View metadata, citation and similar papers at core.ac.uk
brought to you by CORE
provided by Research Papers in Economics

Research Paper No. 2005/66

Tax Reforms in Ghana

Robert Darko Osei and Peter Quartey*

December 2005

Abstract

Ghana's tax reforms constitute the major policy instrument needed to accelerate growth and poverty reduction. Over the past two decades, the government has consistently spent more revenue than it is able to generate and the gap is often financed with foreign aid which has perpetuated the country's aid dependency. Two options can be explored to reduce the gap between government revenue and expenditure; generate more revenue or reduce government expenditure. Although the latter sounds reasonable, the government needs to spend more on key sectors like education, health and infrastructure if the country is to significantly reduce poverty. The critical issue has been how to generate the needed resources domestically, using tax instruments that are least harmful to the poor. This will obviously involve reforming the tax system to ensure efficiency by widening the tax net without necessarily increasing the tax rate. This paper provides an assessment of the changing structure of the tax system in Ghana over the last two decades and suggests ways to improve tax administration in the country.

Keywords: tax reforms, poverty, Ghana

JEL classification: H2, I3

Copyright © UNU-WIDER 2005

* Institute for Statistical, Social & Economic Research, University of Ghana, emails: rdosei@yahoo.co.uk and pquartey@ug.edu.gh

This study has been prepared within the UNU-WIDER project on Tax Policy Reform in Developing Countries.

UNU-WIDER gratefully acknowledges the financial contribution to the project by the Royal Danish Ministry of Foreign Affairs, Danida.

UNU-WIDER also acknowledges the financial contributions to the research programme by the governments of Denmark (Royal Ministry of Foreign Affairs), Finland (Ministry for Foreign Affairs), Norway (Royal Ministry of Foreign Affairs), Sweden (Swedish International Development Cooperation Agency—Sida) and the United Kingdom (Department for International Development).

ISSN 1810-2611 ISBN 92-9190-754-5 (internet version)

The World Institute for Development Economics Research (WIDER) was established by the United Nations University (UNU) as its first research and training centre and started work in Helsinki, Finland in 1985. The Institute undertakes applied research and policy analysis on structural changes affecting the developing and transitional economies, provides a forum for the advocacy of policies leading to robust, equitable and environmentally sustainable growth, and promotes capacity strengthening and training in the field of economic and social policy making. Work is carried out by staff researchers and visiting scholars in Helsinki and through networks of collaborating scholars and institutions around the world.

www.wider.unu.edu *publications@wider.unu.edu*

UNU World Institute for Development Economics Research (UNU-WIDER)
Katajanokanlaituri 6 B, 00160 Helsinki, Finland

Camera-ready typescript prepared by T:mi LHR Editorial and Secretarial Assistance

The views expressed in this publication are those of the author(s). Publication does not imply endorsement by the Institute or the United Nations University, nor by the programme/project sponsors, of any of the views expressed.

1 Introduction

Ghana's tax policy constitutes one of the key instruments needed at this stage of the country's development. This is because the gap between public expenditure and domestic revenue remains large and has resulted in a high level of aid dependency. Although there have been calls for a reduction in public expenditures, this has proven to be difficult and the fact still remains that the government needs to spend more on key sectors like health, education, and infrastructure if the country is to make significant strides at sustained poverty reduction. It is therefore crucial that the government generates more tax revenue. The critical issue has been how to generate the needed resources from the domestic economy using tax instruments that are least harmful to the poor. Good tax instruments are those that widen the tax net without necessarily increasing the tax rate. This paper provides an assessment of the changing structure of the tax system in Ghana over the last two decades. Section 2 provides a discussion on the trends and changing composition of tax revenue. In section 3 some evidence of the distributional impact of taxes in Ghana is discussed. A chronology of the main tax reforms as well as the problems associated with some of these reforms is examined in section 4. The conclusions are given in section 5.

