multipliers for each financial year for the whole of the country (ie England, Scotland Wales and Northern Ireland). The multipliers change each year in line with inflation and to take account of the cost of small business rate relief. In the year of a revaluation the multipliers are set at a level which will keep the total amount raised in rates after the revaluation the same as before, plus inflation for that year. The current multipliers are shown on the front of the rate bill.’

Source:<http://www.bedford.gov.uk/business/business_rates/nndr_explanatory_notes.aspx>

¹⁹ See <<http://www.scotland.gov.uk/Publications/2008/01/23112333/20>>

In the case of Scotland, there currently exists an option for it to add an additional 3p to the basic rate of personal income tax paid by its residents. The recent Calman Commission (2009) proposal for the introduction of a Scottish Variable Rate (SVR) of income tax administered by HMRC has received UK Government support as a replacement for the current 3p option. With the Scottish Variable Rate of income tax, the default arrangement would be that 10p of the basic and higher rates of personal income tax paid by Scottish residents (Table 5) would be assigned directly to the Scottish Government and offset against its general (or block) grant.

The Scottish Parliament would then be able to set the SVR above or below 10p with their grant from the UK Government being reduced by an amount always equivalent to revenue collected from a rate of 10p. This Scottish base-sharing arrangement has its parallels in Australia as shown in Table 7. Australian States had the option between 1976 and 1989 to impose their own tax on personal taxable income (through a State 'piggyback' arrangement with the Australian Government) but as with the current Scottish 3p, the Australian States never took up the option. The argument (*Henry Review 2010, Volume 2 p682*) has always been that this did not occur because the Australian Government did not make room for the States to impose their own levy. This will not be an issue with the proposed Scottish income tax option since the UK Government would 'make room' by cutting the Scottish general grant by an amount equivalent to the revenue collected from the 10p tax, resulting in no change in the overall income tax rates.

Scotland will also have an incentive to increase its rate of tax with the proposed arrangements. This is because if Scotland imposes a rate greater than 10p, the UK Government will not reduce its grant allocation by the new greater amount of revenue, giving Scotland an incentive to impose a rate greater than 10p. If Scotland opts to reduce the rate below 10p, then it will have to find equivalent expenditure reductions or funding from other sources.

The Holtham Commission (2010) income tax proposal is conceptually similar to that of the Calman Commission (2009) but different in two important respects: that the proportion of the rate in each rate band assigned to Wales is variable while constant in Scotland; and that any variance from the UK rates in Wales would be limited to 3p while being uncapped in Scotland. In both the Scottish and Welsh proposals, it is assumed that the UK Government makes room for the tax.

An obvious issue is just how durable such an arrangement would be since it would be dependent for its success on UK Government cooperation. What is apparent from the above discussion is that while arrangements have existed in the Australian federation for States to share both the revenue and base of Commonwealth taxes (Table 7), such arrangements have not been durable. A key factor driving changed central government attitudes to such arrangements has been budgetary considerations, especially where these arrangements are perceived as too generous to States or where the States' policies run counter to central government objectives²⁰. The response in Australia has been for the central government to either abandon (often without consultation) any cooperative arrangement (as with income tax surcharge and revenue

²⁰ For example, what ultimately led the Commonwealth to repealing the provision enabling States to impose their own income tax surcharge was not a move by States to impose a 'positive' surcharge but a move by them to use this mechanism to introduce income tax rebates for residents. Such a rebate had the potential to run counter to Australian government objectives of equity.

sharing options) or to reduce grants equivalent to any revenue raised from actions not sanctioned (as with the State own-tax on income in 1942).

TABLE 8: HENRY REVIEW RECOMMENDATIONS FOR REFORMING STATE TAXATION

| <i>Tax</i> | <i>Short term</i> | <i>Medium term</i> | <i>Long term</i> |
|---|--|--|--|
| Payroll Tax | Base broadened through reducing/removing threshold. | Rate increased | Repealed |
| State Cash Flow Tax (or Business Activity Tax) | | | Introduction of Cash Flow Tax accompanies repeal of Payroll Tax and most stamp duties (other than conveyancing) |
| Insurance Duty | Repeal Fire Service Levy component | Repeal other insurance duties | |
| Other Stamp Duties | Progressive repeal (funded through changes to payroll taxation) | | All repealed |
| Land Tax | Base broadened through reducing threshold; | Base broadened through removing exemptions; increase rate and reduce conveyancing duty | Rate increased and conveyancing duty repealed Local government administer land tax with Local Rates and Fire Service Levy |
| Property Conveyancing Duty | | Reduce duty | Repealed |
| Gambling taxes | Set rates to recoup rents. Abolish concessions, an industry support through direct expenditures | | |
| Road transport taxes (Progressive implementation) | Introduce congestion taxes and market based road pricing. Motor vehicle ownership and use set related to road provision. Government administration funded through user charges. | | |

Source: Henry Review (2010), Volumes 1 and 2, Warren (2010a)

While ever a DA does not impose its own-tax legislation and have its own tax administration, the risk will always be there that the UK Government may not be cooperative and could act to be unresponsive or positively antagonistic towards any proposed DA tax changes. This would be expected if such changes were seen as counter to central government objectives or predatory in relation to other DAs. The Holtham Commission recognised this issue in relation to a Welsh income tax when recommending that any variation from the UK Government rate should be limited to 3p.

Where arrangements have been more durable in Australia is where the Commonwealth has completely vacated an area of taxation to States. This was the case with the reassignment of the Australian Government Payroll Tax to States in 1971. The UK Government acceptance of the Calman Commission proposal to reassign four UK taxes imposed in Scotland (Stamp Duty Land Tax, Aggregates Levy, Landfill Tax and Air Passenger Duty) to the Scottish Government therefore has its parallels in Australia and is likely to be a durable arrangement. However, based on Australian experience, such reassignment will not result in a substantial increase in own-source funding for States, largely because such reassigned taxes do not have the potential to contribute significantly to State funding. Also, there is a real risk that the design of these taxes will be compromised as a result of tax competition.

In summary, there are three basic options available to sub-national governments intent on increasing their access to taxes and tax bases administered by a central government:

1. Share tax revenue;
2. Share tax bases;
 - a. with harmonised base, own rate but central (or shared) administration of the State tax (eg ‘Piggyback’ Scottish Variable Rate personal income tax)
 - b. with harmonised base, and own tax and administration of the State tax (eg reforms to local property tax base managed at national level but tax imposed at local level)
 - c. with own tax base, rate and administration of the State tax (eg land tax at State and local level)
3. Reassign taxes
 - a. central taxes assigned to sub-central governments (eg Payroll Tax in Australia assigned to States in 1971)
 - b. sub-central taxes assigned to central government (eg the introduction of the Council Tax in 1991 effectively assigned the determination of the local property tax base to the UK central government and rate setting to DAs in consultation with the UK government)

What the Australian experience has shown is that revenue sharing (1 above) without a legally binding agreement between the levels of government sharing the tax is prone to failure. With no formal binding agreement, the government collecting the revenue can arbitrarily rescind the arrangement, impose reforms to this tax which directly impact the level of revenue being shared, or more fundamentally, arbitrarily change the proportion of the revenue being shared.

Reassigning minor tax bases to sub-central governments (3 above) is also not a long term solution and potentially the source of economic inefficiencies (as the Henry Review (2010) concluded in relation to the current Australian State Payroll Tax). However, such minor taxes (and own-income taxes) might have a role in ensuring accountability by DAs who confront ‘hard budget constraints’ (as in Scotland and Wales) such that a direct link can be drawn between increased expenditure and increased funding. In Australia, soft budget constraints and substantial VFG has done little to encourage accountability by States. For DAs, access to own-taxes on broad bases is essential. While the Calman and Holtham Commissions proposed these taxes being linked directly to the UK income tax, there is a strong case for the DAs imposing their own legislation related to such a tax.

None of the discussion in this section has considered the important issue of how any new taxes in DAs will impact on their grant allocation in the longer term. While both the Calman and Holtham Commissions supported a full offset against grants to DAs for the basic rate structure in Table 5 and some tax reassignment, the important question is how might the UK government then respond in an attempt to shift some of the burden of addressing its current budgetary crisis to DAs through changes to grants. To this end, we need to review how current intergovernmental transfer arrangements might change following any tax reassignment and how this might impact on both the quantum and distribution of grants amongst DAs and England.

4. INTERGOVERNMENTAL TRANSFER ARRANGEMENTS

In theory, there is no reason why the financial obligations accompanying any expenditure assignment should ultimately equate to the revenue arising from any tax assignment. For reasons of equity, efficiency and simplicity, some level of intergovernmental fiscal transfers is justified. Principal amongst these reasons are:

1. the achievement of national priorities (and so the need to override local preferences);
2. positive externalities (or spillovers) associated with State expenditure (and the resulting risk of under-expenditure by States);
3. negative externalities associated with State expenditure (such as congestion);
4. States have varying access to tax bases;
5. States confront differing disabilities (eg cost structures) in the delivery of services; and
6. economies of scale in delivery of services and the administration of taxes.

