

CONSTITUTIONAL ASSEMBLY

THEME COMMITTEE 3

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CHAIRPERSON: ... Deputy Chairperson of the Constitutional Assembly - just to open and welcome our foreign guests that are here today on behalf of the Constitutional assembly - Mr Wessels.

MR WESSELS: Thank you very much Madam Chair. It is wonderful to be with you this afternoon. I would, in particular, like to come and thank the participants from abroad who are here to enlighten us about their experiences and share with us some of the knowledge they have gained over the time. 10
It is really, when one looks at the list of the discussants, some of them are known to us and we have met on other shores before. I think we are really privileged to have them with us today.

May I say how pleased we are for the time you have spared to be with us. We trust that you will enjoy this afternoon as well as the interaction with the members of this Theme Committee. May I just say that when one looks at the Constitution making process - one may 20
conclude that we are moving at a snails pace or one may conclude that some other exercises we are involved in are

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not really worth our while, but when one looks at a programme such as this one we are having this afternoon, one cannot but come to the conclusion that this is a wonderful opportunity for all of us to be involved in building our new Constitution.

Without any further ado, I would also like to welcome the members of the financial and fiscal commission here this afternoon and trust that they will also be able to share some of their experience with the Theme Committee. 10
Once again to all of you attending.

CHAIRPERSON: Thank you Mr Wessels. We call on our first speaker on a framework for financial and fiscal relations and their Canadian experience, Dr A W Johnson. Over to you.

DR JOHNSON: Thank you Madam Chair. Honourable Members. Honourable Senators and professional Colleagues from other Countries. I welcome and I am honoured by this opportunity to review with you the Canadian experience 20
and the field of national provincial and fiscal arrangements and to compare them with the emerging fiscal

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arrangements in South Africa. I am fully convinced from my two years in South Africa that comparisons between Canadian and South African experiences. In this area, as in other areas of Governments are a great benefit to both of our Countries.

What I will try to do today is to describe Canada's experience in tax sharing between National and Provincial Governments in the equalisation of fiscal capacity and in conditional and unconditional grants to the provinces and 10 in doing so, to try and compare our arrangements with those that are contemplated in Section 155 of South Africa's interim Constitution.

I think I distinguished when I spoke here two weeks ago between two families of Constitutions of 2 tier or federal states. The divided responsibility model under which the legislative competencies and financial powers divided up between the National and the Provincial Governments. And the shared responsibility model under which the 20 legislative competencies and the financial capacities are shared between the two orders of Government. I shall

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continue with this theme as we talk about the National and Provincial fiscal arrangement showing in one column and I think you may have copies of this. If not, you will shortly, I believe.

Essentially two columns comparing our two situations. Let me start with the revenue for major tax fields. In Canada the Provinces are given the same access to personal income tax, Corporate income tax, VAT, excise taxes as the National Government enjoys. The only exception 10 custom duties and other taxes that reach beyond the Provinces boundaries. This approach - the access to taxes approach which is distinguished from the sharing of tax fields approach. In our system the tax shares of the National and Provincial Governments -the tax shares are the products of the autonomous decisions of National and Provincial Governments concerning the level of their respective taxes. The tax shares are derivatives.

Now this approach, of course gives to the Provinces a 20 great deal of autonomy - both in the levying of taxes and

in the allocation of those revenues among competing expenditure programmes. But two problems arise.

Firstly, the per capita revenue tax shields vary widely as between the rich provinces and the poor provinces. And the questions is how to achieve equity in the division of tax revenues under this access tax fields approach. Canada has the developed an equalisation formula to achieve this goal and I am going to describe it later.

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The second problem that arises here and every province has access to every tax field is how to avoid the development of a tax jungle - different tax laws in all of the Provinces. Canada's approach to this problem has been to develop tax collection agreements under which the National Government will collect the provincial taxes on their behalf at provincial tax rates providing that provincial tax laws are substantial identical with the National Laws. Now we have not been uniformly successful.

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9 out of 10 provinces have tax collection agreements in the personal income tax field - 7 out of 10 have

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agreements for Corporate Income Tax collection and only one province has entered into a tax collection agreement in respect of the recently introduced VAT. The Canadian system might take on a little bit more meaning if I were to give you some number. On the question of the proportion of total revenues collected by the National Government as opposed to the Provincial and local Governments. 45% of the total is collected by the National Government and 55% by the Provincial and local Government. Unfortunately, I do not have a breakup of the local Governments and 10 Provincial separately.

Our statistic agency adds them together and it is along way between here and Ottawa to give a breakdown. 45/55. If you take into account only the taxes mentioned in Section 155, personal income tax, VAT and Sales Taxes plus fuel levies. The proportion of such taxes collected by the National Government in Canada is 55.5% and by the Provincial Governments 45.5 - 44.5%. It may be interesting to know to what proportion of Provincial 20 Revenues is made up of taxes and levies and what proportion is made up of grants from the National

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Government including equalisation payments. These percentages are about 80% from taxes and levies and 20% from fiscal transfers.

If you include cash and tax transfers. If you eliminate tax transfers, its closer to 50%, but this is a rough and ready figure. If you ask me to explain what tax transfers are. I will have to spend the rest of the afternoon. It is kind of boring stuff. Why we ever did it I am not really sure, but in any private conversation we might have, I will be happy 10 to try and explain that.

Now going to the South African's Interim Constitution. Of cause, you know this all better than I, but just to rush through it. The National Government would under section 155 impose all of the major taxes and then divide the Revenues. Firstly between the National and Provincial Governments and secondly among the Provincial Governments, the later to be equitably. The equitable share of Revenue wil consist of a percentage of each of 20 the individual income tax, VAT and the sales taxes and the National fuel levy.

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It will also consist of an equitable division of any conditional or unconditional grants paid by the National Government and I will deal with all of those categories later. Now, this Constitutional provision. Your provision as it stands, gives the National Government very substantial powers. And results in less autonomy for Provincial Governments relative to our divided responsibility model.