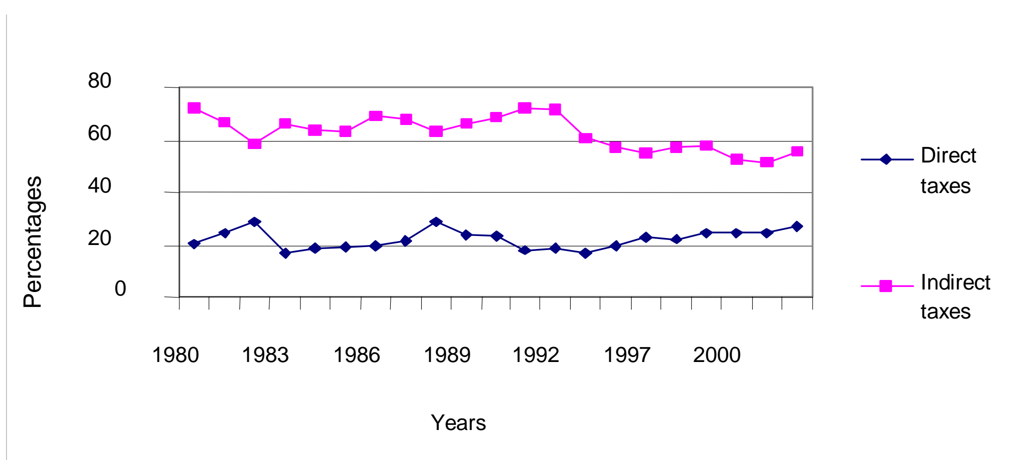
2 Tax revenue and composition

There are four main components of taxes in Ghana, namely, taxes on income and property, taxes on domestic goods and services, international trade taxes and value-added tax. The first three tax categories have been operational for a very long time but the value-added tax (VAT) was introduced initially in 1995, withdrawn and re-introduced in 1998. Prior to 1999 when VAT became operational, taxes on international trade were the major component of tax revenue in Ghana, followed by taxes on domestic goods and services and then taxes on income and property. Taxes on international trade as a proportion of total revenue averaged 38.8 per cent for the period 1980-93 and 32.1 per cent between 1996 and 1998. Meanwhile, taxes on domestic goods and services averaged 28.5 per cent and 24.4 per cent over the same period. Taxes on income and property as a proportion of total revenue were 21.3 per cent and 27.5 per cent for the periods 1980-93 and 1996-98, respectively.

There was a tax shift in 1999 and this coincided with the period when VAT became fully operational. Income and property taxes were the major source of tax revenue after 1998, accounting for 24.5 per cent of total revenue in 1999 and increasing consistently to 27.1 per cent by 2002. VAT was the second major tax component in Ghana, contributing 21.9 per cent of total revenue in 1998 and increasing steadily thereafter to 22.3 per cent of total revenue by 2002. International trade taxes, which used to be the largest major component of tax revenue ranked third in 1999 with 20.9 per cent of total revenue, declined to 17.3 per cent the year after but recovered marginally to 19.3 per cent in 2002. Similarly, the importance of taxes on goods and services decreased; these contributed 14.9 per cent of total revenue in 1999, fell to 13.1 per cent and 10.5 per cent in 2000 and 2001, respectively, but increased to 14.0 per cent in 2002.

Viewed in terms of direct and indirect taxes, indirect taxes have contributed more to tax revenue than direct taxes. Direct and indirect taxes averaged 26.1 per cent and 73.9 per

Figure 1
Direct and indirect tax revenue in Ghana, 1980-2002



Source: World Bank (2003).

cent, respectively, of total tax revenue over the period 1980-2002. Direct taxes as a per cent of total tax revenue ranged between 19.5 per cent and 33.0 per cent over the same period, while indirect taxes ranged between 66.9 per cent and 80.5 per cent. Direct taxes have increased since the introduction in 1983 of the economic recovery programme (ERP) until 1986 when their share declined to 21.9 per cent of total tax revenue. Direct taxes as a proportion of total tax revenue increased to 24.1 per cent and 31.2 per cent in 1987 and 1988, respectively. These, however, had declined thereafter to 19.5 per cent by 1991 but experienced some recovery from 1992 onward and had by 1997 reached 29.3 per cent of total tax revenue. Direct taxes as a proportion of tax revenue declined in the following year but have since increased, accounting for 32.7 per cent of total tax revenue in 2002 (Figure 1). Thus, between 1999 and 2002, the share of direct taxes has increased steadily while the share of indirect taxes continued to decline.

Tax-to-GDP ratios in Ghana are low relative to African standards, although they have been increasing since the introduction of economic reforms in 1983. Tax-to-GDP ratio in 1983 was 4.6 per cent and by 1986, had reached 12.6 per cent but these gains were compromised by the marginal declines in these ratios from 1988 to 1990. Tax revenue as a percentage of GDP has been increasing since 2000. Total tax revenue as a percentage of GDP averaged around 20.4 per cent for the period 1996 to 2002. Similarly, income and property taxes as a percentage of GDP have increased consistently from 4.1 per cent in 1996 to 5.9 per cent of GDP in 2002. Taxes on goods and services[1] as a percentage of GDP went from 5.4 per cent in 1996 to 2.7 per cent in 1999, to 2.4 per cent in 2001 and 3.0 per cent in 2002. Between 1998 and 2002, international trade taxes as a percentage of GDP decreased 6.6 per cent in 1998 to 4.2 per cent in 2002. The decline was greater with export taxes than with import taxes. VAT receipts as a percentage of GDP increased from 4.0 per cent in 1999 to 4.8 per cent in 2002, although the VAT-GDP ratio was 5.2 per cent in 2001.

The different components of the four tax categories have also undergone changes over the years. Income and property taxes comprise of PAYE, taxes for the self-employed, company taxes and others. Income and property taxes (as a percentage of total revenue)

[1] The decline was due to VAT replacing the sales tax on domestic goods and services.

have been quite volatile since 1980, and as a percentage of total revenue totalled 20.5 per cent in 1980, rose to 28.7 per cent in 1982 but declined thereafter. By 1993, taxes on income and property had dropped to 16.7 per cent (Table 3). However, there was some recovery in income and property taxes in 1996 and these have increased constantly since then (19.5 per cent in 1996, 24.7 per cent and 27.1 per cent in 2000 and 2002, respectively).