Even if these issues were not important, a *fiscal gap* may arise for a sub-central government because either the central government has greater revenue raising capacity (vertical fiscal gap or VFG) or because comparable sub-central governments have a greater capacity to raise own-source revenue than similar governments (horizontal fiscal gap or HFG). In practice, these issues are resolved primarily through intergovernmental fiscal transfers between levels of government and through transfers being distributed to reflect tax capacity and expenditure disabilities.

Four elements typically characterised most intergovernmental transfer arrangements:

1. A grants management process which focuses on the form of the consultative and performance assessment framework;
2. Grant design issues including the mix of general and specific grants;
3. Grant value determination which could be based on some fixed formula (eg tax share) or variable arrangement (such as based on needs and priorities); and
4. General grant distribution arrangements which are based typically on fiscal equalisation principles.

Any push for further devolution in the UK inevitably raises the issue of the appropriateness of current intergovernmental transfer arrangements and how they, or any changes to them, might interact with changed tax and expenditure assignment. The Calman and Holtham Commissions recognised this issue but did not fully acknowledge its implications, in fact confusing two important issues in making their recommendations. On the one hand, they recommended a move away from current grant allocation arrangements towards applying fiscal equalisation principles; while on the other, recommending DAs have imputed to them a grant equivalent to the revenue collected from the income tax rates in Table 5 – even where these rates are different in practice. However, these tax assignment proposals are not compatible with rigorously applying fiscal equalisation principles when allocating grants amongst DAs.

The risk for the Calman and Holtham Commission proposals on intergovernmental transfer allocation is that they lack a systematic approach to the problem and that this may ultimately work against the scope for introducing their otherwise worthy reforms. For example, Warren (2010a) models the interaction between grant entitlements and

tax design in Australia and shows just how significant but little understood is the potential disincentive this interaction might be to any State either reforming current taxes or introducing new ones – an issue not even addressed in the recent Henry Review (2010) recommendations on State tax reform.

If the UK government moves to have DAs bear a greater share of the burden of addressing public sector net debt through reduced and redistributed grants (with or without tax and expenditure reassignment), it cannot achieve this simply with a focus on introducing fiscal equalisation principles (4 above). Rather, based on Australian experience, elements (1) through (4) must be addressed sequentially to ensure the approach taken avoids division and derision.

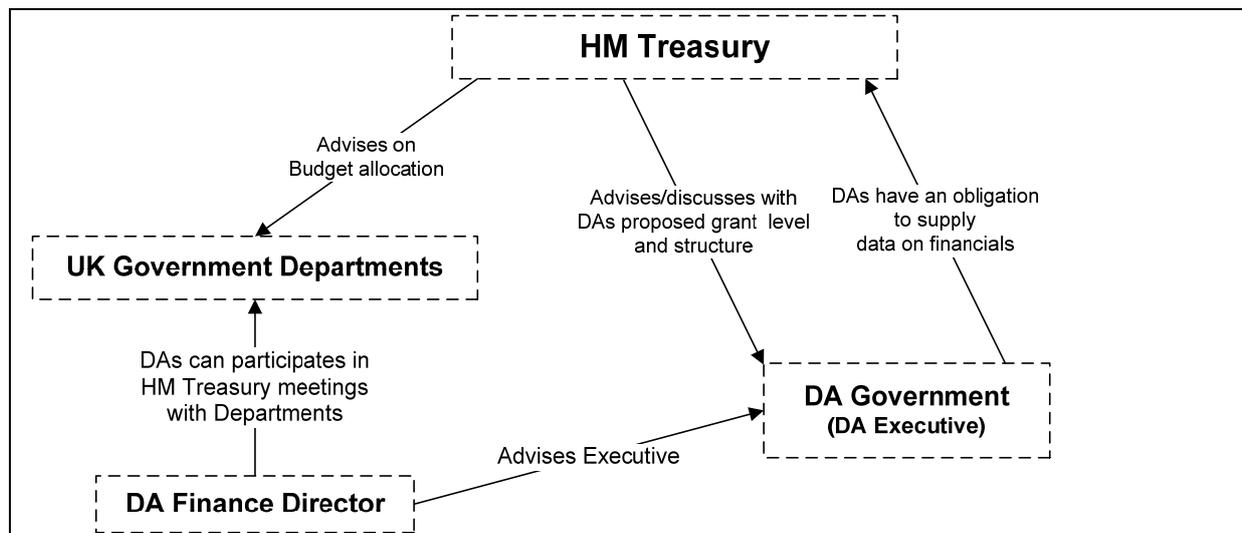
In the remainder of this section, attention will be given to the basic approach taken in Australia when responding to the four key elements identified above as being involved in determining intergovernmental transfer arrangements, and how this knowledge can inform the UK debate on a pathway to the reform of its current intergovernmental arrangements.

4.1 Grant management process

Too often, policy makers focus on outcomes rather than process. In the UK debate, while there is seeming agreement about the need for change in current grant allocation arrangements, there is a critical lack of accompanying discussion over the consultative framework for negotiating such transfers. This oversight is important as ‘process’ is everything when negotiating changes to intergovernmental agreements, especially on the sensitive issue of funding. Without due process, ownership and commitment from the parties involved will be missing. In the UK, grant levels are determined as part of the annual UK Government budget process and their level is not the subject of substantive consultation with DAs or England. Instead, the ‘top-down’ approach outlined in Figure 1 is applied with HM Treasury working with the UK Government to determine total expenditure by Department which directly impacts grant allocations to DAs and to England.

In the HM Treasury Statement of Funding Policy, HM Treasury sets out the arrangements which apply in setting devolved budgets. In addition, there is a Concordat between each DA and HM Treasury which sets out the relationship between HM Treasury and a DA Executive to ensure that both are aware of the requirements of the other and that both are consequently able to fulfil their responsibilities fully. This concordat is made in addition to any statutory arrangements for the provision of information to HM Treasury under the Acts which brought about the DA or as outlined in the Statement of Funding Policy. What results is at least twice-yearly, formal liaison meetings between HM Treasury and the DA Executive to ensure that there is co-operation between the two administrations and that the business of both operates effectively. This consultation is complemented by the Finance Director of the DA Executive being invited to attend HM Treasury’s regular meetings of Finance Directors of UK Government departments.

FIGURE 1: INTERGOVERNMENTAL CONSULTATIVE FRAMEWORK IN THE UK



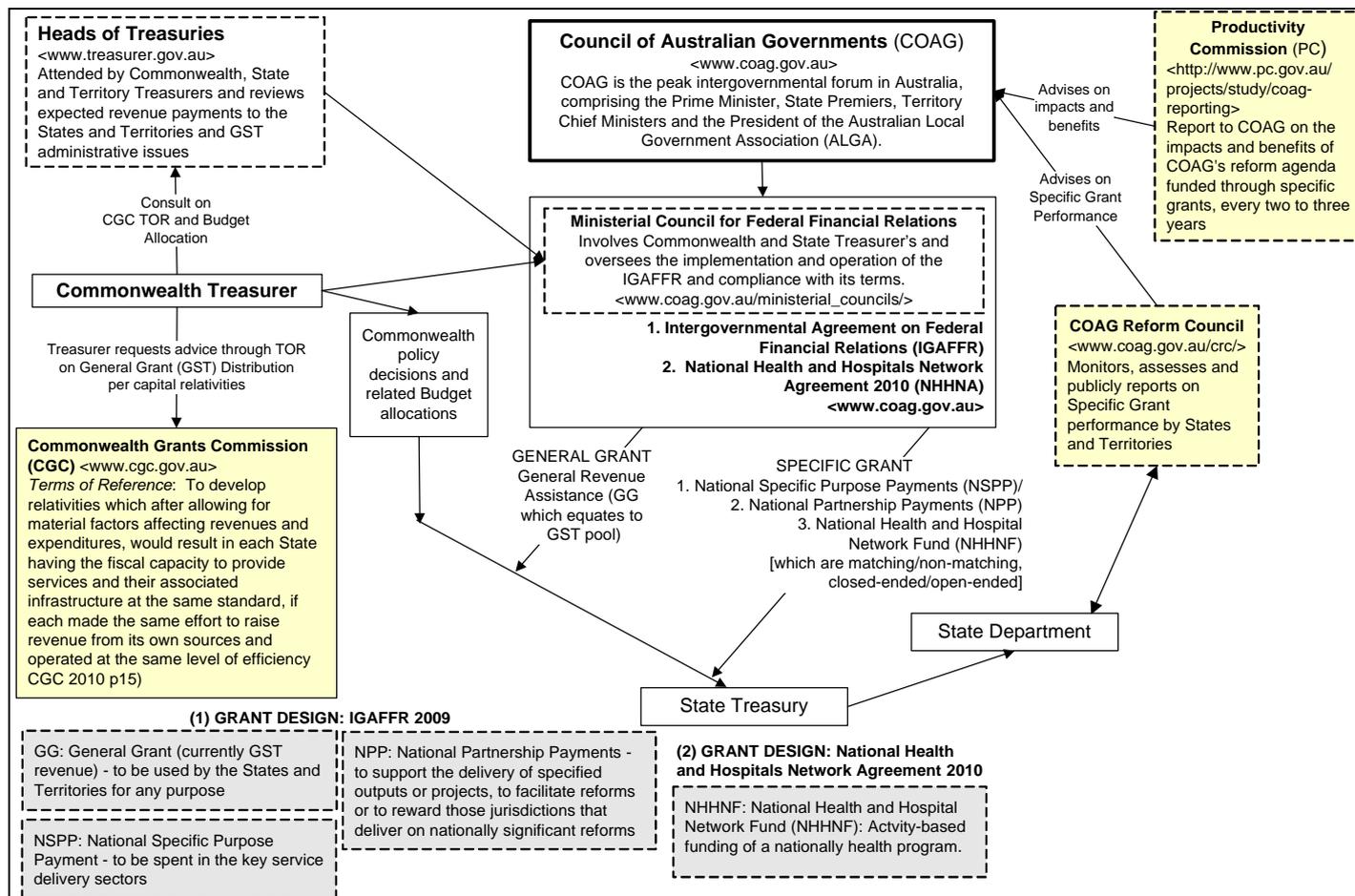
Source:
 HM Treasury (2007), *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy*, October, (PU401) <http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/d/pbr_csr07_funding591.pdf>
 Concordat Between HM Treasury and the Scottish Executive (2005) <http://www.hm-treasury.gov.uk/d/scottish_executive_concordat.pdf p2> and <http://www.hm-treasury.gov.uk/psr_devolved_assemblies.htm>