However, the Provinces are given certain protection in the 10
Constitution in a number of ways against Arbitrary action on the part of the National Government. There is a Constitutional injunction that the tax shares and any conditional or unconditional grants will be equitable. The National Government must receive and listen to the advice of an independent fiscal and financial commission here represented. National Government must receive the tax shares must be paid to the Provinces without any deduction there from and the Senate may veto any fiscal or financial legislation which affects the Provinces. Thus 20
giving to the productivity of the Provinces more power, but

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obviously without increasing the powers of individual provincial or Provinces or Provincial Governments.

Well, clearly one of the major fiscal decisions to be taken in South African pursuant to Section 155 would be what share of the big three taxes which I will call PIT, VAT and fuel revenue for short. What percentage should go to the Province and what should be retained by the National Government. Obviously, that decision has not been taken yet, but to get some feel for the importance of this 10 decision, however, I wanted to this myself to get some feel for it, so I hope you will forgive me venturing into this. You need to look into a couple of hypothesis.

For example, if Provincial share of the proceeds of the big three taxes were 40%, the Provincial revenues from such taxes would amount to about 35.5 Billion Rands, which is 52.5% of estimated provincial revenues for this year. Those revenues amounting to R66 Billion from National Government transfers and R3.5 Billion approximately from 20 revenues. Obviously, if the Provincial share were 50% and the Provincial Revenues from the Big Three would be

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larger 45.5 Billion roughly or 65 or 66% of the Provincial Revenues for the current year.

And the next major fiscal decision. Is how the Provincial share of the big three taxes should be divided up and that is what I deal with in the next section which I am describing as equalisation of Provincial Revenues. This being the major unconditional grant in Canada. Well, in our system, the equalisation formula provides that the per capita tax fields in every Province from every provincial revenue source at National average provincial tax rates - the actual Provincial tax rates averaged out, the per capita tax fields in every Province will be brought up to the National average tax fields again at Provincial tax rates and this is achieved through the payment of equalisation grants to make up the difference between the per capital yields in the poorer provinces and the National average per capita tax yields in the - across the Country as a whole and by the way we have the national tax yields as given way to something we call the National Standard, but it is more convenient to think and talk in terms of the National average.

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Well, on page 5 I give you a detailed breakdown as to how these calculations are made. I won't read it. You have the document now or if you don't you will have it shortly. If there are questions, I will be happy to try and answer them, but the essence then is that every Province is entitled to have at least the national average per capital revenue from provincial revenue sources.

This principle is now held so strongly and uniformly across Canada, that it has been enshrined in the Canada's 10 Constitution and I have quoted from the Constitution in that paragraph of my text. It is important to note, however, that Canada is equalising the fiscal capacity of the Province. The Revenue collection capacity of the Provinces. We are not equalising on the basis of expenditure needs. For example the disproportionate costs of providing adequate services in the most severely disadvantaged provinces. That is the Canadian approach.

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If one looks at Section 155, comparisons being, I think, instructive and useful. One recognises that after having

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decided on the aggregate Provincial share from the big three taxes and then the next decision is the distribution of the Provincial among the Provinces taking into account the Constitutional requirements that the sharing must be equitable. Now, clearly this decision has yet to be taken as well.

But to understand what is involved, I found it helpful, again to pursue and look at a couple of hypotheses. If the Provincial share of the big three taxes were divided among 10 the provinces on an equal per capita basis. Then every Province automatically would be receiving the National average per capital yield which would be similar to the Canadian approach, but obviously very much simpler. They would be limited to three tax fields.

If this approach would be used in South Africa, the Revenue equalisation as we know it as a separate entity would be built into the Provincial shares of the Revenues concerned and follows that in those Provincial shares the 20 numbers of which I gave under the 2 hypotheses would include equalisation. It would be the tax return and the

equalisation. But the next question to be posed would be this one. Would the Provinces in which the per capita yield was greater than the National average per capita yield. Notably in Gauteng and Western Cape and possibly marginally in the Northern Cape. Would they be given or retain the excess as it is the situation in Canada or would the difference be retained by the National Government for other purposes such as for example equalisation on the basis of expenditure needs.

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Well, another - this raises what I say another fiscal issue which of course is whether your equalisation regime will come to include some equalisation of expenditure need as well as equalisation of expenditure capacity. And I have said that we in Canada have not gone into that, we have discussed it a great deal, but to put it very briefly and bluntly. When I was involved in the development of this equalisation formula delivery.

We do have! We had to face up to the question as to 20 whether the provinces would welcome a National Government finding out, measuring expenditure needs in

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individual provinces and in the Country and decentralised in Canada. Our mutual conclusion was no - the Provinces would not welcome the National Government in doing that, but we are still discussing it and I phoned the Department of Finance and they said "yes" we are still discussing it. That's, oh dear, its 30 years ago, and we are still discussing it.

Well, let me shift to Provinces own tax fields. I told you that the Provinces that are free to impose any tax that they 10 want at whatever rates they want, so long as they don't levy duties between the Provinces or between Canada and other Countries and I didn't put in my tax, so long as I they don't offend the tax payers too much.

On your side, the Provincial legislature may - may raise taxes, levies, duties under Section 155. Other than the major taxes above, where it is authorised to do so by an Act of Parliament passed after recommendations of the fiscal and financial Commission have been submitted to be 20 considered by Parliament. The Province provincial

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legislature may also impose surcharges on taxes subject to the same provisions.

The Provinces have exclusive competence to impose taxes and levies and duties on Casinos, Lotteries and Betting. Provincial legislature may impose user chargers for having received advice from the Fiscal and Financial Commission regarding the criteria upon which those charges would be based. Provinces are entitled to receive any Nationally collected duty on the transfer or sale of property situated 10 within their boundaries, but you will know all this.