Company taxes and PAYE are the major components of the income and property tax group. Company taxes accounted for about 11.0 per cent of total revenue in 1997 and had increased to 12.2 per cent in 2000 but had again declined by 2002 to 11.2 per cent. On average, between 1996 and 2002 company taxes as a proportion of total revenue were around 11.4 per cent. On the other hand, PAYE, the second major component of property and income taxes, increased significantly from 5 per cent in 1996 to 8.5 per cent in 2000.

Table 1
Tax-to-GDP ratios, 1996-2002

	1996	1997	1998	1999	2000	2001	2002
Tax revenue	0.16	0.14	0.16	0.15	0.16	0.17	0.18
i) Income and property	0.04	0.04	0.04	0.04	0.05	0.06	0.06
ii) Domestic goods and services	0.05	0.04	0.05	0.03	0.03	0.02	0.03
iii) International trade	0.07	0.06	0.07	0.04	0.04	0.04	0.04
Imports	*0.04*	*0.04*	*0.04*	*0.03*	*0.03*	*0.03*	*0.03*
Exports	*0.03*	*0.02*	*0.02*	*0.01*	*0.01*	*0.01*	*0.01*
iv) VAT	0.00	0.00	0.00	0.04	0.05	0.05	0.05
Non-tax revenue	0.03	0.03	0.03	0.02	0.01	0.01	0.01
Other revenue	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Divestiture receipts and NPART	0.01	0.01	0.01	0.00	0.01	0.00	0.00
Grants	0.01	0.01	0.01	0.01	0.02	0.04	0.03
Total revenue and grants	0.21	0.19	0.20	0.18	0.21	0.23	0.22

Source: World Bank (2003).

Table 2
Tax revenue (% of current revenue)

	Income and property	Domestic goods and services	International trade	Tax GDP ratio
1980	20.47	28.19	44.19	6.41
1981	24.77	39.05	27.95	4.09
1982	28.75	39.22	19.05	4.84
1983	16.99	16.96	49.03	4.60
1984	18.69	25.87	37.93	6.63
1985	19.19	22.21	40.90	9.30
1986	19.41	28.35	40.81	12.11
1987	21.50	25.28	42.51	12.59
1988	28.70	28.25	35.17	12.48
1989	23.78	26.96	39.61	12.31
1990	23.02	29.95	38.75	11.44
1991	17.62	38.90	33.62	13.16
1992	18.62	38.61	33.26	10.77
1993	16.77	33.89	26.76	13.15
Mean	21.31	30.12	36.40	9.56

Source: World Bank (2003).

Table 3
Ghana's tax revenue as a percentage of total revenue

	1996	1997	1998	1999	2000	2001	2002	Mean
i) Income and property	19.52	22.68	22.13	24.45	24.69	24.64	27.05	
PAYE	4.98	7.29	6.59	8.48	8.47	7.86	8.99	7.52
Self-employed	0.93	1.13	1.16	1.74	1.32	1.32	1.67	1.33
Companies	10.92	10.96	11.01	11.87	12.21	11.22	11.24	11.35
Others	2.70	3.30	3.35	2.35	2.70	4.25	5.15	3.40
ii) Domestic goods & services	25.91	23.34	23.96	14.93	13.08	10.45	14.01	17.95
Excise duty	5.07	4.17	4.63	4.45	3.76	2.95	3.56	4.09
Sales tax	7.76	7.40	8.16					
Petroleum tax	13.07	11.75	11.16	10.48	9.32	7.50	10.45	10.53
iii) International trade	31.64	31.40	33.28	20.93	17.29	18.07	19.30	24.56
Imports	19.13	21.45	21.63	14.16	14.15	14.59	15.73	17.26
Import duty	9.65	10.37	11.15	12.11	13.07	12.30	12.73	11.63
Sales tax on imports	7.09	7.83	8.01					
Special tax	0.50	0.62	0.58	0.68	0.01	0.35	0.26	0.43
Other taxes	1.88	2.64	1.89	1.38	1.07	1.94	2.74	1.93
Exports	12.51	9.94	11.65	6.77	3.13	3.48	3.57	7.29
Cocoa duty	12.51	9.94	11.65	6.77	3.13	3.48	3.16	7.23
Lumber						0.00	0.41	0.21
iv) VAT				21.95	22.29	22.79	22.34	22.34
Domestic				10.00	6.75	5.90	6.87	7.38
External				11.95	15.54	16.89	15.46	14.96

Source: Bank of Ghana (2003).

Taxes on domestic goods and services include sales tax, excise duty and petroleum taxes. Petroleum taxes have been the major source of revenue within this sub-category although its share of total revenue has declined since 1996. Petroleum taxes accounted for 16.9 per cent of total revenue in 1996, but declined thereafter to 9.9 per cent in 2001. However, with the petroleum price increases of about 91.3 per cent in 2002, petroleum tax revenue recovered and accounted for 12.6 per cent of total revenue.

International trade taxes cover import duty, sales tax on imports, special taxes, cocoa duty, lumber and other taxes, with the major sub-categories being import duty, sales tax on imports and cocoa duty. Cocoa duty has been the major source of international trade tax receipts in Ghana. Whereas cocoa duty as a percentage of total revenue declined from 12.5 per cent in 1996 to 3.2 per cent in 2002, import duty as a percentage of total revenue increased from 9.7 per cent in 1996 to 12.7 per cent in 2002. In general, international trade taxes have decreased over the years.

