Taxation and Development in Ghana: Finance, Equity and Accountability

by Wilson Prichard, Institute of Development Studies, University of Sussex with Isaac Bentum of A, A & K Consulting – April, 2009

GHANA REPORT

Tax Justice Country Report Series

This report is the first report in an initiative to create a comprehensive, and globally representative series of country reports that touch on diverse tax justice issues. The intent is to analyse the national tax systems, the distribution of the tax burden, the incentive structure and explore emerging national or regional themes including existing and proposed tax related advocacy issues among stakeholders. The production of this report is the collective effort of both of the organisations involved.

The Tax Justice Network promotes transparency in international finance and opposes secrecy. TJN was initiated at the European Social Forum in Florence in 2002, and officially launched at the British Houses of Parliament in 2003. It is dedicated to high-level research, analysis and advocacy in the field of tax and regulation. Tax Justice Network Africa was launched in 2007 with the aim of bringing tax issues to the foreground of the broader development agenda. We work to map, analyse and explain the role of taxation and the harmful impacts of tax evasion, tax avoidance, tax competition and tax havens. Our objective is to encourage reform at the global and national levels. We support a level playing field on tax and we oppose loopholes and distortions in tax practices and regulation, and the abuses that flow from them.

ISODEC is a Ghanaian non-governmental, rights-based, public policy research and advocacy organisation with sub-regional affiliates in Burkina Faso, Nigeria, Sierra Leone, Mali, Senegal and Niger. ISODEC's mission is to promote fundamental human rights, especially of the poor and those without organised voice and influence. Through education, research and advocacy/popular campaigns, ISODEC strives to leverage public action and resources to end poverty and inequality in Ghana and the West Africa sub-region. Through information exchange (including economic literacy programmes), ISODEC has built solidarity with like-minded civil society groups world-wide to promote accountability of international institutions and private. ISODEC nurtures accountability and good governance through grassroots capacity-building in tracking revenue flows, especially natural resource rents and their utilisation at the national and sub-national levels. ISODEC is a member of Tax Justice Network and sits on the Tax Justice Africa Steering Committee.

This report is meant to be a starting point for developing local advocacy campaigns around issues of taxation, equity and public accountability. The report itself draws on a month of research conducted in February-March 2009 by Wilson Prichard and Isaac Bentum, while drawing heavily on PhD research conducted by the former, and a lifetime of experience in tax administration for the latter. The final report was written by Wilson Prichard, who bears final responsibility for its contents. We owe a debt of gratitude to all of those who contributed their time and knowledge to this report during interviews and data gathering. We sincerely hope that we have done justice to your viewpoints. Finally, thanks are due to Rebecca Dottey and Tzvetelina Arsova from Christian Aid, and to Steve Manteaw from ISODEC, for their support for the project, and to Thomas Akabzaa, whose work on the mining sector provided the basis for the mining section of this report. We'd like to acknowledge that this report is produced with the funding received from the UK Department for International Development (DfID) and Christian Aid Ghana.

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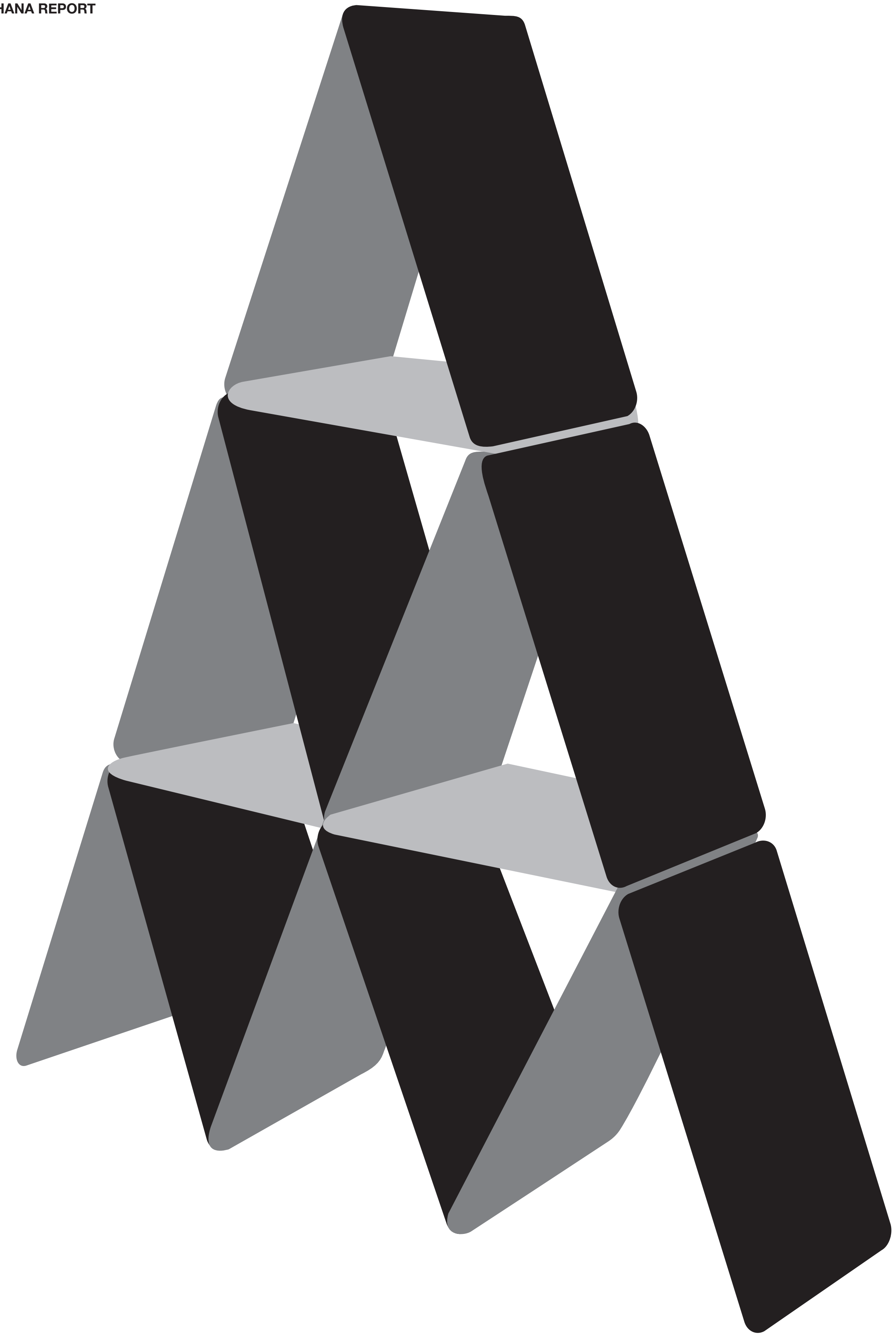


Taxation and Development

In many ways the raising of tax revenues is the most central activity of any state. Most fundamentally, revenue from taxation is what literally sustains the existence of the state, providing the funding for everything from social programs to infrastructure investment.