It is in Section 155 of your Interim Constitution. I estimated it or it is estimated that the total of the above Revenue sources not including surtaxes would be around some R3.5 to R4 Billion again out of total Provincial Revenues of R69,5 Billion taking this years taking the estimated revenues for 1995/1995 - 1995/1996. Now let me shift to unconditional grants. Beyond the equalisation that I have been talking about.

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In Canada Parliament may pay unconditional Provinces - may pay grants to the Provinces and Provincial Government. I was DG for Finance last time in the Province, Saskatchewan for 12 years. We never objected to any amount of unconditional grants. But in Canada the other unconditional grants other than the equalisation one are called "block grants". These were really formally conditional grants, but the conditions have been drops, but the grants go on being paid and once again that is going to sound like an acronym to you and it sounds like 10 an acronym to me too. But, there is it.

I guess we all have acronyms. Under your interim Constitution the National Government of South Africa may also pay unconditional grants to the provinces and beyond the equalisation of Revenues, as I have said, I am sure one of the questions that will be debated is the whole question of equalisation on the basis of expenditure needs. Now conditional grants. In Canada. By Constitutional interpretation. Canada may pay conditional 20 grants to the Provinces. Sharing the costs of Provincial Programmes where the National Government sets certain

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national standard or norms and principles and which the provinces agree to by accepting the National Government conditional ground.

I might just add that it is worth noting that Canada does not have a Senate that represents Provincial interests which means there is no institutional within the National Government or Parliament so which Provincial influence or power may be brought to on the National Government in respect of its use of conditional grounds. In South Africa's 10 interim Constitution conditional grants are explicitly provided for. They must be equatable. They are based on certain criteria provided for in the Constitution and I won't read Section 155 further than I have. I have cited it here from my own advantage. While the important fiscal questions was to be asked obviously is whether conditional grants might be used to partially recompense the provinces for the higher costs of those programmes - they are associated with the establishment of the National Government of National norms or standards. So you have 20 under your interim Constitution the power - the National has the power to legislate norms and standards or to

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make conditional grants whereas in our case in Canada we may only establish norms and standards through the use of what we call our spending power.

So the National Government is more limited that it is here. In South Africa as well they say you have a Senate veto is available to Representatives of the Provinces in that body.

Let me look for a moment, if I may at the place of conditional and unconditional grants in National budgets.

To lend a quality of reality to this discussion of conditional 10
and unconditional grants in Canada beyond Revenue equalisation.

It may be useful to look at some numbers again. There are two major conditional grant programmes in Canada - now called blocked grants, but still subject to national criteria. The first is a University Health Insurance Plan - a Universal Health insurance Plan - legislated and administered by the Province, but subject to five nationally established criteria. The plans must be universal, they 20
must be comprehensive, they must provide for accessibility -they must be publically administered and so

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on. The National Government provides a significant proportion of the total costs amounting to some 15 Billion Dollars or about 35% of all of the National Governments fiscal transfers.

The other major conditional grant is the Canada assistance plan - its a social assistance plan which again involves provincially administered programmes, but which after this year's Canadian budget which are subject - seem to be subject to one National criteria or condition. There is an 10 argument going on in Canada now as to what happened to the conditions under the former arrangements. Well, the national contribution to this programme is in the neighbourhood of 8 Billion or 19% of the total fiscal transfers.

On the South African side of the legislature. One cannot predict of course when conditional or unconditional grants will come into existence in your Country, but it is possible to predict the kinds that may be considered and there is 20 nothing original about this. This is fairly universal. I have already spoken about the different kinds when I talked

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about the possibility of equalisation of the use of expenditure need and the possibility of partially recompensing provinces for those programmes in respect of which there is or are National standards which increase the costs.

I tried to get some sense of the fiscal room for such conditional or unconditional grants. As I did in Canada, in the Canadian situation. Your Provincial Revenues for the current year are estimated at R69,5 Billion with the 10 amounts from the National Government being shown at R66 Billion and the balance from own revenues. If Section 155 were being followed, I say here under potential Section 155 arrangements.

If for example, again hypothesis, the provinces were entitled to an equalised share of taxes at the level of 40% of the big three taxes. That would provide to the provinces R36,5 Billion. Own Revenues - R3.5 Million and that would leave, if the total budget is R69,5 that would 20 leave available for conditional grants or other unconditional grants R29.5 roughly, but obviously if

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equalised taxes were larger, then the amount available for further conditional or unconditional grants would be smaller. I know here that in bold face type these numbers are by no means meant to be indicative or prescriptives.

They are meant simply to indicate the range and the scale of the issues that have to be that will be considered here as we have considered them in Canada. In South Africa, when Section 155 provisions are converted into operating 10 fiscal arrangements. If Section 155 survives in its present form, the Provinces would be constrained in their allocation of expenditures, by the proportion of those expenditures devoted to programmes that are effective by National norms or standards. What we always call conditional grants because that is the only way we can do it.

Under the alternative hypotheses spelled out earlier. The maximum amount available for conditional or unconditional 20 grants are shown here and a 40% share - R29,5 Billion or 42% of the Provincial budget at a 50% share - R20,3 or

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29% per provincial budget. The generalisation really is clear. The larger the Provincial tax share is in Canada or in any multi tier Country. The larger the Provincial tax share is, and the larger the Provincial Governments own revenues are and the larger the unconditional grants are e.g. equalisation.

Then the greater discretion - some would call it autonomy. The greater discretion the Provincial government legislatures have in allocating funds in accordance with 10 their own priorities and needs. And then I give some figures here derived from the analysis that I have been pursuing under the hypotheses that we have discussed. And I shall not read those figures to you having advanced the generalisation which I think is the important thing, but it is important to remember to bear in mind particularly if you are working in a Department of Finance that the more you go in one direction - the one I have mentioned larger tax shares etc, the larger the area of expenditure allocation is within your exclusive power. And the more you go in 20 the other direction the smaller is the proportion of the total

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budget that can be allocated by the Legislative Assembly according to the priorities that they decide to pursue.