VAT, which was introduced in 1998 but became operational in 1999, is another component of taxes that has assumed importance in Ghana's tax revenue mobilization. VAT replaced the sales tax in Ghana and the external components of VAT exceed the domestic components of VAT. In 1999, domestic VAT accounted for 10 per cent of total revenue but declined and by 2002 accounted for 7.4 per cent of total revenue. Meanwhile, external VAT (on imports) accounting for 11.9 per cent, has shown an increasing trend in the last three years and reached 15.5 per cent of total revenue by 2002.

3 Distributional impact of taxes

Very few studies have examined the incidence of taxes in Ghana. The most cited study is by Younger (1996), which uses a partial equilibrium analysis to assess the distributional impacts of various taxes in Ghana. A more recent study by Colatei and Round (2000) uses a SAM-based CGE model to simulate the financing of poverty-alleviating transfers through various tax instruments. Results from these studies are mixed.

In the study by Younger (1996), household data based on the 1988/9 Ghana Living Standards Survey are used to assess the incidence of taxes in the country. Results from the study show that direct taxes are progressive while indirect taxes are proportional. On some of the more specific indirect tax instruments, it is found that petroleum taxes are progressive with a coefficient that nearly matches that for direct taxes. Taxes on alcoholic beverages and tobacco products are found to be regressive. Consequently, it is argued in the paper that complaints about gasoline price increases falling disproportionately on the poor are unfounded (Younger 1996: 251).[2] The problem with a tax incidence analysis of this kind is that it looks only at the first-order impact and this may not be appropriate in welfare analysis. Indirect taxes may have important spillover effects that may not be captured by incidence analysis alone. Therefore the study by Colatei and Round (2000) provides a better basis for looking at the welfare impact of various taxes in Ghana.

The study by Colatei and Round (2000) uses a multisectoral CGE model to assess a range of redistributive policies on poverty incidence in Ghana. More specifically, they examine the general equilibrium effects of a targeted programme aimed at eradicating extreme poverty. As a first step, they estimate the total transfers necessary to eliminate poverty in each of the household groups in the model. In the analysis, the government is assumed to finance its programmes by increasing existing tax rates or introducing potentially new taxes. These authors then consider the consequences of three alternative financing schemes for these poverty-alleviating transfers. The financing schemes considered in the study are increases in income taxes, domestic commodity taxes, and import duties. Attention is limited to transfer schemes that target each socioeconomic group separately.

Generally, their results show that income transfers targeted at any one household group have important spillover effects for other groups so that poverty is not totally eradicated for that group. Income transfers targeted at Ghana's poorest households (the Savannah farm households) have the greatest impact on poverty.

The results from the study by Colatei and Round (2000) highlight the differences in the effect on poverty of the various tax schemes used to finance these transfers. The poverty-reducing effects of the transfers are the greatest when they are financed with direct taxes. In other words, the indirect or spillover effects tend to be lower for direct taxes than for indirect income taxes. Import duties are found to be the least effective way of raising revenue to finance poverty-alleviating transfers. Changing the model assumptions from the short- to long-run re-enforces these conclusions.

---

2 This analysis is based on the consumption of gasoline and transport services.

Probably, the major point of departure of these two studies is highlighted by Addison and Osei (2001). They argue that the results, which suggest that petroleum taxes are progressive in Ghana, may be misplaced if one considers the kinds of spillover effects alluded to by Colatei and Round (2000). In fact, Addison and Osei (2001) present a hypothesis, which challenges this particular result from the study by Younger (1996). In spite of the mixed results with respect to the distributional effects of petroleum taxes, there is common ground within these two main studies (i.e., Younger 1996 and Colatei and Round 2000). Both studies reach the conclusion that direct taxes are the most 'poverty-friendly' of the main tax categories in Ghana. This conclusion is consistent with the results of some other studies that look at the distributional impact of taxes (see, for instance, the Younger *et al.* 1999 study on Madagascar).

The results from these studies have important implications for the distributional effects of taxes in Ghana over the 1990s. There seems to be a gradual shift from indirect to direct taxes from 1998 to 2000. Direct taxes as a share of total domestic tax revenue increased from about 28 per cent in 1998 to about 33 per cent in 2002, while indirect taxes decreased from about 72 per cent to about 67 per cent. In line with the distributional implications of the results from the two studies discussed above, it could be argued that taxes in Ghana have generally become more pro-poor. We note that international trade taxes are becoming less important compared to other tax components. As a share of total domestic taxes, trade taxes decreased from about 41 per cent in 1993 to about 23 per cent in 2002. This is certainly a positive thing for sustained poverty reduction in Ghana because the results of both studies (Younger 1996; Colatei and Round 2000) suggest that trade taxes are not pro-poor. The argument is also made that overreliance on international trade taxes has an adverse effect on the economy as these taxes increase the degree of instability in government revenue (Bleaney, Gemmell and Greenaway 2000).