This approach is a legacy of devolution in the UK which involves only a devolving of expenditure responsibility and a central role for HM Treasury. While it has the advantage of being administratively simple for HM Treasury and the UK Government, any push for greater devolution with the assignment of increased taxing powers and needs-based funding cannot be undertaken without a more open, transparent and consultative approach. Moreover, it will need to move from consultation between HM Treasury and the DAs to between the UK Government and the DA Executive.

In contrast to the UK, Australia has a long tradition of high level engagement between the Australian Government and State governments. This approach has its foundations in the Australian Constitution which made provision for transfers during the post-federation transitional period, following the loss by States of taxes to the Australian Government. In contrast, the unitary system of government in the UK has not required such a level of formal engagement with DAs.

Figure 2 outlines the consultative, advisory and performance assessment framework which accompanies the current intergovernmental transfer arrangements in Australia. Central in this process is the consultative forum, the Council of Australian Governments (COAG) which is the forum for the Prime Minister and State Premiers to come together to consider issues. It is here that intergovernmental agreements are negotiated, one of which relates to intergovernmental transfers. On intergovernmental fiscal relations, COAG is in turn advised by a Ministerial Council for Federal Financial Relations which involves the Heads of all Federal and State Treasuries who oversee the implementation of any intergovernmental agreements relating to financial issues. In relation to fiscal transfers, this might involve a number of different agreements relating to different grants, whether general or specific.

FIGURE 2: INTERGOVERNMENTAL CONSULTATIVE AND ADVISORY FRAMEWORK IN AUSTRALIA



Source: Warren (2006, 2008)

In relation to specific grants, a grants management and performance framework often accompanies these transfers and in recent years, oversight has been through the COAG Reform Council (COAGRC²¹) or through advice from the Productivity Commission²² to COAG on the impacts and benefits of COAG's reform agenda. In the case of general (or block) grants, the Commonwealth Treasurer requests through a Terms of Reference (TOR) to the Commonwealth Grants Commission (CGC) advice on their distribution between States²³. The CGC is an independent statutory authority which, having received its TOR from the Commonwealth Treasurer, consults openly and frankly with all State and Commonwealth Treasuries on its methodology and any issue which might be of concern to any government. All documents related to all consultations around each response to the TOR are published by the CGC²⁴. Ultimately, the response to the TOR is a set of eight per capita relativities which when

²¹ See <<http://www.coag.gov.au/crc/index.cfm>>

²² See <<http://www.pc.gov.au/projects/study/coag-reporting>>

²³ See Collins and Warren (2006), Warren (2006, 2008 and 2010a).

²⁴ For the 2010 CGC Review, see

<http://www.cgic.gov.au/method_review2/2010_review_documents2/2010_review_final_report>

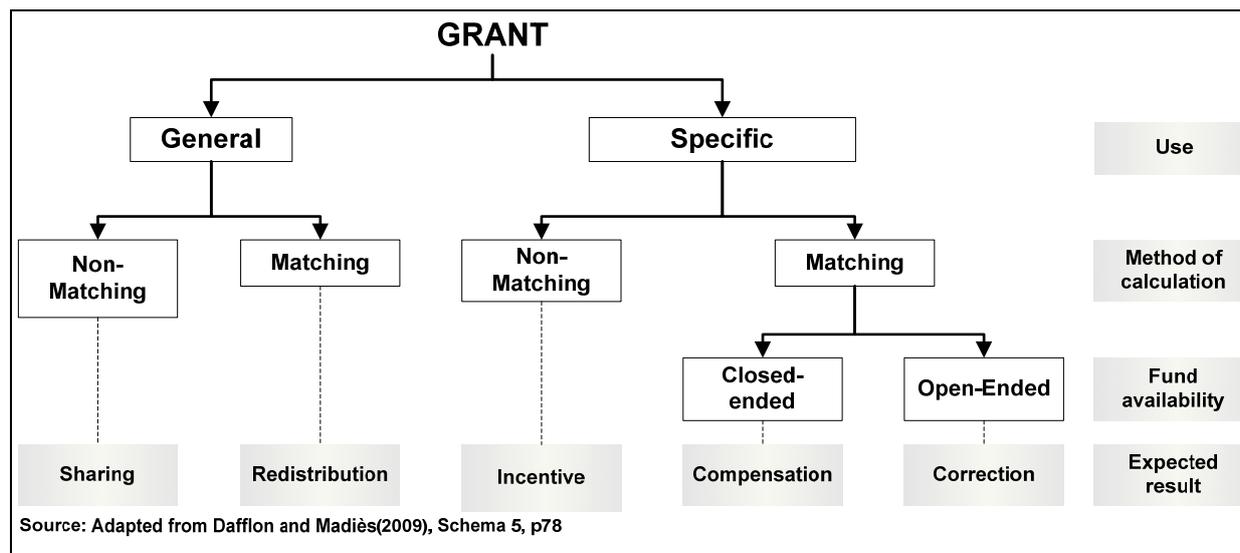
applied to each State’s population provides advice to the Australian Treasurer on how to distribute general grants between States.

The great strength of the Australian approach to determining intergovernmental transfers is the open and consultative forum it provides for States with widely divergent populations and interests (Warren 2010b), to have equal voice. What results is a federation with a heightened sense of fairness for all residents, which has had a cohesive influence on the federation.

4.2 Grant design

Figure 3 outlines the basic design options for intergovernmental grants. In the UK, grant funding for the devolved administrations is through the Departmental Expenditure Limit (DEL)²⁵ which is a general grant for 3 year funding by expenditure category from the UK Government. The Annually Managed Expenditure²⁶ (AME) grant includes funding for those expenditures that cannot be predicted with relative certainty (eg NHS). Other funding in DAs is from the Council Tax and National Non Domestic Rates (NNDR) which are imposed at the local level with the latter distributed by the DA. From these transfers, the DAs also fund LG. In the case of England, the UK Government is the direct funding source for LG.

FIGURE 3: GRANT DESIGN



²⁵ The Departmental Expenditure Limit forms the majority of the Scottish Government’s budget and is made up of operating and capital expenditure. DEL is set for three years during the Spending Review process, and the annual DEL spend is subject to End Year Flexibility (Source: *Scottish Budget Draft 2010-11* <<http://www.scotland.gov.uk/Resource/Doc/284860/0086518.pdf>>)

²⁶ Annually Managed Expenditure is set each year and contains those elements of expenditure that are not readily predictable. For example, NHS and Teachers Pensions (*Scottish Budget Draft 2010-11* <<http://www.scotland.gov.uk/Resource/Doc/284860/0086518.pdf>>)

In Australia, while States in 2008-09 raised \$50,118m or 14.8% of all tax revenue, their expenditure was \$173,876m or 42% of all government expenditure. This was only possible because States were the recipient of some \$84,006m in total grants (Table 9), 49% (or \$41,189m) from a GST based general grant distributed on fiscal equalisation principles. Some 51% of grants were specific grants and comprised National Specific Purpose Payments (NSPP) which are assigned to healthcare, schools, skills and workforce development, disability services and affordable housing; National Partnership Payments (NPP) which are designed to deliver on nationally significant reforms; and National Health and Hospitals Network Funding (NHHNF) which are health activity-based grants. While 100% of the GST is currently assigned to the general grant, from 2011-12, the introduction of NHHNF will result in this share declining to 67%.