This then brings me to the end of my presentation. It has been pretty dense. I know. I apologise for that, but I am afraid that it pretty much in the nature of fiscal arrangements. They always seem to be complicated and I don't envy the task of the Financial Commission. But my hope is that out of what I have said, the - principles of the central issues have become clear. Simply stated in my 10 view and one is talking the shared responsibility family of Constitutions as opposed to ours in Canada or Section 155 at it stands.

Following other principle issues to be decided. The decision as to Provincial shares to be designated national tax the decision as to the Revenue that will be assigned exclusively to the Provinces, the decision as to how the Provincial share of such taxes will be divided between the Provinces and whether that division of taxes will be 20 equalised or not.

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Then the decision of the scale of the fiscal transfers of the Provinces, which I hope I have been clear about -enough about in my exposition which is dependant on your first two decisions - your tax share and your equalisation of fiscal capacity and finally as to how other fiscal transfers is to be divided as between one the one hand unconditional grants e.g expenditure need equalisation or conditional grants as a means of compensating Provinces for costs they have occurred in meeting national norms and standards and other example. Well, I thank you again 10 for the great privilege of meeting with you and if there are any questions that I can answer I will be very happy to try. Thank you Madam Chair.

CHAIRPERSON:

Thank you Dr Johnson. I will now open the floor for questions and clarity. We will take two or three questions at a time and then ask Dr Johnson to respond. Professor Davis.

PROF. DAVIS:

Thank you Chairperson. My question is that I think Dr 20 Johnson has given us a clear division as between divided responsibility and shared responsibility model. But I think

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most of his remarks at the end were really about what needs to be taken into account about shared responsibility models. I think there is also another area which is obviously of concern to us. I mean what would be the consequences, advantages and disadvantages of moving more of the divided responsibility direction and I am particularly interested in such things as - given that there are powers to levy different - I mean to levy a wide range of differences in both National and Provincial level.

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Do you actually find in practise in Canada that there are fairly significant variations in rates of interest, VAT and so on and so forth. What does this imply in terms of economic activity in Canada. The other thing is that I think I understand that there is quite a strong powers of the Provinces to raise loans on their own account and I am wondering what effect this is having on the overall fiscal state of Canada in recent years.

CHAIRPERSON:

Thank you Dr Davis. Any further questions. Deputy 20
Minister.

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DEPUTY MINISTER: Dr Johnson, could you give some incite in to how the budgets would be prepared between the Provinces and the National where you have here quite a high degree of discretion or autonomy whatever one would like to refer it as in the Provinces. Is there a common process with timing around the budgets and which very much links to the previous question as to what extent lending would be co-ordinated in the preparation of the budgets.

UNKNOWN: I wonder whether you could - brief us as to - what impact 10
did the Quebec decision to succeed or whatever from the greater Canada have on the financial arrangements and the cutting of the cake within current arrangement that would be very interesting to hear.

CHAIRPERSON: Dr Johnson, can you respond.

DR JOHNSON: Yes Madam Chair. The consequences of the divided responsibility model. Yes, the tax rate vary quite substantially between Provinces. The poorer Provinces 20
tend to have higher tax rates than the richer provinces, but the incentive for the smaller Provinces and the poorer

Provinces to raise their tax rates is relatively lower than in the richer Provinces.

Why, for the fairly obvious reason that you are guaranteed the National average no matter what your tax rates are you are guaranteed the National average in our equalisation formula. OK. So you can raise some extra money for your own purposes if you raise your tax rates, but you know if you (inaudible) ... of land that you are not going to get a lot of it per capita because your people are poor and 10 therefore you find a certain limit - a natural limit among the poorer Provinces in the imposition of additional taxes rates.

In the richer Provinces. Yes. They may raise their taxes. I think it depends a good deal on to be frank about it, the Political faction of the Government and obviously on its views concerning fiscal responsibility taxes versus expenditure reduction. So there are variation in tax rates. Impact on economic activity. I guess one always has to 20 talk about the margins. I think that the margin, the impact on economic activity as between Provinces is fairly

substantial. Why. Because obviously the Provinces are competing for the investment dollars and indeed you will find the Provinces of Canada competing with incentives.

Financial and other incentives, but certainly the corporate income tax levels are affected by this consideration, but in the aggregate, I cannot really say what the impact on economic activity has been. Except to make a very obvious comment. Is that, yes, if the National Provinces of the Government enter into competition and drive the 10 Corporation income tax too high relative to that massive neighbour we have to the South of us. That is an abiding restraint and problem for Canadians, is having this huge country - rich Country right next door to you.

But individual income tax. How can you tell. I think the marginal rates have gone up to the point where - yes there is some impact. Some brain drain, but we do not have any veto on it. The marginal rates that I think, for example, in the Province of Ontario is that I think Keith 20 57%. That is a pretty high rate and there is another province where it is 60% top marginal rate. Raising loans

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on own account. We, in the Provinces. I speak as if I were still working for Provincial Government. We in the provinces have complete freedom to borrow as much as we want whenever we want. And there is no co-ordination, no formal co-ordination and indeed when I was Director General of Finance in Saskatchewan informal co-ordination between the National and Provincial Governments - none at all.

The only constraint was the internal constraint. A. The 10
internal constraint - what's happening to your death charges. You can end up wasting all your money paying interest instead of paying building houses and having a decent educational system. And that is a constraint that any far-sighted Politician is going to observe. And then there is another constraint that is externally imposed.

And that is your bond rating from Moodies and Standard and Poors in New York and we now have a bond rating Agency in Canada as well. And if your debt is rising or if 20
the mix of borrowing as opposed to taxing and spending less is judged by these bond raters as being hazardous to

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the investor down goes your rating and up go your interest rates, so their are disciplines.

Which brings one to the question, of course of how are budges prepared in Canada. Well, they are prepared - on the face of it they are prepared autonomously.