Taxation also plays an important role in shaping the distribution of benefits, as it is the basis for redistribution from those with the highest incomes to those most in need, and allows government to encourage certain activities and discourage others by altering their relative prices.

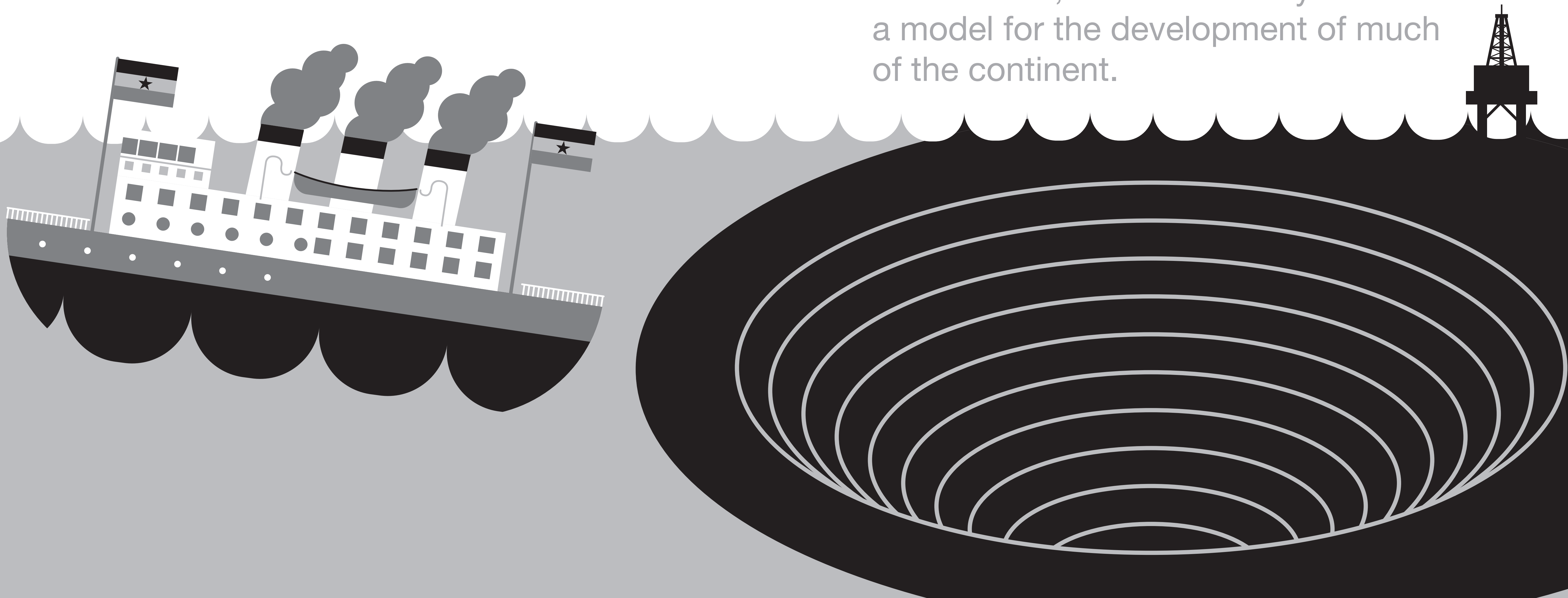
What is less frequently noted is the broader centrality of taxation to good governance, which encompasses the capacity, responsiveness and accountability of government. In the realm of capacity, taxation lies at the administrative heart of government and provides the foundation for the provision of public goods and the implementation of effective regulation. As importantly, taxation is the venue through which citizens are most intimately connected to the state and can be an important catalyst for public demands for responsiveness and accountability.

Despite this fact, attention to the issue of taxation in the developing world has been sorely lacking and generally limited to technocratic policy and administrative reforms. Public participation in debates about taxation has been particularly rare despite major issues of public interest related to tax system equity, tax avoidance and evasion and the broader drive for improved governance. This research forms part of a broader civil society effort to expand pubic participation in debates about taxation, and to correspondingly improve development outcomes.

The paper begins with a brief introduction to the economic, social and political context in Ghana, and this is followed by a detailed overview of the existing tax system and its limitations. The third section looks at tax avoidance and evasion in various forms in order to identify ways to both increase collection and improve equity. The fourth section looks at the relationship between taxation and the development of political responsiveness and accountability, focusing on the ways that taxation can become a catalyst for public demands for improved governance. The final section concludes and provides a set of recommendations for potential campaign targets and further research.

Economic, social and political profile

In 1957 Ghana became the first nation in the region to achieve independence from colonial rule, and was initially viewed as a model for the development of much of the continent.



Yet it was not long before economic challenges came to the fore, while the years from 1966-1982 were characterised by several episodes of military rule, punctuated by brief periods of civilian government. By 1982, when the Provisional National Defense Council (PNDC) led by Flt. Lt. Jerry Rawlings seized power in another military coup the country was in a state of near total economic collapse, while political cohesion was highly splintered[1].

With the public treasury depleted and economic activity ground to a virtual halt, the new government quickly turned to the World Bank (WB) and International Monetary Fund (IMF) for financial support and embarked on an ambitious Structural Adjustment Program (SAP). With opposition political forces under attack by the new regime and depleted after a decade of general decline the adjustment to the market occurred rapidly and dramatically. While the program was not without its critics, and may have created some short term increases in poverty, it quickly came to be viewed as an SAP success story, as economic growth quickly resumed, government finances were revived and stabilised and poverty rates had begun to decline by the early 1990s[2].