With respect to petroleum taxes, it could be argued that this component has become less important, contributing about 12.6 per cent in 2002 compared to the 1996 and 1997 levels of 17 per cent and 15 per cent, respectively. One will expect an increase in this ratio, given the almost 100 per cent increase in the price of petroleum products in February 2003. The progressivity or otherwise of petroleum taxes in Ghana is debatable. While the results of Younger (1996) suggest that these taxes in Ghana are progressive, Addison and Osei (2001) strongly challenge this conclusion arguing that important spillover effects may not have been captured in the former study.

It is important to put the issue of the recent increases in petroleum taxes in perspective. The increase in February 2003 was not a result of an increase in the tax rate on petroleum *per se*. Petroleum prices, which in Ghana are set by the government, were until recently below the cost recovery level of Tema Oil Refinery. This resulted in the government having to finance the difference, causing the induced fiscal deficits to have a destabilizing effect on the macroeconomy. The recent increase in petroleum taxes therefore was a corrective measure to ensure that prices reflect true refinery costs. Hence the effect of this increase is uncertain in the medium term. To the extent that it is aimed at creating a more stable macroeconomy, it could have a positive effect on poverty in the medium term, even if short-term effects are more harmful to the poor.

The discussion so far lends support to the view that taxes in Ghana have generally become more progressive. However, it is important to note that the distributional implications discussed here are based on the assumption that the generated revenue is

put to the best possible use with respect to poverty reduction. In other words, public expenditure patterns can exacerbate or counteract the welfare effects of the taxes. For instance, Devarajan and Hossain (1998) find that the incidence pattern of taxes in the Philippines is neutral but the combined incidence of taxes and certain public expenditures[3] is progressive.

Even though an incidence analysis gives some guide as to the potential welfare implications of taxation, it is not the only consideration in deciding whether or not the tax system is good. The other consideration is the efficiency property that taxes must have and there is a trade-off between this property and the equity property that incidence analysis seeks to address. Optimal tax models provide some guidelines as to how the efficiency and equity properties must be balanced in theory. However it is not possible to determine what the optimal levels in practice should be. Therefore we are unable to say whether the current tax level and its distribution are optimal for Ghana.

4 Chronology of main tax reforms

This section traces the major tax reforms[4] since the inception of the economic recovery programme (ERP) in Ghana in 1983. One of the major aspects of the economic reforms has involved the reform of the tax system. The tax reforms have undergone three major overlapping stages, namely, (i) a restoration of the taxbase, which involved exchange rate liberalization and de-control of prices; (ii) strengthening production incentives for domestic and foreign investors, and (iii) enhancing efficiency in tax administration and equity, which involved building capacity and morale within the revenue collection agencies so as to facilitate and monitor taxpayer compliance and prevent non-compliance. To an extent, the first stage of the reforms is over; the second and third stages are still on going. The specific nature of the three different but overlapping reforms is presented chronologically below.

4.1 Restoring the taxbase

Between 1983-84 the exchange rate was adjusted in order to increase receipts from cocoa export taxes and import duties. In addition, the increased availability of foreign exchange due to donor inflows stimulated import expansion and consequently also the base of import taxes. Hence, the tax reform measures over this period were designed mainly to restore the taxbase, which had declined due to over-valuation of the domestic currency and the large margin between official and market prices (Kusi 1998). The reforms also aimed to widen the tax net, reduce evasion, and lower the tax burden. Hence, in 1983, a multiple exchange rate system was introduced which imposed surcharges on foreign exchange payments and granted bonuses on foreign exchange receipts. Two exchange rates operated initially but these were eventually unified in 1988.

---

[3] The expenditures items noted to drive the progressivity result are those on health, education and infrastructure.

[4] A tax reform refers to a movement away from a certain given *status quo*. A tax reform is beneficial if it increases both revenue and social welfare.

Also, during the same period (1983-84), prices were de-regulated. Prices of consumer goods were allowed to fully reflect production cost plus profit margins, while a flexible producer pricing system was adopted for cocoa, maize, rice and palm oil to maintain prices in order to provide incentives for producers. In addition to these, budgetary subsidies for consumer goods and public utilities were reduced if not eliminated entirely, while fees, levies and charges for various public sector services were adjusted upwards as part of the new cost recovery measures.

In addition to the price and exchange rate adjustments, there was a revision of the system of tax assessment for import duties, sales and purchase taxes. These taxes were revised to make the basis for dutiable goods reflect their full face value plus certain surcharges. Also, the basis for tax assessment for corporate income tax was changed from profits of the previous year to actual income earned during the current year (Kusi 1998). Moreover, the system of advance payment of taxes at the beginning of each quarter that had led to extensive evasion was discontinued, and instead corporate bodies and the self-employed were to pay taxes at the end of each quarter. The lowest tax-free personal income bracket was raised and marginal rates lowered to reduce the average effective rates. For instance, in 1984, taxes on cigarettes and beer were increased but at the same time personal income tax was reduced.