TABLE 1: TOTAL PAYMENTS TO STATES: AUSTRALIAN GOVERNMENT

| | Previous payments for specific purposes | National Partnership payments | National SPPs(a) | Health and Hospital Network funding (b)(c)(d) | GST | Other general revenue assistance | Total | Growth | Per cent of GDP |
|-----------|--|-------------------------------------|---------------------|---|--------|---|---------|--------|--------------------------|
| \$million | | | | | | | | | |
| 2000-01 | 19,207 | - | - | - | 24,355 | 3,715 | 47,277 | - | 6.7 |
| 2001-02 | 21,458 | - | - | - | 26,632 | 4,841 | 52,931 | 12.0 | 7.0 |
| 2002-03 | 21,781 | - | - | - | 30,479 | 1,734 | 53,994 | 2.0 | 6.7 |
| 2003-04 | 22,940 | - | - | - | 33,219 | 647 | 56,806 | 5.2 | 6.6 |
| 2004-05 | 24,795 | - | - | - | 35,323 | 944 | 61,062 | 7.5 | 6.6 |
| 2005-06 | 26,904 | - | - | - | 37,182 | 1,039 | 65,125 | 6.7 | 6.5 |
| 2006-07 | 28,549 | - | - | - | 39,552 | - | 68,101 | 4.6 | 6.2 |
| 2007-08 | 31,994 | - | - | - | 42,630 | - | 74,624 | 9.6 | 6.3 |
| 2008-09 | 16,874 | 18,664 | 6,116 | - | 41,189 | 1,162 | 84,006 | 12.6 | 6.7 |
| 2009-10 | - | 28,892 | 24,409 | - | 44,529 | 717 | 98,547 | 17.3 | 7.6 |
| 2010-11 | - | 19,347 | 26,098 | - | 47,930 | 707 | 94,082 | 4.5 | 6.7 |
| 2011-12 | - | 14,419 | 15,033 | 26,575 | 37,497 | 647 | 94,172 | 0.1 | 6.3 |
| 2012-13 | - | 15,026 | 16,000 | 28,695 | 39,439 | 650 | 99,811 | 6.0 | 6.4 |
| 2013-14 | - | 12,602 | 17,060 | 30,959 | 41,259 | 604 | 102,483 | 2.7 | 6.2 |

Source: Australian Government, 2010-11 Budget, Budget Paper No 3, Table 1.2, p20

4.3 Grant value

The Australian mix of general (GST) and specific grants is detailed in Table 9. General grant value to States in Australia is equivalent to the agreed share of the GST, currently 100% (agreed in 1999) declining to 67% from 2011-12. Specific grants (NSPP/NPP/NHHNF) are the subject of a number of intergovernmental agreements negotiated between States and the Australian Government. In the case of both general and specific grants, such agreements are not binding and any party can move to change or withdraw its involvement. Historically, the initiative for new or changes to established agreements has come from the Australian Government primarily, as it is the funding source. Specific grants are largely driven by national priorities and as evident in Table 9, there has been a trend from general to specific grants in Australia.

In the UK, general and specific grants are provided to DAs and LG. The quantum of such grants is determined very differently from similar grants in Australia. While specific grants can be changed at the margin for specific purposes, the UK system has a rigid formulaic approach to determining the quantum of general and specific grants.

With England having no representative assembly (a major focus of the ‘West Lothian Question’) unlike the DAs of Scotland, Wales and Northern Ireland, funding for public service delivery in England is determined by the UK Parliament and is assigned either directly to English LG or to the UK Departments providing these services. Based on the change in the various levels of UK Government expenditure in England, grants to DAs are adjusted using the Barnett Formula²⁷ as shown in Figure 4.

FIGURE 4: BARNETT FORMULA

| | | | | | | |
|---|---|---|---|---|---|---|
| ‘Consequential’ change (or additional spending made available) in the allocation to a Devolved Administration | = | Change expenditure on service in England* | X | Relevant ‘comparability proportions’ to England’ by Devolved Administration | X | Relevant population proportion to England’ by Devolved Administration |
| * The base can in practice be England, England and Wales or Great Britain, depending on the coverage of the expenditure considered. | | | | | | |

The strength (and weakness) of the Barnett Formula is that it is simple in its application – and for the UK Government (and HM Treasury) something over which they have direct control. Under Barnett, the grant to a DA in any year is the previous year’s grant plus a ‘consequential change’ as calculated in Figure 4.

If, for example, expenditure on an English service increases by £100 million and the service is 100% comparable in Scotland and Scotland’s population relative to England is 8.4%, then Scotland’s consequential is £100m x 1.0 x 0.084 = £8.4 million. The actual expenditure on any service at any point in time in a DA is therefore an historical construct; the combination of the allocation made available to service agencies in DAs prior to the introduction of the Barnett Formula – over 30 years ago – and the many ‘consequential’ changes made since then which impact only at the margin. The current total grant allocation to a DA is therefore not reflective of current needs but needs evident in the pre-Barnett grant allocation adjusted for government expenditure growth in England and population changes in the DAs relative to England. An obvious long-term consequence of this (mathematical) approach is the convergence of the DAs share to the average English level of funding per capita as the cumulative ‘consequential change’ becomes increasingly important as a share of the total grant (Holtham Commission 2010, p5, para1.12).

It is not surprising that there has been a broad based call for a systematic revision of the allocation of grants in the UK designed to fund expenditure on services in devolved administrations, both across DAs and within administrations across service areas²⁸. The Holtham Commission(2010, p140 paraA4.23) estimated that if the per capita funding index for England was 100, current Welsh funding is 112 when it should be 115 per capita – the equivalent of underfunding Wales by £400m per annum²⁹. In the Holtham Commission, the focus on perceived grant distribution inequities (and therefore Barnett) is an avenue for strengthening its case for a greater share of the general grant pool available to DAs.

²⁷ For example, the Barnett Formula allocates Scotland a population share of changes in comparable spending programmes in England. For comparable expenditure, Scotland gets exactly the same £s per head increase as in England. (See discussion in *Scottish Budget 2010-11* <<http://www.scotland.gov.uk/Resource/Doc/284860/0086518.pdf>>)

²⁸ See <<http://www.niassembly.gov.uk/finance/2007mandate/research/090320d.pdf>>

²⁹ See footnote 6.

In the recent past, this legitimate concern by Wales about being underfunded relative to Scotland when needs-based criteria are applied to grant allocation has been addressed through a Barnett Formula bypass. This was most evident when Wales secured Barnett Formula bypass from the UK government to enable the Welsh Assembly Government to access available European Union Structural Funds. Such an approach is a temporary solution to a known problem which can only worsen with the passage of time. Central to the problem for Wales is that the Barnett Formula is essentially an uplift regime for a needs-based grants distribution between the nations in the UK as determined in 1978. While the Barnett Formula can adjust for population changes between regions, it does not accommodate the changing needs of the different regions in the UK.

Recommended responses have taken two forms: firstly, directly addressing the underfunding of selected DAs (such as Wales) through increased specific grants; and secondly, revising the distribution of grants between DAs (and England) to reflect current needs. The UK Government response to both issues has been arbitrary rather than systematic and considered. While Wales has been the recipient of ad hoc grants which assist with addressing the issue on underfunding, this only addresses the 'symptom and not the disease' – the disease being the failure of Barnett to reflect current funding needs in Wales.

With the pressure on the UK government in the current budgetary crisis to reduce the level of funding to DAs, this will inevitably place far greater attention on the distribution of the shrinking grant 'pool'. Avoiding potentially deleterious effects on the union of dissent over the distribution of the shrinking grant 'pool' must inevitably mean attention on reforming grant distribution arrangements.

4.4 General grant distribution

The distribution of general grants in the UK is based on a 1978 *Needs Assessment Study* by HM Treasury³⁰. The findings of this study (which was not officially released) formed the basis for allocating grants to Scotland in 1978 and two years later in Northern Ireland and Wales³¹. As HM Treasury stated at the time 'It is a long-established principle that all areas of the UK are entitled to broadly the same level of public services and that the expenditure on them should be allocated according to their relative needs'³².