In 1992 Ghana held renewed multi-party elections, with the newly constituted National Democratic Congress (NDC), led by Rawlings, winning the election amidst uncertain claims of fraud by the opposition[3]. In the years both before and since the election economic growth, and the strengthening of the fiscal position of the government, have continued with the notable exception of interruptions surrounding the elections in 1992, and preceding the election in 2000. Political liberalisation has also continued, as there was a peaceful electoral transition of power to the New Patriotic Party (NPP) in 2000, and a similarly peaceful return to power by the NDC at the end of 2008. These developments have led international observers to look once more at Ghana as a model of economic and political development in the region.

Like most countries in the region, agriculture remains the dominant sector of the economy, accounting for 37.9% of GDP in 2004, and employing a substantially larger share of the workforce. Likewise, resources drive the dominant economic activities, most notably cocoa (7.6% of GDP, 38.4% of exports in 2004), mining (4.6%, 30.2%) and timber (4.0%, 7.6%)[4]. Both within and outside the resource sectors, a large share of economic activity in Ghana remains in the informal sector, which was estimated at 38.4% of GDP in 2000[5]. This corresponds to an even higher share of total employment, and a recent report argues that only 13.7% of the economically active population is employed in the formal wage economy or by government, leaving 86.3% of individuals in agriculture and the informal sector[6].

In recent years real GDP growth has remained strong, at greater than 4% in every year since 2001, and hovering around 6% during each of the past three years. This growth has been broadly shared across sectors, though agriculture has fared relatively less well while mining, construction and finance have all performed particularly well in recent years. These improvements in growth have been matched by increased spending on the social sector and poverty reducing programs, and by strong improvements in revenue collection and the overall fiscal position of the government until 2005. Continuous growth appears to have translated into significant poverty reduction, particularly in the period since 2001. In aggregate the World Bank estimates that poverty has fallen from 51% in 1991 to 28.5% in 2005. While other studies provide slightly less optimistic figures, the overall trend is clearly strongly positive[7]. The troubling sign is fairly conclusive evidence that overall inequality has been on the rise between urban and rural areas, and most dramatically between the north and south[8].

Looking forward, two issues loom largest on the economic and political horizon with respect to fiscal and tax issues. The first is the sharp deterioration in the fiscal position of the country since 2005. After dramatically reducing deficits from 2000-2005 the NPP government allowed deficits to increase dramatically beginning in 2006, while the budget deficit reached over 11% of GDP in 2008. This deficit is slightly larger than the peak of the fiscal crisis under the NDC in 2000, and occurred despite extremely high divestiture receipts in 2008. While some popular discourse has attributed the soaring deficit to exceptionally high spending linked to hosting the Cup of African Nations, the reality is that the deficit is the result of the initial budget being exceeded across virtually all budget lines. These developments have put major fiscal pressure on the incoming government and increase the likelihood that revenue mobilisation will remain near the top of the political agenda in the immediate future[9].

The second major issue is the prospect that the country will begin extracting oil as early as 2010. Estimates suggest that government revenue from oil in a very conservative scenario would be about $200 million, while more ambitious scenarios could yield as much as $1.6 billion in government revenue[10]. The most recent government budget puts tax revenue in 2011 at $5.043 billion (7.135 billion cedis), implying that oil revenue could amount to anywhere from 4% to 30% of total revenue. This is likely to lead to a sharp increase in government spending, and possibly also to reductions in taxes, though in the latter case it will be important to ensure that the integrity and equity of both tax policy and administration is maintained. As importantly, country experience elsewhere suggests that transparency in the collection of oil revenues can be a major source of corruption, and as such upgrading of the tax administration presents an important means to guard against such adverse outcomes[11].

The budget deficit reached over 11% of GDP in 2008

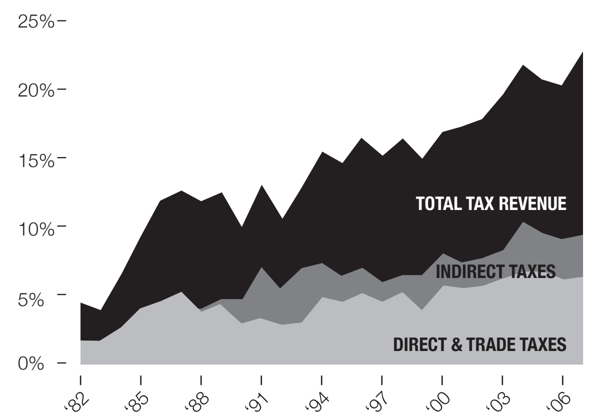
1 Frimpong-Ansah 1991, Chazan 1983, Nugent 1995
2 Herbst 1993, Martin 1993, Teal 2001
3 Nugent 1999
4 IMF 2005
5 Schneider and Klinglmair 2004
6 GNCCI 2008
7 GoG 2005, Teal 2001
8 Teal 2001, McKay 2007, Shepherd and Gyimah-Boadi 2004
9 GoG 2009
10 Gary 2009
11 Kolstad and Wiig 2009, Oxfam America 2009

The Tax system and the Allocation of the Tax Burden

National Taxation System Overview

At the beginning of the 1980s the Ghanaian tax system was deeply in crisis. Central government taxation amounted to less than 5% of GDP, while the government relied on heavy exactions from the agricultural sector, and cocoa producers in particular, through pricing policy in order to raise enough revenue to maintain the most basic functions of government. The years since then have witnessed a dramatic reversal, as Ghana has become one of most effective tax collectors measured by tax per GDP ratios in sub-Saharan Africa, trailing only South Africa and Kenya.

Total Tax Revenue by Component, 1982-2007 (fig. 1)



The overall growth of revenue, broken down by different tax types, is captured in Figure 1. During the years 2004-2007 tax revenue averaged greater than 20% of GDP, and reached 3.2 billion cedis. Growth in tax revenue has been driven by large increases in both direct (income, and corporate) taxes, and taxes on goods and services, including a large expansion following the introduction of the VAT in 1998. Trade taxes, the third major component of tax revenue, have remained relatively stable since the late 1980s, though this masks a significant shift, as export taxes have been virtually eliminated, while tariff revenue has grown, largely owing to expanded trade and improved customs administration. As with most tax systems in the region, there has been a growing reliance on goods and services taxes as a share of revenue, and a declining reliance on trade taxes.