4.2 Production incentives

The tax reform process in Ghana took another form with the introduction of the investment code (PNDC Law 116, 1985). The code provided a range of incentives for domestic and foreign investors, covering four priority areas, namely, agriculture, manufacturing, construction and buildings, and tourism. Incentives under the code are varied. First, when an enterprise with priority status undertakes or supports an approved programme of scientific research which would help to develop the enterprise, the related capital expenditure is fully tax deductible. Also, to encourage regional dispersion of industrial activities, an enterprise located outside the Accra-Tema metropolis also qualifies for a tax reduction in the range of 15-40 per cent depending on the area of location. The code also makes special provisions for enterprises located in areas that lack basic infrastructure and particularly in the case where the enterprise provides for the infrastructure.

In 1986, a new minerals law (Minerals Commission Law, 1986) was introduced. The minerals law modified eight existing laws, and sought to clarify mining rights as well as provide new incentives for investors. The incentives extend to corporate tax allowances, capital allowances under which it is possible for companies to write-off between 40 per cent and 100 per cent of capital investment against taxes. Companies are also permitted to use offshore bank accounts to service foreign loans, dividend payments and expatriate staff remuneration.

Other direct tax reforms continued in Ghana. In 1987, the corporate tax rate on manufacturing concerns was reduced from 55 per cent to 45 per cent. Also, all excise duties on products other than petroleum, beverages and tobacco were abolished with the revenue loss being compensated with an increase in the general sales tax rate from 10 per cent to 20 per cent and subsequently to 25 per cent. It was believed in 1998 that an across-the-board increase in import duties would be undesirable, hence the special tax

levied on locally produced textiles, tobacco, alcoholic beverages, etc. was also applied to similar imported items. The general sales tax was reduced to 22.5 per cent in 1989.

Similarly in 1990, the special taxes that had been introduced in 1988 to protect local industries were compressed into a uniform rate of 10 per cent since it has become evident that these various taxes were encouraging inefficiency in local production and rendering local industries internationally uncompetitive. At the same time, the import licensing requirements were gradually removed and duty rates lowered by 5 percentage points, thereby reducing the primary import tariff on most goods. By 1991, corporate taxes on real estate, manufacturing and construction had been reduced to 35 per cent. Also, corporate taxes (banking) were reduced from 50 per cent in 1991 to 40 per cent in 1992.

In 1991 a flat rate of 5 per cent was introduced to replace the progressive structure of capital gains tax, with income from mergers and acquisitions and publicly traded shares becoming exempted from capital gains tax. The reduction was intended to lessen the impact of the inflation tax on disposed assets. In 2000, the government proposed to exempt all veterinary drugs as well as ingredients for the manufacture of poultry feed from import duty. A bill for reviewing tariff and other policy measures to make local industries more competitive and to harmonize tax rates was submitted before Parliament. Production incentives were continued and they were more generous to companies listed on the Ghana Stock Exchange. Hence, in 2001, corporate tax rates were reduced from 35 per cent to 30 per cent for companies listed on the Ghana Stock Exchange while unlisted companies were charged 32.5 per cent.

4.3 Enhancing efficiency

The focus of tax reforms was broadened after 1986 in order to enhance efficiency in tax administration and to ensure equity within the tax system. Until 1986, the tax administrative system was not adequately monitored nor was tax compliance ensured. Hence, a major element of tax reform was to strengthen the revenue collection agencies to ensure that they increase revenue and also to change the structure of the tax system to make it more efficient and equitable. The year 1985 witnessed the birth of three autonomous institutions, namely, National Revenue Secretariat (NRS), Customs Excise and Preventive Service (CEPS) and the Internal Revenue Service (IRS). The NRS was responsible for supervising the activities of CEPS and IRS as well as recommending revenue policy to the government.[5]

Other measures to improve efficiency in tax collection were the conversion in 1986 of the IRS and CEPS into autonomous bodies with new organizational structures similar to those of state-owned enterprises. In addition, new incentive policies for the staffs of IRS and CEPS were introduced to improve productivity in tax collection. Also, between 1986 and 1992, the IRS operated with ministerial powers alongside the Ministry of Finance but this full autonomy has been partially reversed (Kusi 1998).

Another major shift in the Ghanaian tax system that was intended to improve tax efficiency was the introduction of the value-added tax (VAT). The contract for the design and implementation of VAT was signed in 1993. In December 1994, the VAT

---

5 Similar to the Canadian system, see Terkper (1995).

bill was passed into law to become effective March 1995, when it became operational at a flat rate of 17.5 per cent compared with the earlier sales tax rate of 15 per cent. A few months later in June, VAT was withdrawn after mass demonstrations in almost all the regional capitals around the country and a 15-per cent sales tax was re-introduced in 1998. In 1999, the VAT offices in all the regional capitals were re-opened. In addition to the re-introduction of VAT, renovation and rehabilitation work on residential houses for the staff of CEPS and the computerization of the Long Room at CEPS (Tema) were completed.

In 2000 an income tax law (Act 592, 2000) was passed and became operational in 2001. The minimum taxable personal income was raised from Cedis 0.9 million to Cedis 1.2 million and the top marginal rate of 35 per cent for incomes in excess of Cedis 17.4 million was applied to incomes exceeding Cedis 48.0 million. In addition, the top marginal rate was reduced from 35 per cent to 30 per cent for the higher-income group and from 25 per cent to 20 per cent for the middle-income groups. There were other tax reliefs such as tax concessions for dependent children, tax allowances for disabled businessmen, tax relief for persons over 60 years of age, and tax deductions for a person sponsoring the education of his or her child.