³⁰ The original fiscal equalisation methodology was detailed in HM Treasury *Needs Assessment Study-Report* (London: The Treasury, December 1979) (unpublished). See also
<<http://www.publications.parliament.uk/pa/cm199798/cmselect/cmtreasy/341ii/ts0204.htm>>
<<http://wales.gov.uk/docs/icffw/report/090708barnettfullen.pdf>>.
<<http://www.publications.parliament.uk/pa/ld200809/ldselect/ldbarnett/139/13907.htm>>

³¹ For a brief history of Barnett Formula see
<[http://www.devolution.ac.uk/pdfdata/Impact%20 of Barnett Formula on Scottish Economy.pdf](http://www.devolution.ac.uk/pdfdata/Impact%20of%20Barnett%20Formula%20on%20Scottish%20Economy.pdf)>
and <<http://www.assemblywales.org/09-012.pdf>>

³² See p6 in <<http://www.niassembly.gov.uk/io/research/8102.pdf>>

FIGURE 5: HOLTHAM COMMISSION PROPOSAL TO REVISE THE BARNETT FORMULA

| | | | | | | | | | | |
|--|---|---|---|---|---|---|---|-----------------------|---|---|
| 'Consequential' change (or additional spending made available) in the allocation to a Devolved Administration | = | Change expenditure on service in England* | X | Relevant 'comparability proportions' to England* by Devolved Administration | X | Relevant population proportion to England* by Devolved Administration | X | Needs adjustment term | X | Transition mechanism to account for any discrepancy between the needs-based assessment and the last block grant |
| * The base can in practice be England, England and Wales or Great Britain, depending on the coverage of the expenditure considered | | | | | | | | | | |

Source: Holtham Commission(2010, p27)

It is this 1978 needs-based grant distribution that the Barnett Formula (Figure 4) is designed to update 'as if' the needs in 1978 applied today in each DA. Not surprisingly, with the passage of time, the Barnett Formula has proven increasingly controversial. In its Final Report, the Holtham Commission (2010)³³ strongly supported the introduction of needs-based funding of DAs and recommended the changes to the Barnett Formula shown in Figure 5. By introducing a 'needs adjustment term' which reflects per capita relativities in a DA relative to England (where this factor for England=100), changes in needs over time are introduced (but only at the margin). The Final Report of the Commission on Scottish Devolution (Calman Commission in June 2009)³⁴ and the Final Report of the House of Lords Select Committee on the Barnett Formula (July 2009)³⁵ also supported applying the principle of fiscal equalisation to grant distribution to DAs. In each Report, there was particularly strong support for the adoption of an approach similar to the independent advice provided by the Australian Commonwealth Grants Commission (CGC) to the Australian Treasurer on the allocation of general grants amongst States.

In the case of the Holtham Commission proposal in Figure 5, it would be the role of an independent statutory organisation (similar to the CGC) to advise the UK Government on the 'needs adjustment term'. Alternatively, if the Australian CGC approach was adopted, it would provide a 'needs adjustment term' for all regions of the UK, not just DAs. The response of the UK Government in December 2009³⁶ to the House of Lords Select Committee recommendation on the Barnett Formula (2009) was emphatic:

2.10 Recommendation: The role of the Commonwealth Grants Commission (CGC) in Australia offers a useful institutional model of an independent body that has responsibility for making recommendations about the allocation of finance. An independent body, similar to the CGC should be established in the UK. It should be the role of such a body to recommend the allocation of public monies based on population and through a needs based formula. Within the new framework the Treasury will need to retain its authority over the overall level of the block grant but not the proportionate allocation of the grant between the devolved administrations. This independent body might perhaps be called the UK Funding Commission. This Commission would carry out an assessment of relative need, undertake periodic reviews, and collect and publish information on an annual basis about the allocation of finance to the devolved administrations.

³³ See <<http://wales.gov.uk/docs/icffw/report/090708barnettfullen.pdf>> and <<http://wales.gov.uk/icffw/home/report/?lang=en>>

³⁴ See <<http://www.commissiononscottishdevolution.org.uk/>>

³⁵ See <<http://www.parliament.uk/business/committees/committees-archive/hlbarnettformula/hlbarnettformula/>>

<<http://www.publications.parliament.uk/pa/ld/ldebarnett.htm>>

³⁶ See <<http://www.official-documents.gov.uk/document/cm77/7772/7772.pdf>>

The Commission should be advisory in nature rather than have the power to make substantive allocation of funds on its own account. Its advice should, however, be published.

The remit of the Commission should be to determine the relative needs of each devolved administration on a regular basis, perhaps every five years. The Commission should also advise on the relative proportions of public spending for the devolved administrations, compared with spending within England, during a transitional period and recommend annual increments based on the latest population figures.

The Commission should be appointed by the UK Government as a non-departmental public body. It should be politically neutral and independent. It should be composed of a small number of members with sufficient expertise to ensure the dispassionate and authoritative nature of its work.

2.11 Response: The Government notes the Committee's views on the role of the Australian Grants Commission. Under the devolution settlements for Scotland, Wales and Northern Ireland the UK public expenditure framework and allocation methodology is reserved to the Treasury. We note the Committee's views on the desirability of establishing an independent UK Funding Commission, notwithstanding the potentially substantial costs of establishing and running such a system, but currently have no plans to set up such a body.

In the recent pronouncements by the new Conservative-Liberal Democrat government, it too has indicated that while it is in support of devolution including addressing the 'West Lothian Question' and addressing concerns by Wales about being relatively disadvantaged under Barnett, it has not given any priority to replacing the Barnett Formula as the basis for allocating transfers to DAs. In fact, in an outline of their future program, they stated that³⁷:

We recognise the concerns expressed by the Holtham Commission on the system of devolution funding. However, at this time, the priority must be to reduce the deficit and therefore any change to the system must await the stabilisation of the public finances. Depending on the outcome of the forthcoming referendum, we will establish a process similar to the Calman Commission for the Welsh Assembly.

This is despite the Liberal Democrats Manifesto stating that it would 'Replace the current Barnett formula for allocating funding to the Scottish, Welsh and Northern Irish governments with a new needs based formula, to be agreed by a Finance Commission of the Nations.'³⁸

The hesitancy of the previous Labour Government and now the new Conservative Liberal Democrat Coalition to embrace the introduction of a needs-based formula appears to have a number of sources.

1. Changing the Barnett Formula is potentially controversial and politically divisive;
2. Reviewing the Barnett Formula will raise issues which are complex and not easily resolved;
3. Potential cost of ensuring there are no losers in the long term (and therefore the difficult issue of how to manage the transition to any new arrangement); and

³⁷ See p4 in *The Coalition: our programme for government*, HM Government, <www.cabinetoffice.gov.uk/media/409088/pfg_coalition.pdf>

³⁸ See p92 of <http://network.libdems.org.uk/manifesto2010/libdem_manifesto_2010.pdf>

4. Potential costs of establishing and running such a system (including an independent advisory organisation (eg CGC) and the consultative framework (such as COAG).

These concerns are unreasonable and taken to their extreme, the basis for never changing current arrangements, no matter how unjustifiable in theory and practice. In relation to (1), this is true of most change but the solution lies in how the process is managed. On (2), this is contradicted by the seemingly uncontroversial and politically accepted operation of an already complex fiscal equalisation arrangement for the allocation of grants to local government. In the case of England's local government, since 2006-07 the UK Government has administered the Four Block System of allocating Grant Revenue to local authorities (LA) where, under this system, the distribution of the formula grant is determined by four factors: Relative Needs Formulae, the Relative Resource Amount, the Central Allocation and the Floor Damping Scheme³⁹. In the case of the DAs of Scotland and Wales, conceptually similar but operationally different and equally complex grant allocation arrangements exist structured around needs-based formulae⁴⁰.

On the cost of the transition (3 above), this is more an issue of 'when' rather than 'if' as the failings of Barnett will only increase as will the need for a systematic rather than ad hoc response. The Holtham Commission proposed transitional arrangements in their revision to the Barnett Formula (Figure 5), and acknowledges this as a real issue. Whether the Holtham approach is accepted or an Australian CGC-type approach implemented across all regions in the UK, the greater the delay, the greater will be the challenge in resolving the transitional problems encountered in returning to a needs-based distribution of grants from the Barnett Formula which is inextricably leading all DAs to converge to the England average per capita grant.

On the issue of the cost of funding a CGC-type organisation in the UK (4 above), any such costs will be miniscule in relative terms and has the far greater benefit of increasing transparency and engagement of the nations in the union in the discussion about the distribution of funding.