Direct Taxes

The two major components are individual income tax and corporate tax, as other direct taxes, including capital gains, property and rent taxes, contribute very little revenue due to extremely weak enforcement. Individual income tax is a progressive tax with a top rate of 25%, while the corporate tax rate has been significantly reduced over the past few years from 32.5% in 2001 to 25% in 2006. These reductions in the corporate tax rate, coupled with improved ease of compliance, were reflected in Ghana's gains in the World Bank Doing Business survey, climbing from 83rd position to 77th position in a League of 175 countries. Ghana was for that period among the top ten movers in the World Bank Doing Business survey. In revenue terms, corporate taxes and individual income taxes comprise almost identical shares of the total tax take, which is the end result of steady gains in the area of individual income taxation. Of individual income taxes the overwhelming share (88.7% in 2007) comes from withheld taxes on formal sector wages (PAYE), with only tiny share accruing from the self-employed, which encompasses most of the informal sector and many professional occupations, such as consultants. Figure 2 illustrates the evolution of income tax collection since 1982, while Tables 1-5 in Appendix 1 capture total collections by tax types for all major taxes, the total number of taxpayers by tax type for 2007-08, and actual collections versus projected collections from 2000-08.

Direct Taxes by Component, 1982-2007 (fig. 2)

Arguably the most glaring weakness of the direct tax system is the almost total failure to tax property or rental income. While this failure is common across most of sub-Saharan Africa, it nonetheless represents a major revenue loss, and erodes the redistributive capacity of the tax system. The housing market in Accra in particular is dominated by rental properties, while rental prices and property values are remarkably high given the relatively low-incomes of most citizens (CHF 2004). As such taxation of rental incomes and property could yield potentially very significant additional revenues, which some estimate at as much as 1-2% of GDP. Property taxation would have the added advantage of implicitly clarifying ownership, which would represent a major success given that land tenure disputes are a source of major conflicts in Ghana, and one of the major causes of inefficiency and high costs in the property and real estate markets (CHF 2004).

Taxes on Goods and Services

The bulk of indirect taxation is comprised of the VAT and excise taxes, the latter of which have declined consistently over time. The VAT was initially introduced to replace the existing sales tax in 1995 under significant pressure from the IMF, which was concerned about high levels of indebtedness in the aftermath of huge expenditure increases surrounding the 1992 election. Because of the looming fiscal crisis it was introduced at a relatively high rate of 17.5%, with somewhat less public education that may have been desirable, and without the support of the opposition, which was boycotting parliament over alleged electoral irregularities. The consequence of these three factors was the outbreak of massive street demonstrations against the tax, with the protests becoming incorporated into broader demands for political liberalisation. The government eventually revoked the tax and only reintroduced it three years later at the much lower rate of 10%[12]. The rate was subsequently increased to 12.5% in 1999, but was earmarked for the newly created Ghana Education Trust (GET) Fund in order to secure political support. In 2003 the rate was effectively further increased to 15%, though political concerns led the government to go so far as to identify it as an independent tax item, the National Health Insurance Levy (NHIL), which was earmarked for funding a new health insurance scheme[13].

There has been a growing reliance on goods and services taxes as a share of revenue, and a declining reliance on trade taxes

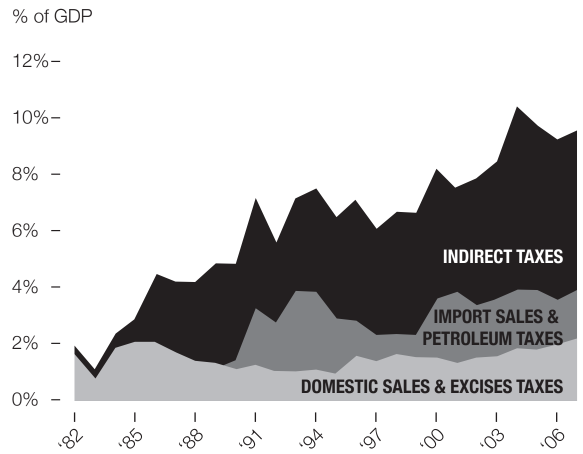
Though smaller in absolute terms, the most volatile element of indirect taxation has been the share of petroleum taxes in total revenue. Initially introduced under the cover of major price increases associated with the Gulf War in the early 1990s, petroleum taxes comprised more than one-third of total tax revenue during the period. Yet by the late 1990s petroleum had fallen to around 15% of total tax revenue, while the government was in fact subsidizing the price of fuel through off budget deficits incurred by state agencies involved in purchasing, refining and transport. The change of government at the end of the year 2000 saw a renewed surge in petroleum taxes, but this began to be reversed by 2005, while further major cuts in petroleum taxes were announced in the run-up to the 2008 elections.

12 Osei 2000

13 Osei and Quartey 2005

These major fluctuations in petroleum taxation are indicative of the political salience of petroleum prices, which have frequently spurred significant political mobilisation, and were an important part of the NDC political platform in 2008.

Indirect Taxes by Component, 1982-2007 (fig. 3)



The reach of the VAT is significantly wider than income tax, as it is, in principle, levied on all forms of consumption. Because the VAT is levied on every transaction along the value chain, even goods that are not taxed at the final point of sale may carry a significant tax component that was levied at an earlier stage.

That said it is worth noting various factors that reduce the tax burden on lower income taxpayers. First, the Value Added Tax Act contains a fairly wide range of exemptions (Appendix 1, Table 6 for a full list), primarily on basic consumption goods, which reduces the burden on lower income taxpayers. Likewise, in 2008 there were 46 842 traders registered (up from 30 377 in 2006), of whom 36,000 filed tax returns, which represents only a fraction of the total number of businesses in the country. This is partly a function of tax evasion, and partly the result of the fact that many firms fall below the VAT threshold of GH¢10,000, which is meant to protect small firms from excessively burdensome and unrealistic bookkeeping requirements, while maximising the use of administrative resources. In an effort to bring small traders into the tax net the government introduced the VAT Flat Rate Scheme (VFRS) in September 2007 at a flat rate of 3% of turnover. In principle every trader is meant to be registered, irrespective of the VAT threshold, though the VAT Service estimates that only about 26.4% of potential informal sector traders are currently registered.