During 2002 the automation of clearing procedures was completed with the installation of the Ghana Customs Management System (GCMS) and the Ghana Community Network (GC-Net) computer-based information systems at Tema and Kotoka International Airport and at the CEPS headquarters. The objective was to reduce leakage in revenue and minimize physical contact between traders and customs officers so as to ensure greater efficiency in achieving a target clearance period of one or two days. Also, a service charge of 5 per cent was to be levied by CEPS on companies, which processed warehoused and re-exported goods. A large taxpayers' unit (LTU) comprising 350 tax-paying entities was launched in the middle of the year. In support of the LTU and other tax initiatives, a system of taxpayers' identification numbers (TIN) was set up and all revenue agencies were to ensure its implementation. The Taxpayer Identification Number Law was subsequently passed. Section 123 of the Internal Revenue Service Act 2000 (592) was amended to incorporate requisite guidelines for companies wishing to submit tax returns in foreign currency. Government proposed legislation action to narrow the scope of VAT exemptions and to bring more payees into the tax net.

In order to further improve efficiency in tax collection, CEPS proposed in 2003 to collaborate with destination inspection companies to minimize under-invoicing of poultry products and to ensure the good quality of poultry products being imported into the country. Export duty on lumber was reduced, taxes on insecticide-treated materials were waived and VAT on salt was eliminated. The CEPS bonded warehouse scheme was reviewed. Stamp duty on share capital was reduced from 2 per cent to 0.5 per cent.

4.4 Problems of tax reforms

Usually any tax reform that leads to an increase in the amount of taxes paid by citizens is not popular anywhere in the world. Mahon (2000) is noted to have made the argument that effective tax systems historically have resulted from the exchange of resources for institutions so that governments are better able to sustain their tax effort by providing

effective institutions.[6] Even though Ghana is no exception to this rule, public resistance to tax reforms in the country has usually been minimal, mainly because Ghana, prior to 1992 (when it ushered in the new constitutional rule), had predominantly been under military rule and alternative views on policy were considered to be sabotage. The challenges of the move from sales tax to VAT in the 1990s therefore represented a major shift in the whole paradigm of policy implementation. The massive demonstrations that followed the introduction of VAT in March 1995 led to its withdrawal in June of the same year. VAT was, however, re-introduced successfully in 1998.

Failure in implementing VAT during the first attempt in 1995, however, has been partly blamed on inadequate investment in institutional capacity (Addison and Osei 2001). This manifested as the lack of a thorough policy analysis that resulted in the decision to replace the 15-per cent sales tax with VAT at the rate of 17.5 per cent. Education of the public was also inadequate, resulting in confusion over this new tax system. It is argued that this was probably the most instrumental factor that worked against VAT's effective implementation (Osei 2000: 275).

A second factor that led to the public rejection of VAT in 1995 was political. The 'old policy style'[7] which had excluded vocal interest groups from participating in the formulation and implementation of policy did not make matters any better. The main opposition party had opted out of the parliamentary elections and therefore found themselves excluded from the only forum where VAT policy was effectively debated. Consequently opposition took an uncompromising stance on VAT policy. Added to this was the internal wrangling within the incumbent party between the president and his vice-president. In fact the vice-president asked the people of Ghana to revolt against the VAT policy (Osei 2000: 274).

Osei (2000: 273) argues that VAT's second implementation attempt succeeded largely because the opposition was now in Parliament and therefore contributed to the shaping of the policy. He is of the opinion that public education was still poor and on its own would not have been enough to have the second VAT accepted by the Ghanaians. However, the basis for this argument is not strong. After the first VAT was rejected, the then finance minister resigned and was replaced.[8] Shortly after his appointment the new finance minister announced his intention to re-introduce VAT. Ghanaians were therefore aware that VAT would be coming back. Also, the policy think-tanks as well as private business associations kept the debate on VAT alive. It is therefore fair to say that before the second implementation people were more informed about VAT. In other words, education of the public was instrumental in the second, successful round of implementing VAT.

In spite of the gains made especially in connection with the shift from sales tax to VAT, significant problems remain and this imposes a constrain on the amount of revenue that is generated at the existing tax rates. The institutional structures for tax collection in Ghana are still weak. This problem is partly manifested in the lack of logistics and

---

6 This is also cited in Addison and Osei (2001).

7 It has to be remembered that Rawlings was a military leader who metamorphosized into a democratic one after 1992 but even after the change to constitutional rule, he still retained dictorial characteristics.

8 Kwasi Botchwey resigned in June 1995 and was replaced by Kwame Peprah.

skilled personnel to identify and provide comprehensive information to potential taxpayers regarding the source and levels of their income tax. It is estimated that the self-employed in the informal (non-agricultural) sector constitutes over 34 per cent of the economically engaged population. It is essential that businesses and people in this sector be roped into the tax net if the country hopes to make significant gains in domestic revenue mobilization.