Such transparency and engagement is not always welcomed by all governments. States in the Australian federation have been quick to blame other States and the Australian Government for their policy failures. The Australian Government has always been able to ignore the CGC advice and address issues of concern to States about grant allocation – but has opted not to take such an action. In the UK, HM Treasury has shown no interest in open engagement with DAs. Most telling of their position are the comments of Treasury officials appearing before the House of Lords Select Committee on the Barnett Formula⁴¹. Here they present a clear exposition of

³⁹ See <<http://www.sigoma.gov.uk/sigoma/WhatWeDo/LocalGovernmentFinanceAndLocalTax.aspx>>

⁴⁰ For Scotland, see <<http://www.scotland.gov.uk/Topics/Government/local-government/17999/Glossaryofterms>> and in particular, <<http://www.scotland.gov.uk/Topics/Government/local-government/17999/Glossaryofterms>>. For Wales see <http://www.assemblywales.org/qg_08-0084.pdf> and Northern Ireland <<http://www.nidirect.gov.uk/index/government>-citizens-and-rights/government-1/local-government.htm>>

⁴¹ See transcript in the First Report at <<http://www.parliament.uk/business/committees/committees-archive/hlbarnettformula/>>

the basis for the UK Government's continued support for the Barnett Formula despite the general chorus call for change. In particular, that:

1. Barnett Formula is simple and with Barnett Plus, flexible, whereas a needs-based arrangement would be complex and far less simple;
2. Barnett Formula places greater control of both the quantum and distribution with the central government (and HM Treasury);
3. Central government concern that sub-central governments might not be accountable given they do not have substantial revenue ('hard budget constraint' issue) or expend untied general grants according to national principles ('National Priorities').
4. That while ever England is not a DA, the allocation to the current three DAs could not take place without effectively modelling England as if it was a DA. This has the potential to duplicate (and possibly conflict with) the needs-based approach to allocating grants to English LG.
5. That despite the House of Lords Final Report asserting that the new system should not duplicate what DAs currently do for LG when determining their grant entitlement, this is a real possibility when the LG has essentially an agency relationship with the DA⁴². In effect, moving to needs based grant allocation at the DA level and the DA's grant allocation framework for LG funding would need to be consistent. Since DAs 'pass-through' a substantial proportion of their DA funding from the UK Government to LG, anything else would lead to inconsistencies.
6. Identification of needs is often unavoidably linked to funding levels whereas with Barnett, needs are not really determined, only the level of available funding which is in the control of HM Treasury.

For a Government (and a bureaucracy), these concerns are more about control than about good governance. The issues raised warrant a direct response as they have the potential to be major impediments to moving away from Barnett at any time in the near future.

1. *Barnett is simple and flexible*: Simplicity and flexibility are worthy attributes but the key purpose of grants is to achieve distribution objectives reflective of revenue raising capacity and expenditure disabilities.
2. *Barnett is operated at minimal cost*: Cost is not the issue. There is no substance to the argument that replacing Barnett with the equivalent of the Australian CGC fiscal equalisation grant allocation framework would be complex and therefore expensive and poorly understood. The CGC is not expensive and no more complex than the needs-based framework used in allocating UK LG grants. Moreover, complexity can be addressed in the design of the grant assessment framework.. Australia in 2010 introduced a more simplified system, addressing criticisms that the previous framework was overly complex.

⁴² The House of Lords *Select Committee on the Barnett Formula 1st Report of Session 2008–09* stated that 'The new system should respect territorial autonomy. The new system must leave the devolved administrations free to decide what to do with their block grant. There should be no ring-fencing. Neither should the new system attempt to duplicate the detailed assessments of local needs that the devolved administrations must themselves necessarily make.' (p 38) at <<http://www.publications.parliament.uk/pa/ld200809/ldselect/ldbarnett/139/139.pdf>>

3. *Barnett is not divisive:* In fact, the lack of transparency around Barnett and perceptions of unfairness, is divisive. In contrast, the CGC approach in Australia since 1933 has been a cohesive force within the federation.
4. *Barnett facilitates greater central control:* Any needs-based approach to grants would force greater transparency and engagement between the central and sub-central governments than has historically occurred, the result being less UK Government control and a greater need to engage nations in the union;
5. *DA accountability and achieving national priorities:* Accountability can be achieved through tax assignment and grant design, ensuring 'hard budget constraints' are imposed. National priorities can be achieved transparently through specific grants and associated performance agreements.
6. *Needs-based grant allocation would require an all of UK approach:* This is not a criticism but a strength of any needs-based approach, ensuring that the 4 nations in the Union are treated equitably.
7. *An all of UK needs-based framework would conflict with a LG needs-based framework:* The factors determining the allocation of LG grants by DAs should be consistent with the framework determining the DAs' share of any national grant pool. Anything else could lead to funding level and distribution issues. If a region should choose to fund LG differently from some national needs-based criteria, then it should be funded from own-sources and if the national government sought regional priorities, then this can be achieved transparently through specific grants.
8. *Needs-based framework would raise issues about the level of funding, not just about distribution:* This is not a criticism of the needs-based framework but of the level of funding. In practice, funding and distribution are two separate issues which involve different considerations and are readily separable.

Central to the above concerns about applying fiscal equalisation principles to general grant allocation in the UK is its operation in practice and whether its advantages outweigh any disadvantages. In the remainder of this section, attention is therefore given to the Australian approach to fiscal equalisation and whether the support for such an approach by the Calman Commission, Holtham Commission and the House of Lords Committee on Barnett Formula, is justified.

TABLE 2: CGC ESTIMATION OF POPULATION RELATIVITIES: PRE AND POST 2010 CGC REVIEW

| Revenue | Expenditure(b) |
|---|---------------------------------------|
| 1 Payroll tax | 1 Schools education |
| 2 Land tax | 2 Post-secondary education |
| 3 Stamp duty on conveyances | 3 Admitted patients |
| 4 Insurance taxes | 4 Community and other health services |
| 5 Motor taxes | 5 Welfare and housing services |
| 6 Mining revenue | 6 Services to communities |
| 7 Other revenue(a) | 7 Justice services |
| | 8 Roads |
| | 9 Transport services |
| | 10 Services to industry |
| | Depreciation |
| | Investment(b) |
| | Net lending |
| Revenue from Australian Government payments | All other State expenditure(d) |

(a) Includes gambling taxes, emergency levies, user charges and any other revenue in GFS.
(b) Includes expenditure funded by State revenue, the GST and Australian Government payments.
(c) Investment on new infrastructure and equipment only. Replacement of existing assets is assumed to be funded by depreciation expenses.
(d) Includes State legislatures, central administrative agencies, national parks and cultural services and a balancing item to ensure the expenses equal those in GFS

Source: *CGC 2010 Review* CGC 10) Vol 1 p 43

The Australian approach to distributing grants between State governments is internationally recognised as one of the most comprehensive in acknowledging differences in each State government's capacity to raise revenue and to provide services. Each year, the Australian Government Treasurer issues a Terms of Reference to the Commonwealth Grants Commission (CGC) requesting advice on per capita relativities to use in the distribution of general grants to States. While the basic approach taken by the CGC has changed over the years⁴³, its overriding focus has been on applying the principle of fiscal equalisation. In its most recent review of its methodology completed on 26 February 2010, it sought to 'place the Commission's methodology on a sounder and more sustainable basis'⁴⁴. Table 10 details the categories of revenue and expenditure identified in any CGC estimates of per capita relativities.

The definition of fiscal equalisation applied by the CGC (*CGC 2010 Review* p34) is that:

State governments should receive funding from the pool of goods and services tax revenue such that, after allowing for material factors affecting revenues and expenditures, each would have the fiscal capacity to provide services and the associated infrastructure at the same standard, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency.

As noted by the *CGC 2010 Review* (p34-35):

- the aim is to equalise the fiscal capacity of the States to deliver services and to acquire the infrastructure used in their provision. Equalisation does not aim to equalise actual service

⁴³ For a history of the CGC, see <http://www.cgc.gov.au/about_cgc>

⁴⁴ See *Cover Letter to CGC from the Australian Treasurer* in his Terms of Reference for the Review available at <http://www.cgc.gov.au/data/assets/pdf_file/0005/18086/2010_Review_ToR_final_Pt_I.pdf>

levels. Since States have the right to spend the GST revenue according to their policy priorities, the GST distribution cannot equalise the actual level of services provided unless States choose to do so; and

- the equalising GST distribution is determined on the basis that all States make the same effort to raise their own revenue and operate with equal efficiency. States are not obliged to follow any particular service delivery or revenue raising policies. However, if any State adopts revenue raising or service delivery policies that differ from the others, the GST distribution would not compensate it for any lost revenue or extra expenses; nor would it offset any extra revenues or cost savings.

The CGC approach is subsequently based on ‘five pillars’ (Warren, 2010a):

- Pillar 1 a State’s **financial capacities**, not its performance or outcomes;
- Pillar 2 **what States collectively do** (on average);
- Pillar 3 **policy neutral** or a State’s own policies or choices should not directly influence its grant;
- Pillar 4 **practical**; and
- Pillar 5 **contemporaneity**, delivering relativities most appropriate to the application year.