It is true that starting in 1965 we began having annual meetings with the Minister of Finance and the Provincial Ministers and National Minister of Finance and the 10 Provincial Minister of Finance as long as I was attending those meetings - I haven't attended them for quite a while. I would say they had a mild influence on the fiscal decisions taken by the two orders of Government and by the Provincial Government, but - I think the influence was not all that significant until all of the Governments got themselves into the kind of fiscal mess they are in.

I mean - as a loyal Canadian I shouldn't use those words. But our deficits are too bit and our debts are too big and that applies Nationally and it applies Provincially and so 20 there is a mutual discipline that is felt by the Ministers of Finance and what goes on behind closed doors, of

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course, we Citizens do not know, but having been in the public services for along time in Canada, I would think that the informal the affect of the informal and un - non -public discussion is increasing, but the other side of the Coin is that you respond to your Political Constituency and you respond to the external financial constraints.

And the Provinces do not necessarily act according to a Plan or putting it rather more briefly, there is no national plan and there is no national co-ordination of lending. 10
Informal, I don't have any doubt, - but it, it is a divided responsibility model.

What can I say. There are hazards like the ones I described. If I am being too negative on Canada, somebody correct me. Quebec and the Secession debate. I don't have. There is no doubt in my mind that secession debate is having a negative economic impact on Canada. None at all.

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It may be as a matter of interest, I can say a little bit about this. I said something at lunch just very briefly. The

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debate is going on. The debate of Nationalism in Quebec. The Nationalist in Quebec have been active since before I could read. Starting in 1919. It's a long long story.

The notion of separatism, however, has a short history. We are going through another round of debates. It seems that the proportion of people in Quebec who would vote for strict - more likely it will - it would be a closer vote, but the impact economically, I think is serious and I am not just speaking personally. I have tried to keep up with the 10 debate on the financial - the judgement of the Financial Institution. And it will - and the impact increases as we seem to be getting more towards the positive vote - positive to for the (inaudible) ... but it is there.

CHAIRPERSON: Thank you Dr Johnson. Dr Jacobs and Mr Ken Andrew.

DR JACOBS: I conclude from what Dr Johnson has said that there is no question of the central government providing any security for the loans of Provinces. Now, what I would like to know 20 is this. When Provinces do decide to take up loans. Are there any guidelines laid down. I mean you have mentioned a few things which seem to be very very informal indeed. Are there any guidelines laid down by Central Authorities or some banking institution to indicate

between what parameters Provinces can operate to raise these loans.

MR JOHNSON:

No, there are no final guidelines. The National Government does not establish any formal guidelines. I don't want to leave the impression that the National Government - the Governor of the Bank of Canada don't exert pressure on the Provinces, quietly, privately, yes, they do, I can remember when the DG of Finances in Saskatchewan way, should I tell you how old I am.

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When the Governor of the Bank called me in and said - do you realise what you are doing Al Johnson when you borrow by Saskatchewan Savings Bonds and by Short term money instruments. You are defeating my purpose - my purpose is to control the supply of money and you are increasing the velocity of circulation of money.

And I said. That is exactly why I am doing it. Because you won't increase the money supply and this the only way I can get around you. But, yes, some pressure put on here and there, but no National co-ordinating body or Agency.

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DR JACOBS:

Thank you. Could I just follow up on that - arising from what you have said now. So is the major pressure put on the Provinces from the point of view of the growth of the money supply and the deficit.

MR JOHNSON:

I would say that the number 1 now is the size of the deficit and the size of the debt and number 2 the interest rate. And that becomes very much - the larger your debt, obviously the more the larger the marginal impact of a slight rise or a large rise in interest rates and certainly the omnipresent concern about the Bond rating agency because not only does that raise your interest rate but it raises in the question of your electorate - it raises in the minds of the electorate? The question is whether they have got a very sane Government.

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CHAIRPERSON:

Thank you. Mr Andrew, but before I give you an opportunity I would just like to welcome Dr Ranshot, the Deputy Speaker of the National Assembly. You are most welcome. Mr Andrew.

MR ANDREW:

Thank you Madam Chair. Dr Johnson, may I ask you, it obviously does not fall under the title of your talk directly.

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Local Government. Are there any specific and in particular in your Constitution. Are there any specific arrangements between National and Local or Provincial and Local Governments in terms of fiscal financial relations and if you can also just tell us a little about local Government financing. Both in terms of Constitutional

terms and the second part in de facto. What actually happens.

MR JOHNSON:

The only provision concerning local government in the Constitution is that it is - is the Declaration that Local Government is the exclusive responsibility of the Provinces. There is no Section or Chapter as there is in the interim Constitution in South Africa concerning local governments.

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The National Government has from time to time become involved with programmes that affect local governments for example, we have a mortgage lending a guaranteed national mortgages - a mortgage system. We still have that, have we not Kieth.

But a straightforward answer to your question concerning local governments is - Al Johnson does not know a lot about local governments, so he had better be careful. There is now doubt, however, that the Provincial 20 Governments have a concern about the level of borrowing of local governments, but I am afraid that I am not well enough informed to enlighten you beyond that.

CHAIRPERSON:

Any further questions? I just want to announce that the television crew here wants to just make an advertisement for about five minutes. So while we are waiting for our

next speaker to come on, we will allow the CA crew to just finish their business.

UNKNOWN: What is the product being advertised Madam Chair?

MR WESSELS: Ladies and Gentlemen. I would just like to not interrupt proceedings, but would just like to thank Dr Johnson. He has to catch a plane. He is leaving for Canada at 5.30 this afternoon and I would really like to thank him for his presence and his contribution. I am sure that you are - we 10
will all remember you and your inputs when we start finalising our Constitution. Thank you very much Al.