Informal Sector Taxes

The government has shown an increasing desire to tax the informal sector, and has introduced several taxes to specifically target informal sector operators. These include the Vehicle Income Tax on public transport operators, the Tax Stamp for collecting income tax from small traders, and the Flat Rate Scheme for expanding the reach of the VAT. These taxes all collect relatively very little income, but the government is determined to continue to expand their collection. This is discussed in greater detail later in the paper.

Table 1: Total Tax Collection in the Informal Sector

Year	Vehicle Income Tax	Tax Stamp	VAT Flat Rate Scheme
	GH¢	GH¢	GH¢
2005	6,299,584.61	926,643.03	n/a
2006	7,340,191.76	1,108,967.28	n/a
2007	7,796,509.05	1,879,872.44	2,691,356.37
2008	9,352,838.81	1,812,316.30	25,932,757.62

Source: IRS and VATS
Note: It was not possible to get figures on the total number of taxpayers due to the absence of taxpayer registration and the limits of existing record keeping systems.

Tax Administration

Despite dramatic improvements in tax collection, and the success of Ghanaian tax collection relative to its neighbours, there is little doubt that taxation remains subject to very large leakages. These leakages are more a question of administration than of policy, which is a reflection of the oft-cited claim that in developing countries "tax administration is tax policy"[14].

Taxation remains subject to very large leakages.

Tax administration is divided among three primary agencies: the Internal Revenue Service (IRS), the Value-Added Tax Service (VATS) and the Customs, Excise

14 Casanegra de Jantscher 1990

and Preventive Service (CEPS). Each of them enjoys some degree of autonomy from the Ministry of Finance with respect to human resource policies and the fact that they are able to retain 3% of total collections in order to grant them financial independence. In 1985-86 Ghana was a pioneer in granting such autonomy to its tax agencies, broadly consistent with international advice in favour of semi-autonomous revenue authorities (ARAs). It briefly created a separate Ministerial level cabinet position to oversee revenue collection, while the different agencies were coordinated under the National Revenue Secretariat (NRS). These reforms were initially an important contributor to the major revenue gains that occurred in the 1980s[15]. Yet internal infighting eventually saw the NRS abolished and the tax agencies brought somewhat more closely under the control of the Ministry of Finance. Meanwhile efforts to more closely integrate the different tax services have largely stagnated until the present, apparently due to a combination of territoriality among the different agencies, bureaucratic inertia and the fact that the existence of the individual tax agencies is mandated by the constitution. Thus, Ghana has gone from being a pioneer in the creation of ARAs to having a comparatively poorly integrated system.

On a more positive note, recent years have seen two important reforms that have sought to overcome the isolation of the different revenue agencies. One was the creation of a Revenue Agencies Governing Board (RAGB) in 1998 by the Ministry of Finance, under the Revenue Agencies Governing Board Act, 1998 (Act 558), which was actually implemented in 2001. Its main objective was to oversee the operations of the different tax agencies and improve information sharing and analysis. The second was the creation of an independent Large Taxpayers' Unit (LTU), which integrates the functions of the IRS and VATS and has substantially more sophisticated methods and IT infrastructure than the pre-existing agencies. Yet, despite these reforms two glaring administrative challenges remain.

The first is the continued difficulty of achieving full integration of the different tax agencies, as well as effective collaboration with other relevant branches of government. Experience in other countries suggests that one of the most effective means to improve the equitable and efficient collection of revenue is improve information sharing between agencies. While seemingly mundane, the simple ability to cross reference tax filings across agencies has the potential to close significant loopholes, particularly with respect to income tax assessments. At a more general level, the challenge of tax collection is fundamentally about information, and the ability to draw on multiple information sources to identify taxpayers and their actual tax liability. Thus, being able to draw on information from, among others, the Registrar General, the Department of Vehicle Licensing and Administration (DVLA) and the Ministry of Lands, Forestry and Mines, holds huge potential for improving tax collection through greater knowledge of the assets and activities of taxpayers. Yet these forms of information sharing remain far too limited, owing to bureaucratic infighting, and an overall absence of the political will to bring the assets of high net worth individuals more clearly into the public eye.

It is a generally held principle that tax system should be progressive, meaning that those with higher incomes pay greater taxes as a share of income than those with lower incomes.

The second challenge, and the most dramatic illustration of the inertia affecting efforts to improve administration, is the failure to implement an effective IT system within the IRS. Discussion of the need for improved use of IT has been ongoing for more than a decade and has involved major external pressure as well as important internal voices. Yet, the IRS remains an almost entirely manual system. While six offices in Accra have recently been involved in a relatively successful pilot automation program with support from the German development agency GTZ, concerns remain about the willingness of the government to pursue the project at the national level. Part of the reason for the lack of

15 Terkper 1998

enthusiasm for such small-scale automation efforts is that the government is awaiting the implementation of a much larger and more ambitious project, known as the E-Ghana project and supported by the World Bank, to automate much of the government. Yet, this project has been under discussion since 2004, and there are suggestions in many quarters that an aborted tendering process prior to the 2008 election was undermined by widespread politicisation. While the new government appears to be heavily committed to the task of revenue collection, it remains unclear whether this massive project is likely to go ahead, or whether a more incremental approach is more likely to succeed in practice.

Tax Incidence and Equity Considerations

It is a generally held principle that tax system should be progressive, meaning that those with higher incomes pay greater taxes as a share of income than those with lower incomes. In this conception tax liability should be linked to the ability to pay, and should be used as a mechanism for redistributing wealth within society. In practice, the standard assumption is that income taxation, including corporate taxation, will be progressive, while consumption taxes are likely to be regressive. While sophisticated economic models have occasionally sought to add some complexity to this picture, particularly with respect to corporate taxation, the general picture is borne out by most models and empirical evidence. This has led to a general contention that a more equitable tax system should rely more heavily on income taxes, and less heavily on consumption taxes.

Trade taxes have occupied a more ambiguous position in this debate, as their incidence is dependent on the particular tariff structure, and is consequently not readily subject to economic modelling. At the level of practice this has often been a moot point, as accepted economic wisdom, given support by the World Bank and IMF, has been that trade taxes should be abolished in any event, owing to their creation of economic distortions and opportunities for political rent seeking through trade protection[16]. Without delving deeply into this debate, it is suffice to point out the existence of a significant chorus of voices arguing that the revenue costs of trade liberalisation were too great, and not easily replaceable. They have moreover argued that trade taxes were in some cases a very effective way to tax luxury consumption, and thus increase the progressivity of the tax system[17].