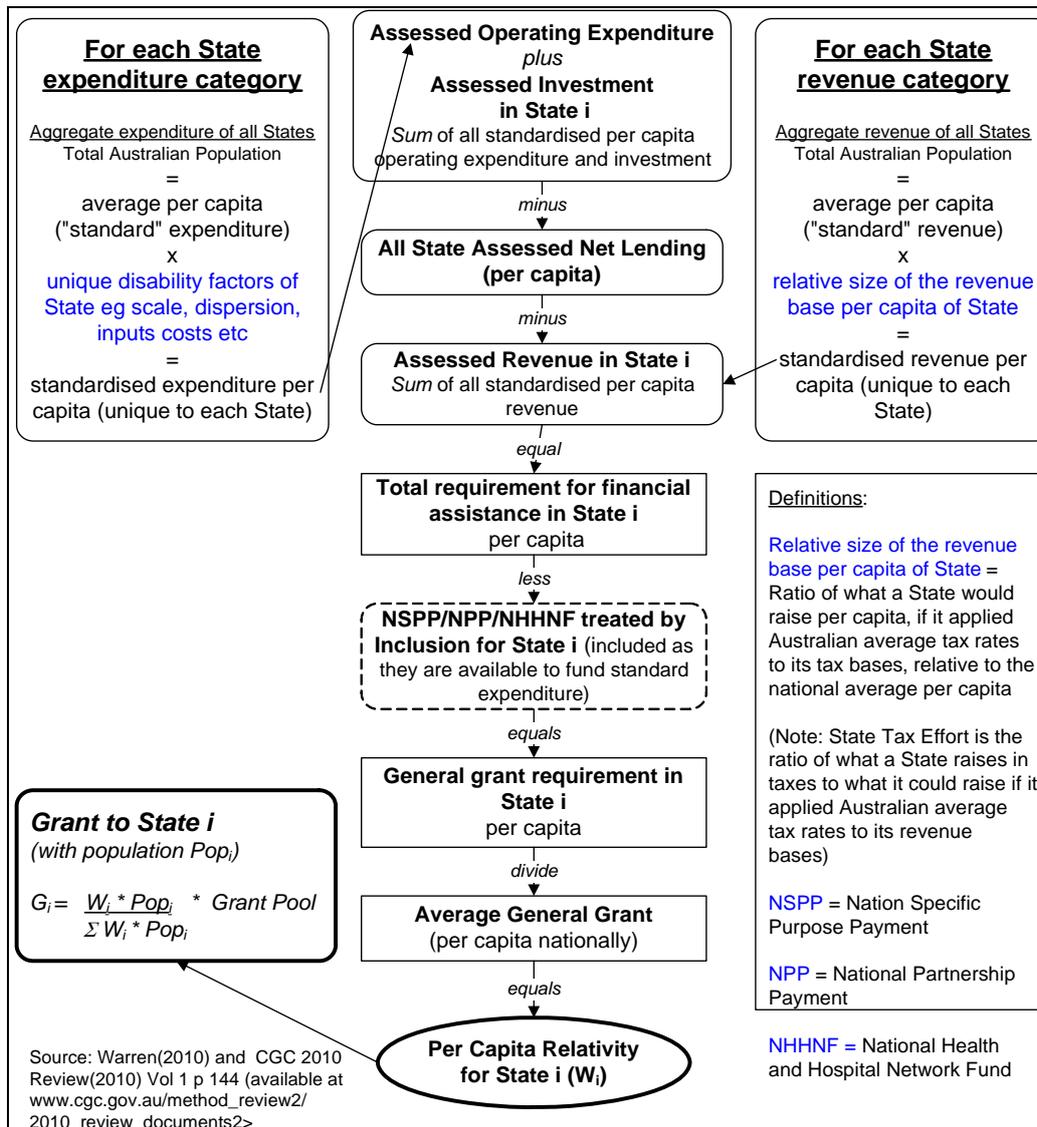
In being based on what states do, the CGC methodology is in no way judgemental about what States should or could do. However, in practice, ‘what individual States do’ is widely divergent (Warren 2010a) as they choose very different approaches to spending their general grant, reflecting divergent local preferences. It is in part this divergence which has led to the growth of NSPP, NPP and NHHNF, all of which have performance conditions and in some cases, reward payments (as with NPPs). Figures 6 and 7 outline the approach to estimating per capita relativities in Australia. ‘Assessed’ refers to ‘what States do’. For example, in the case of taxation, ‘Assessed State (own-source) Revenue’ is the *All States* average tax rate (schedule) applied to the tax base in each State. In this case, differences in per capita assessed revenue reflect differences in the distribution of the tax base.

FIGURE 6: CGC ESTIMATION OF GST REVENUE SHARING PER CAPITA RELATIVITIES: CGC 2010 REVIEW

| | |
|-----------------------------------|--|
| (1) | Assessed Net Lending (per capita) |
| (2) | Assessed Operating Expenses(a) (per capita) |
| | Assessed Investment (per capita) |
| (3) | Assessed State (own-source) Revenue (per capita) |
| (4)=(2)-(1)-(3) | Total Requirement for Financial Assistance (per capita) |
| (5) | Revenue assistance from Australian Government Payments (treated by Inclusion (ie NPP/NSPP)) (per capita) |
| (6)=(4)-(5) | GST Requirement (from GST Pool) (per capita) |
| (7)=(6) per capita for State i/ | State per capita relativities |
| ((6) National average per capita) | |

Source: CGC 2010 Review(2010) Vol 1 p 144

FIGURE 7: GENERAL GRANT ASSESSMENT FRAMEWORK IN AUSTRALIA



The 'Total Requirement for Financial Assistance' is therefore a measure of the total funding required by States who make an 'average' effort to raise own-source revenue and have acknowledged any disabilities impacting service delivery and infrastructure provision. In offsetting against this funding 'Requirement' the 'Revenue assistance from Australian Government Payments' (or NSPP, NPP and NHHNF), the CGC methodology effectively undoes the distribution amongst States of any special negotiations between the Commonwealth and the States in terms of the allocation of specific grants. However, the Commonwealth Treasurer in his TOR to the CGC has the option to demand a different approach which is currently the case with performance based reward payments to States which are required to be quarantined from the CGC analysis. This CGC approach to specific grants when advising on the distribution of general grants does make it difficult for any real meaning to be attached to the initial distribution of specific grants as they are, in effect, added to the general grant pool.

The Australian Government appears aware of this limitation and this is what drove it to introduce the NHHNF grants from 2010-11. As noted in the 2010-11 *Australian Government Budget Paper No. 3*. (p7):

Horizontal fiscal equalisation does not guarantee that the States will provide a uniform standard of service – its aim is to equalise the capacity of each State to do so, while leaving each State free to determine the standard of service provision.....Under the *National Health and Hospitals Network*, Australian Government funding for public hospitals will be based on the efficient price of public hospital services, determined by an independent pricing authority.’

Under the NHHNF, States will be compensated in a way which provides a uniform standard of service after taking into account local factors which might impact on the cost of service delivery. In effect, the Australian Government is expressing a level of impatience with States and frustration with the operation of fiscal equalisation in Australia – without directly stating as much.

A key question for fiscal equalisation as applied by the CGC for the future in Australia is whether the approach to fiscal equalisation in Australia is out of step with Australian Government objectives and Commonwealth-State developments such as in IGAFRR 2008 and NNHNF (as noted above). Moreover, in the recently released *Henry Review* (2010, Volume 2 p627), it made:

Recommendation 108: The Productivity Commission should examine the principles of public service delivery and the mechanisms that are available to governments to deliver public services and their implications for financial arrangements in the federation. The findings of this study should be considered by COAG.

Of direct relevance to the UK debate over the merits of a CGC-like organisation advising the UK Government on the distribution of general grants on fiscal equalisation principles is the Australian debate about the merits of its approach. The more telling criticisms of the Australian approach are not about complexity or the cost of such a system but how the grant allocation framework balances the competing goals of equity and economic efficiency. In the Australian CGC framework, fiscal equalisation is focused on achieving an outcome which is fair in that it reflects the fiscal capacity (or revenue raising ability) and expenditure (cost) disabilities of regions in a steady-state environment. This focus on fairness has been criticised for failing to adequately acknowledge the implications for economic efficiency of such an approach (Warren 2006, 2008). In particular, the application of full fiscal equalisation principles by the CGC in its advice to the Australian Government can therefore (Warren 2010a):

1. frustrate a central government intent on achieving national standards in areas where States deliver public services (as noted above in relation to health in Australia)
2. create disincentives for individual States to undertake major efficiency-improving reform⁴⁵;

⁴⁵ Warren (2010a) also argues the CGC methodology is best suited to a steady-state evaluation and not well suited to periods of major reform because the fiscal equalisation mechanism can work against change and only with direct Commonwealth involvement (through changing the CGC TOR and supplemental funding for States) can these limitations of fiscal equalisation be overcome.

3. not reflect State preferences (as ‘what States do’ can vary widely); and
4. with the methodology based on ‘what States do’, is not independent of actual State policies and can act as a disincentive to major tax reform.