MEETING INTERRUPTED

ON RESUMPTION:

MR MEYERFELDER: Excuse me. If I could just have your attention please. We are doing a small little commercial for the Constitutional Assembly and we need to indulge your time a bit if you 20
would not mind. We have got some letters and we have got some images being sent from the Public to the CA we need to cheat a sequence where we see folks in Parliament discussing and maybe arguing and showing some interest in the submissions submitted by the General Public. We will try not to be long - we will be brief, so if you could just bear with us for five minutes. Thank you.

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CHAIRPERSON: ... (inaudible) Germany, who will deal with the topic of expenditure functions and revenue powers of a Germanlander. Over to you Sir.

UNKNOWN: Ladies and Gentlemen, Chairman, I am very glad to be here. I thank you very much for inviting and I thank you for the words of welcome. Some words of introducing. My English is not the best and my pronunciation is also not the best, my teacher said it always.

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The reason is that I live in the Southern part of Germany. And the Southern part after Second World War was - French occupation and then we first had to learn French and secondly English. Therefore, excuse my English. But I have on my side a very good translator. He is excellent. He is the Ambassador of Germany and if you have questions after my speech, he will translate it for me so that I can give satisfying answers.

And another word I am for the first time in South Africa - 20
I am here as functionary of Sport - I had a meeting with SAFA - Vice President of the Football Association - we had a match against South Africa and Germany I hope we can arrange it and will be here for the second time because it such a nice Country. Thank you.

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You have invited me to say something about financial structure in Germany. Germany is a Federal Republic. It has been a Federal Republic before the reunification and also a Federal Republic after reunification. Before the reunification we had 11 Provinces named in Germany - Lander. And after reunification, we have 16 Provinces - 16 Lander among them are very weak Provinces and very rich Provinces and therefore we have a structure similar to here where you also have weak Provinces and rich Provinces.

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The German Public finance system reflects the fact that under the thumbs of its basic law the Constitution - Germany is a Country with a Federal Structure. This means that individual Federal States have equal rights with a Federal Government - its a Central state. In implementing the powers and responsibilities granted to them by the Constitution for the fulfilment of public tasks.

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The central problem of any Federal Constitutional system is to achieve a clear demarkation of the duties and powers allocated to the Central Government and the Federal States respectively. In the first place, the Constitution distributes the Public tasks between the Central Government and the Federal States as the fulfilment of such tasks necessary also entails spending.

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The next question is to decide on how the burdens should be shared and how the available public resources should be redistributed. The basis principle is the fulfilment of public duties is fundamentally a matter for the Federal States except where the Constitution provides otherwise. According to the principle enshrined in the Constitution the Federal States have the rights of legislation except where the Constitution allocates such rights to the Central State. In fact, most of the legislative work is done by the Federal State because the Constitution allocates extensive 10 legislative policies.

The Parliament of the Federal states are, therefore, mostly left to legislate on those matters which are not included in Legislative Catalogue reserved for the Central State and in particular local authority and police law as well as Cultural affairs that is the main point for the lands. While Legislative competence is in fact largely in the Federal Parliament - the Federal States have priority over the Central States in the fulfilment of administrative duties. 20

A major part of State Administrative activity concerns the implementation of the Law under the system of our Constitution the Federal States are responsible for not only for implementing the State Laws but also the Federal Laws except where the Constitution provides otherwise for

example, the Foreign Office or the Federal armed forces administration.

We, therefore, speak of the Principle of executive by the states. In this respect, the Constitution answered the question as to which Government level is required to bear the cause for fulfilling the various tasks. The financial relations between the Central State and the Federal States are regulated by the so-called burden allocation principle.

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Fundamentally, the Central State and the Federal States are each separately responsible for bearing the expenditure arising in the fulfilment of their duties. In other words, financing responsibility follows administrative responsibility. Whichever Government level is responsible for performing their duty also bears the costs. Consequently, under the principle of executive by the States, the Federal States have to bear a large part of the financial burden. The Constitution allows exceptions to this principle of allocating burdens to administrative responsibility.

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The Central States bearing all or part of the cost for the task allotted to the Federal States. In cases of administration on behalf of the Federal Authorities. In the implementation of Laws in holding the payment of cash

benefits in the case of financial assistance by the Central State and in the case of joint tasks - in this case the administration on behalf of the Federal Authorities - the Federal State perform administrative tasks on behalf of the

Federal Government - the Central state pays for the material costs incurred. The administrative costs on the other hand have to be borne by the other States. Administration of this kind on behalf of the authorities only permitted in the instances provided for in the Constitution 10 for example in the fields of (inaudible) ... use for peaceful purposes, air transport, and the Administration of the Highways.

The laws involving the payment of cash benefits. These are Federal Laws which explicitly provide for payment of money to third parties. For example the housing benefit Act, for rent, subsidies, to the needy, the educational grants act for students grants and the child benefit act. A number of cash benefit laws are indeed implemented by 20 the Federal States according to the principle of executive by the States, but the spending law itself, provides for these payments to be finances wholly or partially by the Federal Government itself.

Finance assistance. By the Central State involves payment which are made to promote particularly important

investments by the Federal States and Local Authorities designed to lessen the effects of Economic recession with the help of Economic recovery programmes or to assist projects in the field of renewal improvement of local roads or expansion of publicly financed housing. In certain activities which are particularly important to the Country as a whole, the Central State may, if its financial assistance is necessary in order to fulfil the particular goal assist the Federal State in one of that State's duties by contributing to the framework planning or to the posts. Such short 10 tasks are an exception to the fundamental prohibition on mixed administration.

Examples of such activities are contributions by the Central States to the building of Universities or to the costs of improving the original economic structure. The spending on the (inaudible) ...? which the Central State and the Federal States are required to perform is mainly covered by Revenues from taxes. One of the questions in our Country with a Federal Organisations is therefore, how 20 to powers relating to tax legislation, tax yields and tax administration are allocated between the Central State and the Federal States.