5 Conclusions

This paper provides an assessment of the components, structures and the incidence of taxes in Ghana over the last two decades. It also presents a chronology of the country's tax measures and the problems encountered with some of the major reforms. The following observations were made. First, the tax-to-GDP ratio has more than doubled over the last two decades. This increasing tax ratio has been accompanied by a changing structure of the tax system. Indirect taxes have generally been higher than direct taxes, but the proportion of direct taxes seems to be gradually increasing. Also international trade taxes have been noted to be on the decline.

Second, it is argued that taxes in Ghana have become more 'poverty-friendly' over the years. This conclusion is based on two complementary factors. The first factor relates to the changing structure of the tax system—the increasing proportion of direct taxes relative to indirect taxes as well as the decreasing reliance on international trade. The second complementary factor relates to the results of studies that have looked at the distributional effects of taxes in Ghana. These results suggest that indirect taxes and taxes on international trade have adverse effects on the poor in Ghana, relative to direct taxes. Therefore the reduced reliance on these taxes is good for poverty alleviation in Ghana.

Third, it is noted that tax reforms in Ghana over the last two decades have been used to achieve three broad objectives: (i) to restore the taxbase which had been significantly reduced by the price and exchange rate policies pursued in the pre-ERP (1983) era; (ii) to provide better production incentives for investors; and (iii) to enhance the general efficiency of tax administration. The liberalization of exchange rates and domestic prices in the 1980s was mainly aimed at achieving the first objective. Subsequent reforms were targeted at the last two objectives. The most radical of these reforms was the shift from sales tax to VAT. The first attempt in 1995 failed and the government had to wait until 1998 before VAT was successfully implemented. The first attempt failed because of inadequate institutional investments and also for political reasons. Opposition to the first VAT came from both the minority parties as well as from within the incumbent party. The inadequate institutional investment resulted in very low levels of public awareness. These two complementary factors led to the massive demonstrations that culminated in the withdrawal of VAT in the same year.

Fourth, although VAT was successfully implemented in 1998 and is now operational in Ghana, there are still significant institutional problems that constrain its ability to generate more tax revenue. The low skill-level of the staff of the revenue collection agencies means a significant portion of taxpayers still remain outside the tax net. Also it accounts for the slow take-off of the automation/computerization of the customs management systems.

This paper concludes by noting that the tax system in Ghana has improved over the last two decades and this accounts for the increase in tax-to-GDP ratio. However in relation to government expenditures, domestic tax revenue is still low. This has resulted in an unhealthy situation where almost half of total government expenditures are still financed from foreign aid. There is immense pressure to increase pro-poor spending, and foreign aid flows to Ghana have been on the decrease in the last decade. It is therefore essential that the government continues to increase its efforts at domestic revenue mobilization.

Bibliography

Addison, T., and R. Osei (2001). 'Taxation and Fiscal Reform in Ghana' WIDER Discussion Paper 2001/97. Helsinki: UNU-WIDER.

Bank of Ghana (2003). *Statistical Bulletin*, July.

Bleaney, M., N. Gemmell, and D. Greenaway (2000). 'Tax Revenue Instability in Sub-Saharan Africa: Causes and Consequences', in D. Bevan, P. Collier, and N. Gemmell (eds), *Trade and Fiscal Adjustments in Africa*. Basingstoke: Palgrave Macmillan.

Bolnick, B., and J. Haughton (1998). 'Tax Policy in Sub-Saharan Africa: Examining the Role of Excise Taxation'. African Economic Policy Discussion Paper 2. Washington, DC: USAID.

Colatei, D., and J. I. Round (2000). 'Poverty and Policy: Experiments with a SAM-based CGE Model for Ghana'. Paper presented at the XIII International Conference on Input-Output Techniques, 21-25 August. Macerato, Italy.

Devarajan, S., and S. I. Hossain (1998). 'The Combined Incidence of Taxes and Public Expenditures in the Philippines'. *World Development,* 26 (6): 963-77.

Kusi, N. K. (1998). 'Tax Reform and Revenue Productivity in Ghana'. AERC Research Paper 74 (March). Nairobi: African Economic Research Consortium.

Mahon, J. E. (2000). 'Globalization and the Exchange of Institutions for Resources'. Paper presented at the 18th World Congress of the International Political Science Association, Quebec, 1-16 August. Available at: www.williams.edu/PoliSci/mahon/index.www.html.

Osei, P. (2000). 'Political Liberalization and the Implementation of Value Added Tax in Ghana'. *The Journal of Modern African Studies*, 28 (2): 255-78.

Tanzi, V. (1997). 'Asia and the IMF: The Changing Role of Fiscal Policy in Fund Policy Advice'. IMF Seminar Paper, September. Washington, DC: IMF.

Terkper, S. E. (1995). 'Ghana Tax Administration Reforms (1985-1993)'. Harvard Development Discussion Papers. Cambridge, MA: Harvard Institute for International Development.

Younger, S. (1996). 'Estimating Tax Incidence in Ghana Using Household Data', in D. E. Sahn (ed.), *Economic Reform and the Poor*. Oxford: Clarendon Press, 231-53.

Younger, S., D. E. Sahn, S. Haggblade, and P. A. Dorosh (1999). 'Tax Incidence in Madagascar: An Analysis Using Household Data'. *World Bank Economic Review*, 13 (2): 303-13.

World Bank (1993). World Development Indicators. Washington, DC: World Bank.