Such criticisms are not fundamental and do not challenge the merits of applying fiscal equalisation principles to the allocation of general grants. Rather, they highlight the need for flexibility in applying these principles to ensure both equitable and efficient outcomes are derived. In resolving any fiscal equalisation ‘trip’ to the introduction of economic efficiency improving State (tax and expenditure) reforms, Warren (2010a) proposes that strategies in the case of major State tax reform might include:

1. Quarantining (or excluding) some part of the additional revenue raised by States undertaking major tax reforms;
2. Quarantining any Australian Government tax reform incentive grants (such as a share of increased revenue from a growth tax imposed by the central government in the region);
3. Limiting the scope for fiscal equalisation methodology to redistribute State-specific fiscal dividends arising from reforms to other regions not undertaking reform;
4. The central government institutionalising (or formally constituting) arrangements for compensating those regions which undertake reform; and
5. Considering introducing a ‘Flexible Pillar 3’ which enables a partial move to ‘what States should do’ rather than ‘what States do’ to ensure the achievement of national priorities through specific grants.

The above discussion is not a criticism of fiscal equalisation principles as applied in Australia but enhancements which are designed to improve its operation in practice. The real question though is whether there are demonstrable benefits for the UK from moving from the Barnett Formula to a framework similar to that in Australia. The answer must have two parts: is the current arrangement sustainable and is the Australian approach a superior alternative to other options.

In relation to the sustainability of current arrangements, three observations can be made. Firstly, the Barnett Formula is not sustainable because of its convergence characteristic – and patching it is a temporary, not a permanent solution. Secondly, if further devolution is imminent, including tax reassignment and expenditure reassignment, there will ultimately be no alternative but to move away from Barnett. Thirdly, if the ‘West Lothian Question’⁴⁶ is resolved through regional government in England, Barnett is no longer appropriate.

On the issue of the UK adopting an approach to allocating general grants similar to that in Australia, the discussion above has highlighted that there are considerable strengths in the Australian approach but it too requires constant review and enhancement. However, the Australian approach is more than just the application of fiscal equalisation principles to grant allocation – it is about a process of engagement within the federation which is open and consultative and has served the federation well during periods of crisis. COAG (Figure 2) has in recent years been a critical

⁴⁶ *ibid* p27

element in bringing about positive reforms and from which the UK can learn much in terms of how to manage the process of change during a period of budgetary crisis.

If the UK Government moves to reduce funding to DAs or force tax reassignment without addressing inequities in the distribution of current grants, it can only expect division and dissent and a risk to the stability of the union. The new UK Government's stated commitment to a commission in Wales along similar lines to the Calman Commission in Scotland will undoubtedly reach similar conclusions to the Calman Commission (and the Holtham Commission) on Barnett and tax assignment. The commitment to a review of local government financing will also inevitably raise issues about tax assignment and the Barnett Formula based funding to DAs since DAs are a primary funder of LG in their regions. Inevitably, any push for tax reassignment or further expenditure devolution in the UK must bring into question the future of the Barnett Formula and to its replacement.

5. OVERVIEW OF LESSONS FROM AUSTRALIA ON THE WAY FORWARD ON TAX AND IGT IN A FISCAL CRISIS

For the UK, its current difficult budgetary circumstances pose a number of critical questions about the future of devolution in the UK, let alone any push for further devolution as sought by the new UK Government. Of particular concern is that any push for further devolution will be resisted if this involves DAs assuming greater expenditure responsibility in an environment of unfair grant distribution and inadequate access to broad own-tax bases.

In its 2010 Manifesto, the UK Conservative Government proposed that over the next four years⁴⁷:

We will make politics more local, more transparent and more accountable. We intend to build a new political system that serves people rather than politicians. Together, we can change our politics for the better.

Rhetoric in recent months has given way to reality and this has major implications for any broad push for greater devolution in the UK. In particular, key elements warranting reform such as the Barnett Formula have been delayed. The risk to DAs is that if there is no upside to any push for devolution, their resistance or unwillingness to cooperate will be met with coercion. However, such an approach will do nothing to further devolution in the UK. Rather, what is needed is a more open and consultative approach to government where issues such as tax and expenditure reassignment and intergovernmental transfers are a focus of public debate and openness by institutions such as HM Treasury.

While Australia has a history of openness and consultation around intergovernmental arrangements, the UK has no such background. The promised reviews into Wales (similar to the Calman Commission), into local government financing and into the 'West Lothian Question' would all greatly benefit from a decision to develop a framework for facilitating improved intergovernmental consultations across the

⁴⁷ See p63 of <<http://www.conservatives.com/Policy/Manifesto.aspx>> or in particular, <http://media.conservatives.s3.amazonaws.com/manifesto/cpmanifesto2010_lowres.pdf> . The UK Conservative –Liberal Coalition agreement which outlines the shared agreed position on devolution is accessible from <<http://www.conservatives.com/~media/Files/Downloadable%20Files/agreement.ashx?dl=true>>

nations in the UK. The above discussion has shown that the UK could benefit greatly from Australia's experience with its COAG consultative framework and the important role the CGC has fulfilled in advising the Australian Treasurer on general grant allocation amongst States.

The risk for the UK Government is that in pushing for further devolution in an environment of reduced DA funding, that the union will be left to fracture along regional lines – a fact already evident in the Holtham Commission implied reference to the Barnett Formula disadvantaging Wales against Scotland⁴⁸.

In summary, Australia's experience would suggest the following four step approach to furthering devolution in the UK during a period of budgetary crisis:

- (S1) Develop a *COAG-type* consultative and performance monitoring framework for DAs and England (Figure 2);
- (S2) Develop a *CGC-type* independent statutory authority to advise the UK Chancellor of the Exchequer on per capita relativities to apply when allocating grants between DAs and England (Figures 6 and 7);
- (S3) Undertake a review of tax and expenditure assignment by level of government underpinned by a recognition that the role and functions of DAs and LG are inextricably linked; and
- (S4) Make provision for the regular review of the arrangements in (S1), (S2) and (S3).

The consultative framework (S1) is critical to the success of devolution and requires from the UK Government (and HM Treasury), a far more open and consultative approach than is currently evident. Here, issues such as whether DAs should confront hard or soft budget constraints, the design of general and specific grants along with all related intergovernmental agreements would all be determined along with advance knowledge of the level of annual grant funding. The framework does not need to be formal. In Australia's case, the COAG framework is not constituted as a result of legislation but has proven flexible enough to be able to respond to the widely varying and ever changing demands placed on the federation.

Through (S2) DA and LG would have a direct input into how fiscal equalisation principles are applied in practice in the UK and be able to air any concerns they might have about the equity or efficiency impact of grant arrangements. By only having an advisory role, the UK government can still act to ensure any allocation accords with its priorities and principles or outcomes agreed separately through (S1). Where advice is overridden on relativities, the reasons why would need to be made open and explicit.

With (S3), a successful outcome here is conditional on successfully implementing (S1) and (S2). Ultimately, process is everything in implementing and managing change and without the necessary framework capable of managing the process of change (resulting from (S1)), the ideas and recommendations in (S3) will be of little consequence.

⁴⁸ See footnote 6.

Since no system can be designed without the need for constant refinement, (S4) highlights the importance of constant review. In the case of (S1), a flexible arrangement permits its constant review and updating. In relation to (S2), the Holtham Commission (2010) proposed that the revised Barnett Formula (Figure 5) be reviewed each decade. Australia reviews its CGC arrangements every 5 to 10 years. In the case of tax and expenditure reform, Australia has routinely reviewed key aspects of its tax system every 7-10 years.

Over the coming decade, the nations in the UK union will confront a continuing budgetary crisis. In such an environment, any deficiencies in current arrangements will become potentially the source of failure and division within the union. The danger for the UK Government is that as it moves to greater devolution accompanied by tax reassignment and expenditure devolution (S3) during a period of budgetary crisis, that the weaknesses in the current intergovernmental arrangements (S2) will become exacerbated. Open and transparent government based on an informed and consultative decision making approach (S1) will do much to reduce policy-on-the-run and lack of broad support so often a characteristic of crisis policy making.

What the discussion in this paper has highlighted is that any move to further devolution and tax assignment in the UK, especially in an environment characterised by substantial budget deficits, will invariably force necessary institutional change. However, institutional change is typically slow to occur especially where change brings with it reduced influence by key participants (such as the UK Government and especially HM Treasury). What is different though about 2010 is that the UK government has committed to addressing its budgetary crisis and furthering devolution while the devolved governments are demanding a restoration of needs-based grant funding and the assignment of taxing powers. Resolving these potentially conflicting demands would be greatly facilitated through an open and consultative process on engagement by nations in the UK union. Here, the UK has much to benefit from building on the approach taken in the Australian federation (S1, S2, S3 and S4) to managing competing interests and demands across federation members during periods of major change. Change without attention to process and pathway risks divisiveness (and failure) at worst and delayed implementation at best. The UK does not have the luxury of time and the current crisis is the perfect environment in which to implement reforms which require major institutional change.

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