While these general observations about tax incidence are possible, they need to be measured against the reality that remarkably little is know about the actual incidence of different types of taxes in developing countries[18]. This alone has led many international tax experts to conclude that it would be wise to be cautious before assuming that income taxes are necessarily extremely progressive, that consumption taxes are necessarily extremely regressive or that a greater focus on income taxation is the best course of action[19]. In layman's terms the argument can be summarised in several points:

- Because of exemptions on basic commodities and the fact that most retailers fall below the VAT threshold, VAT may be much less regressive than is sometimes assumed.
- Large amounts of wealth continue to lie outside the income tax system for administrative and political reasons making consumption taxes the only existing means by which much of the wealth in many countries can be taxed at all.
- Regardless of the tax structure, the greatest potential for redistribution is likely to be through well-targeted expenditure programs. A slightly regressive tax, coupled with a strongly progressive expenditure structure, will still have a significant redistributive impact. Thus, in the absence of the capacity to raise income tax collection, expanded taxation of consumption may be the most effective way to expand redistribution.

While those who have authored these views are not arguing against the benefits, in principle, of greater income taxation, they do provide a reasonable argument

16 Sachs and Warner 1994, Winters, McCulloch and McKay 2002, Krueger 1974

17 Cheeseman and Griffiths 2006

18 Further data on the tax incidence will be available later in 2009 in the forthcoming international tax research database. It will present an index of tax justice – the Plato Index – which measures "the ration of direct tax revenue to the pre-tax disposable income of the top quintile of households." Tax Justice Network, 2009

19 Bird and Zolt 2005

that where income taxation is weak additional consumption taxation may be better than nothing and less regressive than is sometimes claimed. On the other hand, there is little doubt that the availability of consumption taxation, which is relatively easy to collect, erodes incentives for governments to undertake the longer-term task of improving capacity for income tax collection.

Turning to the specifics of the Ghanaian case, there is no evidence that either the tax administration or the Tax Policy Unit have been able to carry out detailed studies of tax incidence, despite the obvious benefits of doing so. The only other evidence on this question comes from Younger[20] who sought to estimate whether various different tax types were regressive or progressive in their incidence based on household surveys. While he is careful to note the extreme caution that is required in assessing the results, in light of the limitations of available data, his findings generally confirm what has already been said. As expected, he finds that income taxes are significantly progressive, while sales taxes are essentially neutral in their incidence, consistent with the claim that they are somewhat less regressive in practice than in theory. Interestingly, taxes on gasoline are exceptionally progressive, even after accounting for the impact on costs of transport, while he finds that taxes on kerosene are likely the most regressive of the major taxes. He also finds that tobacco taxes are highly regressive, while taxes on alcohol are roughly neutral, suggesting that these taxes are only justifiable on the grounds of the negative externalities associated with the products themselves.

System of Local Taxation

Like most countries in sub-Saharan Africa, local taxation accounts for only a tiny share of total tax revenue in Ghana. A recent paper estimates that the share amounts to less than 0.2% of GDP, or less than 1% of total tax revenue. Despite official enthusiasm for decentralisation both nationally and internationally, districts in Ghana continue to be overwhelmingly fiscally dependent on central transfers and donors revenues, with internally generated funds averaging only 16.5% of local government revenue. This weak revenue performance is attributable to a multiplicity of factors, among which three are regularly cited: limited local government administrative capacity, extremely small tax bases available to local governments and disincentives resulting from large transfers from central government and donors[21]. While evidence from Ghana is limited on this topic, studies in other countries in the region suggest that many types of local taxation also tends to be highly coercive and arbitrary and thus extremely unpopular and costly to collect[22].

Despite these issues, and the comparatively low revenue yield, it is nonetheless true that local taxes are the most salient form of taxation for the majority of citizens. Most citizens fall below the threshold for national taxation, while any VAT or import taxes are paid higher up the value chain and are thus largely invisible. Yet, despite the importance of local taxes to low-income citizens, and the official support for fiscal decentralisation, local taxation receives comparatively little attention from international observers, researchers and the central government alike.

Like most countries in sub-Saharan Africa, local taxation accounts for only a tiny share of total tax revenue in Ghana.

This lack of attention has given rise to ineffective and poorly coordinated taxation. Section 86 of the Local Government Act, 1993 (Act 462) provides a catalogue of items on which a Metropolitan or District Assembly could impose local taxes and levies. A 1997 survey carried out by the National Commission for Civic Education (NCCE) revealed a long list of taxes paid, among them: Basic Rate (head tax), Income Tax, License/Store Fees, Kiosk Rent, Property Rate, Market Toll, Hawkers license, Toilet Fees, Bar Operation License, Lorry Park Tolls, Street/Light/Water Levy, Special Levy, and Birth and Death Registration. Of these taxes the most popular is the Basic Rate, which was reportedly paid by 41-96% of citizens, but at an extremely low rate, and with consequently low revenue yield.

The enormous range of different payments implies three major concerns. First, there is no reason to believe that these taxes are the most efficient or equitable means to raise revenue, as they almost certainty reflect ease of collection first and foremost. Second, there appears to be remarkably little coordination between local authorities and the national tax authorities. Citizens are consistently confronted with two distinct and uncoordinated sets of tax collectors and tax demands, while some national tax officials report that local tax officials sometimes seek to increase local collection by encouraging the evasion of national taxes. Third, such a dispersed and uncoordinated system almost certainly undermines the credibility of the system as a whole, thus damaging prospects for any improvement.

An obvious short-term solution to increasing revenue generation at the local level is to increase pressure of local governments to become self-reliant. The formula for distributing the District Assemblies Common Fund (DACF), which accounts for the largest share of transfers to localities from the central government, applies a weight of only 5% to own revenue generation in determining revenue eligibility[23]. Thus poor revenue performance does little to affect access to much larger funds from the central government, while sparing local governments the political struggle to raise taxes. But the reality is that simply changing this weighting is unlikely to change much without a realistic assessment of the actual revenue raising potential of local governments. As importantly, anecdotal evidence from both Ghana and elsewhere in Africa suggests that sudden decisions to put pressure on local governments to raise additional revenue tend to lead to inefficient, arbitrary and coercive taxation[24], or to revenue shortfalls and the contraction of public services[25].