The Constitution gives the Central State extensive legislative powers in the field of tax law also the approval of the Federal Council, the second Chamber of Parliament

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which represents the Federal States. I must just say one thing - we have two Chambers. The first chamber is directly elected by the people and the second chamber - the Chamber of Provinces. The members are sent by the Government of the Lander that are not elected people by the - elected members by the people. They are sent by the Government.

It is required in both cases in which the Federal States participate in tax criminals. Consequently, all the major tax laws today are Federal Laws. This comprehensive right of legislation is intended to prevent regional tax differences arising. The legislative powers of the Federal States in tax matters are restricted to certain local taxes on consumption and spending which do not yield very high returns. This (inaudible) ... which level of Government is entitled to the tax revenues. Concerning the distribution of taxes. Three main questions arise. 10

First. Which taxes or share of taxes are allocated to the Central State and Federal States respectively and so called vertical tax distribution. 20

The second question. How are revenues to which the Federal States are entitled to be divided among them so called horizontal distribution and third question should the differences in financial strength between the individual

states be adjusted and if so, how. So called horizontal financial equalisation. For each kind of tax, the Constitution regulates in (inaudible) ... the revenues sovereignty of the Central States, the Federal States and the local authorities.

In this context a distinction is made between 4 different groups of taxes. Pure Federal Taxes, pure State Taxes, joint taxes, local authority taxes. The Central State has exclusive entitlement to the Revenue from such taxes. 10 They include, for instance, custom duty, excise duties - for example tax on fuel or tobacco, insurance tax as well as tax a special solidarity levy introduced from 1995 to help finance German unification. The Constitution conclusively defines the taxes to which the Federal States have sole entitlement. They include, for example, general property tax, inheritance tax and motor (inaudible) ... real estate acquisition tax and of special importance. German beer tax.

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The characteristic of these taxes is that the respective territorial authorities are each entitled to a certain percentage of the revenues. The most important taxes which account for about three quarter of all tax income are shared by the Central State and the Federal States and to some extent also by the Local Authorities. Concerning taxes on wages and incomes, the Central States and the

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Federal States each are entitled to 42.5% of the Revenues and the Local Authorities - 50%. In the case of (inaudible) ... taxes. The Central State and the Federal State each have a share of 50%. The shares of the Central States and the Federal States from value added tax are laid down by Federal law. And so because of the importance of the Federal States this required the (inaudible) ... in the Federal Council. In this case, then, the respective shares are not specified in the Constitution.

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In the Federal Republic the (inaudible) ... system which allocates all other taxes (inaudible) ... to the Central State or the States, the revenue from Value Added Tax represents a larger flexible item, which is need to close any financial debts in the budget of the Federal Government and the States not covered from other sources. It should be noted in this context that both the Central Government and the Federal States have claimed to their necessary expenditure being covered.

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The size of these shares (inaudible) ... effectively determined the financial resources of the Central State, the Federal States is therefore a decision of crucial fiscal importance. The respective shares of the Central States or the Federal States have to be redefined if the relationship between the income and the expenditure of the Central States or the Federal States deviations

substantially from what was originally (inaudible) This (inaudible) ... and obligatory revision procedure reaches advantage to restore a balance between the respective shares. Thus from 1993 on, the Federal share was 63% - that of the States - 37%. Starting in 1995, the Federal share will forward to 56% and the States share will rise correspondingly to 44%.

The primary reason for this (inaudible) ... demands placed on the Federal States of the West Germany by the 10 inclusion of financial weak states of the former East Germany is finance equalisation arrangement of the German Federal States. This situation had not been allowed for in the former (inaudible) ... Chairman, Constitutional Law in fact only recognised only two Government levels - the Central States and the Federal States. Nevertheless, the local authorities as part of the Federal States blames the Constitutionally and protected and historically base guarantee of local staff administration. Within this framework, they enjoy financial 20 autonomy and for this reason are also taken into account as a national tax share process.

Besides, their fair share of wage and income tax - the local authorities are primarily entitled to the revenue of tax on land and buildings and local business tax. The allocation of tax revenue between the Central State on the one hand

and the Federal States together on the other, does not say anything about how the taxes to which they are entitled should be distributed amongst them.

The Constitution regulates the horizontal tax redistribution essentially (inaudible) ... to the principle of local yield. The yield from State taxes and the States share of income tax issue to that Federal State in which the taxes are collected. A different arrangement applies to Corporation tax and (inaudible) ... tax. (Inaudible) ... to the place of collection 10 would lead to intolerable divergences between the States. It would, for instance, surely be unacceptable if all the Corporation tax or the wage tax from a Company of rates flew out the Country were received only by the State in which the Company had office. Because of the importance of taxes (inaudible) ... (inaudible) ... of very considerable complexity to be made in order to meet criteria affairs.

Consequently, corporation tax goes to Federal States in 20 which a Company has operating locations and wages to the State in which the employee has his or her place of residence. A special arrangement applies to the allocation of value added tax among the Federal States because its aims at the same time to bring about financial equalisation between States which are financially strong and those which are financially weak. 75% of the States share of

value added tax revenue is allocated according to the number of inhabitation. This has equalising effect between financial strong and financially weak states because revenue from Value added tax is significantly greater in some states than other states due to the concentration of business enterprises there.

The remaining 25% of the States share of Value added tax, serves to strengthen the financial resources of the weaker states. The aim is to eliminate extreme differences in tax strengths between states. An equalisation arrangement of this kind has become highly topical again in the relationship between the old Federal States and the new financial weak ones former East Germany. In order to at least partially even out the differences in financial strengths of the Federal States which still remain under the horizontal tax distribution as described above, the Constitution shall require that financial equalisation shall be made. This is done by (inaudible) ... Federal States with above average financial strengths to make equalisation payments to those with below average strengths.

It is important to note here that this financial equalisation be based not on the complete financial requirements of a State, but on its financial strength. Equalisation is only made on the Revenue side. As far as its spending

conduct is concerned. Each State is responsible for itself. It cannot be the point of Federal Financial equalisation to burden thrifty states to be benefit of high spending lots. In addition to the equalisation payments between the States financially weak ones also receives grants from the Central State as an additional contribution to the general financial needs.

These payments are of crucial importance in particular to the new Federal States in the former East Germany. The 10
system of administrative powers in the field of tax law distinguished between Federal Revenue, authorities and State Revenue authorities. The Federal Revenue Authorities administer custom and excise duties the State Revenue Authority are the other taxes. With the administration of the taxes, the main responsibility, therefore, rests with the State Revenue Authorities. The central and the Federal States are each responsible for their own budgetary management and are completely separate from and independent of each other. This means 20
that within the framework of powers and responsibilities they each have the right to prepare and implement their own budgets. Any joint budget for the Central State and the Federal States is therefore ruled out. As already underlined at the beginning, the tensions which exists in a federally organised Country between unitaristic and

relative tendencies are reflected particularly strongly in the question of financial powers and the yield for taxation.

The financial resources available to any (inaudible) ... are one of the determining factors - in its freedom and call for action. I believe that our Constitution has resolved these tensions in an exemplary manner between the major public (inaudible) ... reform of the late 60's. Our financial system has proved itself outstandingly in practise. I would wish to give any Constitutional Assembly two important 10 pieces of advice. In organising a Country on a Federal Structure.

It is essentially to ensure that each element has comparable financial strength. In this respect, we have considerable problems in Germany. The financially powerful States side by side with extremely weak ones and for a wide variety of reasons - subsequently (inaudible) ... restructuring is virtually impossible as German experience has shown. The fundamental allocation of powers 20 particularly in respect of tax distribution should be laid down in the Constitution clearly and in detail. Obviously, while the Constitution is still being drawn up, this leads to terrible fighting over who should get what, but it subsequently avoids a newly recurring (inaudible) ... on the subject often on the basis inadequate financial planning certainty. Furthermore, such (inaudible) ... over

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the allocation of taxes can give rise to considerable tensions within a Federal Country and have potentially destabilising effect.

Naturally, as the Finance Minister of a German Federal State and the State of (inaudible) ... in the South with the capital as Stuttgart well known as the City of (inaudible) ... I would recommend you to follow our example when drawing up your Constitution. It has proved itself in practise for many - as an element of stability. (Inaudible) 10 ... a new Constitution of your Country will help you to continue successfully of the past of reconciliation between the people of South Africa which has begun so promisingly. I, therefore, wish good luck, every success and God's blessing in your most important work. Thank you very much.

CHAIRPERSON:

Thank you Mr Meyer. We now open the floor for questions and clarity. Mr Andrew.

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MR ANDREW:

Thank you very much for a second most enlightening paper. We have had two this afternoon. I think we have been very fortunate. I would just like to ask you to elaborate a little bit. When you deal with the section of financial equalisation between the States. You make the statement, for example, that this is done by acquiring Federal States with an above average Financial strength to

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make equalisation payment with those below average strength and my question is - how do you measure strengths of - for this purpose of a Federal State.

Is it the average tax revenue per capita from that state or is it the average GDP - Gross Domestic Product per capita or something. How do you measure the financial strength.

MR MEYERFELDER: May I give the answer. I give the answer in German and Ambassador (inaudible) ... will translate for us. 10

CHAIRPERSON: That is fine. Yes.

INTERPRETER INTERPRET FROM GERMAN TO ENGLISH:

MR MEYERFELDER: In Germany we have financially strong and weak Countries.

Each year, the tax potential of each Federal State is being calculated. 20

Then you take the average of all Federal States.

And this is then 100%

And then the financially stronger Federal States will have to supply the financially weak with an equalisation so that they reach 100%

And this is regulated in a Law on Financial equalisation.

This law is being passed by both houses of German Parliament.

And this means that in the second Chamber as you know, 10 the Lender is presented and their majority has to approve this Law.

And this means, again that the financially strong and financially weak lender would have to - so that there is always a satisfying solution in the end.

CHAIRPERSON:

Thank you. Any further questions. Mr Sisulu.

MR SISULU:

Thank you Madam Chair. Two questions. One is around 20 the solidarity levy that was introduced in Germany in 1995 for the purposes of supporting the reunification process. Is this a levy on individuals or is it a levy on Provinces, is it a levy on private sector. What is it based on and how is it disbursed.

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Then the second question is - following number 1 raised by Mr Ken Andrew. It is around the whole issue of tax - you know it is interesting to note that Federal States take 50% of Corporate tax and 43% of the income tax. So is there is a uniform tax. Is there (inaudible) ... between the different states. Between the weak and the poor or is it all uniform or is it varied. Does it vary from State to State.

CHAIRPERSON: Let me take one more question. Mr Andrew.

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MR MEYERFELDER: May I give the answer to the questions.

CHAIRPERSON: Okay, you can go ahead.

MR ANDREW: Mine add onto the second question.

CHAIRPERSON: You want to add on to the second question.

MR ANDREW: Whether the lender's are entitled to impose any surcharges on any of the taxes.

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MR MEYERFELDER: The first question concerning the levy for solidarity. This special tax has been introduced to view of (inaudible) ...

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The average per year is 150 Billion German Marks. This is something like R350 Billion Rands has to be transferred from West Germany to East Germany.

This is a tax levied for certain specified time frame. It will be abolished in the most 3 to 4 years.

This text actually is a surcharge of 7.5% for income tax.

For the second question. The Central Government and 10 this means as regards Parliament, the first Chamber, has the right for tax legislation and this means that taxes are uniform throughout the Country.

The Federal States are not entitled to levy any surcharge on income or corporate tax.

CHAIRPERSON:

Ms Marcus. And then Mapheripheri at the back there.

MS MARCUS:

Thanks very much. If you could just perhaps give us an 20 indication of the marginal rates of tax and secondly if you could indicate whether there are borrowing powers in the - Federal States and if there are, who is responsible when you get into difficulties.

[END OF VOLUME I]

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