What is needed is an entirely new model for expanding the fiscal capacity of local governments. This model should not only increase revenue generation, with its expected benefits in terms of service provision and public accountability, but should also lay the foundations for greater equity, efficiency and transparency in local revenue generation. While this is a topic that warrants much more research, it minimally appears that such a model would demand significant investment in research and capacity, much improved coordination between national and local level tax administrators and the expansion of the tax bases available to local governments.

There appears to be remarkably little coordination between local authorities and the national tax authorities

20 Younger 1993

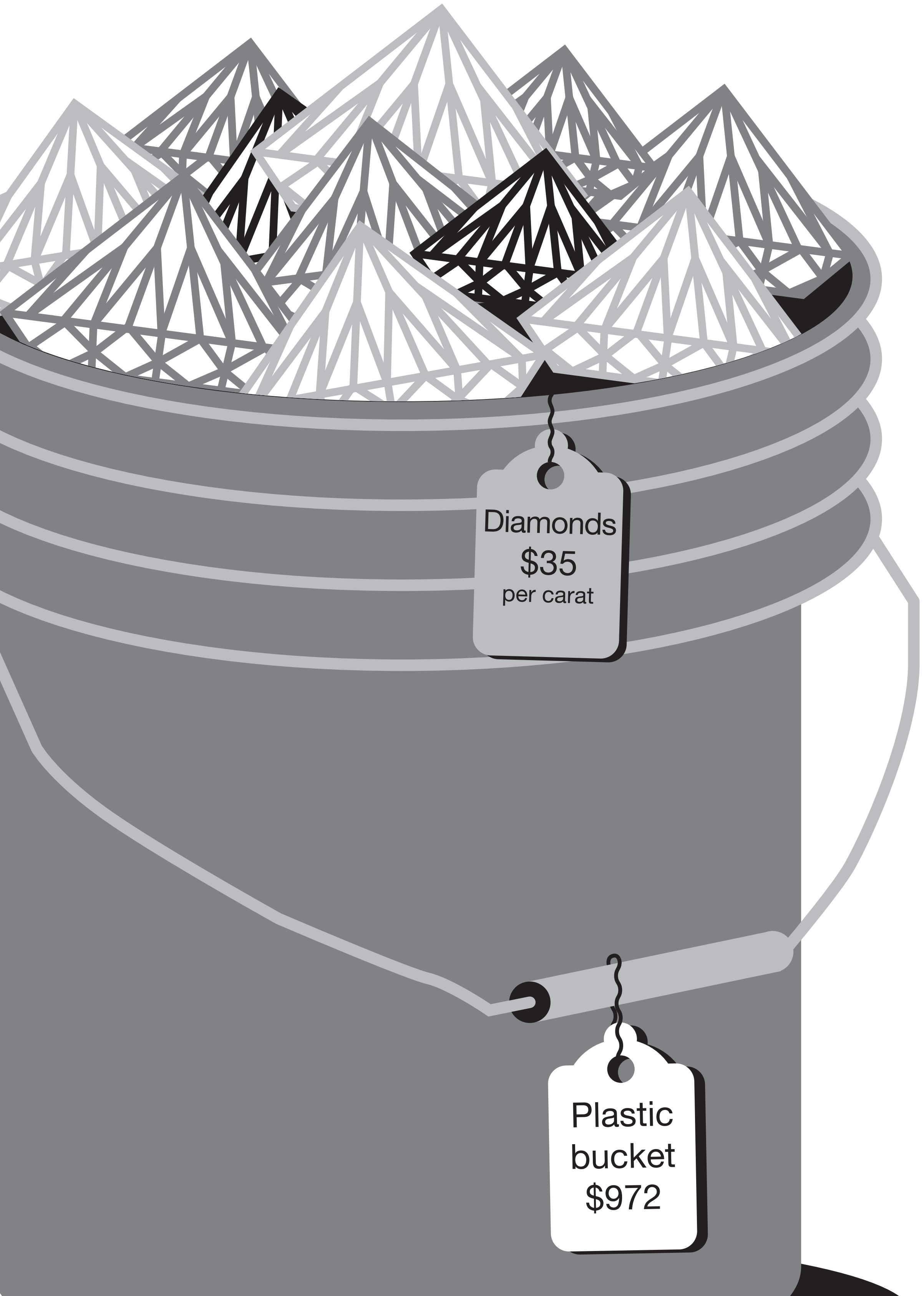
21 Mogues, Benin and Cudjoe 2009

22 Fjeldstad and Therkildsen 2008, Guyer 1992, Juul 2006

23 The DACF is subject to a reasonably sophisticated allocation formula that incorporates considerations about need (existing level of development), equity (population), service pressure (particularly in urban areas) and responsiveness (tax performance).

24 Fjeldstad and Therkildsen 2008

25 Juul 2006



Tax evasion, tax avoidance and tax incentives

This section looks at the issue of tax losses arising from four distinct factors:

- Lost revenue, known as 'tax expenditures', resulting from poorly conceived tax incentives
- Tax avoidance and evasion by large firms, and particularly TNCs
- Dramatic failures to tax effectively the forestry sector
- The inability to tax effectively the informal sector

Tax Incentives and Revenue Losses

Spillovers, Tax Competition and Tax Incentives

As the world has become more interconnected, and economies have become more liberal, countries have increasingly sought to compete to attract foreign investment. This competition has been rooted in a belief that foreign investment is an integral part of achieving rapid economic growth in the developing world. This competition for investment has arguably been most intense in least developed countries. These countries have been competing for a relatively small share of total global investment, while the investments available to these countries have been of the highly cost competitive, low skill and low value added variety.

As a result, many of these countries have sought to find ways to lower local costs of production, including by way of tax relief, regulatory laxity and the suspension of certain types of labor rights. The general rationale for such policies has been that, in the presence of major competition for highly mobile investment, small improvements in the costs of doing business and in the potential profits to be reaped may shift the location of the investment. In fact, in an environment in which many nations are offering investment incentives, there is a belief that an individual nation that refuses to offer incentives may be deprived of significant amounts of investment. This process has been termed 'tax competition' and has increasingly been acknowledged as a driving force in the proliferation of investment incentives and in the general lowering of corporate tax rates[26].

An alternative conceptualization of the argument for investment incentives is that such incentives should be used to correct market failures. Specifically, if certain types of industries create significant positive externalities for the domestic economy, then countries will be justified in providing incentives to encourage these activities. Thus, for example, incentives for relatively high-tech industries may be justified on the grounds that such industries create significant spillovers through skill and knowledge transfer. Likewise, when investor confidence has become unduly eroded, investment incentives may be an effective means to signal the investment friendliness of the destination country. This general justification – using incentives to correct market failures – is a cornerstone of standard economic theory, but is complicated by the difficulty, in practice, of measuring the magnitude of these positive externalities[27].

26 Klemm 2009

27 Klemm 2009, Zee, Stotsky and Ley 2002

Finally, investment incentives are sometimes used to achieve social goals. Thus, for example, the government may offer lower tax rates to those who invest in relatively disadvantaged regions, or may favour investments in labour intensive industries, in order to create employment. While these types of incentives are not economically efficient, they may nonetheless achieve important and legitimate state goals.

There is a belief that an individual nation that refuses to offer incentives may be deprived of significant amounts of investment.

Critiques of Tax Incentives

Despite these justifications for tax incentives, debates about their efficacy are very common. Civil society groups have argued that tax competition amounts to a 'race to the bottom', in which the pressure for tax cuts and deregulation eventually makes all of the countries worse off due to lower tax revenues, while most of the gains are secured by mobile international firms. While academics and policy makers are often more reluctant to use the same terminology, there is a growing acceptance of the view that international capital mobility has increased pressure for lower tax rates. This is, of course, celebrated by those who view taxes as too high and who oppose the corporate income tax, while for opponents there is something fundamentally problematic about tax competition and international intervention is justified to prevent it[28].

While this debate about the general merits and impacts of tax competition is of major significance and warrants international attention it offers little guidance to developing countries that are forced to make public policy in light of conditions as they exist in practice. The question for these countries is whether the systems of tax incentives that are in place are bringing aggregate benefits to the country, relative to what would occur in the absence of the incentives. Economists that study the impact of tax incentives are generally very sceptical.

At the root of these calls has been a belief that the cost of these tax incentives in terms of lost revenue has frequently outweighed the benefits in terms of increased productive investment[29]. This belief is backed by significant cross-country evidence, though it is drawn overwhelming from high-income countries, owing in part to the complexity of establishing whether a given investment would have occurred in the absence of a particular incentive. The perceived ineffectiveness of tax incentives may result from several potential problems, of which the most important are:

- If a firm would have invested in the country even in the absence of the tax incentive, then the tax incentive represents a direct revenue loss. Thus the benefits of new investment attracted by the incentives must outweigh the cost of the revenue lost from firms that would have invested in any event.
- The incentive scheme may create opportunities for new forms of tax evasion and avoidance, thus creating greater revenue losses. For example:
- Firms benefiting from tax exemptions may enter into new business lines or may exploit exemptions to import goods for sale. In the case of Free Zones tax free goods are very likely to leak into the domestic economy.
- Businesses may wrongfully claim certain tax incentives and benefit from the limited monitoring capacity of the tax administration.
- Businesses benefiting from short-term incentives may shut down and restart operations in order to continue to gain incentives.
- The incentive scheme may lead to unproductive rent-seeking behaviour and corruption. Firms will always seek tax incentives, even when they are not actually justified, and may resort to bribery or other forms of corruption in order to gain additional benefits.
- At a minimum, the creation of tax incentives imposes significant additional administrative costs on the tax authorities.

Within the context of these general comments, the creation of Export Processing Zones (EPZs), which are also sometimes called Free Zones, represent an extreme case. EPZs explicitly target highly mobile international investment that is focused on the production of goods for export. They thus offer very significant tax exemptions, sometimes going as far as essentially total exemption from taxation. The underlying logic of these economic zones is that they are competing for projects that are not locations specific and are overwhelmingly focused on cost minimisation. As such, these projects are extremely mobile and are likely to be the most affected by tax incentives. While the tax incentives sharply reduce any subsequent revenues to the state, the EPZs are still expected to produce beneficial employment and potentially also some skills transfer[30].

Despite the more narrow focus of EPZs, they suffer from major risks. These risks are not dissimilar to those facing tax incentives in general and can sometimes be more acute:

- Some firms claiming EPZ status may have invested even in the absence of incentives. In extreme cases existing export firms may claim EPZ status.
- Existing firms may shift their export activities into EPZs to take advantage of incentives.
- There is often huge scope for firms in EPZs to import goods duty free and illegally divert them to the domestic market.
- They create additional administrative burdens for the tax administration[31].

Principles to Guide Tax Incentive Regimes

Ultimately, the basic reason why tax incentives are generally judged to be inefficient is that while taxation does have an impact on the investment decision, it is often only of relatively moderate importance. Consequently, it is only where there is a high degree of competition for the investment or where the potential for profitability is somewhat marginal, that tax incentives are likely to have a major impact on aggregate investment. As importantly, the administrative capacity required to administer incentives effectively is beyond the reach of many developing countries, thus raising the risks of poor targeting and abuse.

With this in mind, the existing literature points towards certain broad principles to govern the provision of tax incentives. While these are highly simplified, they can point towards potential problems with existing incentive regimes:

- Tax incentives are most appropriate when targeting highly mobile capital and in cases in which potential investment sites are essentially similar.
- In less competitive cases tax incentives primarily serve to increase the after-tax profitability of investments. While this may increase the level of investment, the incremental investment is unlikely to be large enough to justify the revenue and administrative costs.
- When applying tax incentives, tax holidays are generally undesirable. They are (a) likely to promote short term investments to exploit the tax holiday, (b) they create highly inequitable competition for firms that do not benefit from the tax holiday, (c) they are very difficult to monitor due to the absence of tax filing, (d) they only benefit firms that would have been immediately profitable in any case, and (e) they are very difficult to eliminate once created.
- Incentive regimes should be rules based, preferably through legislation, and should not grant discretionary power for the granting of incentives. This reduces the risks of rent-seeking behavior and reflects the difficulty that individual officials are likely to have in negotiating with large businesses that will invariably seek to demand concessions.

28 Klemm 2009

29 Zee, Stotsky and Ley 2002, Klemm 2009, Morisset and Pirnia 2000

30 Muller, Frans and Tulder 2004

31 Muller, Frans and Tulder 2004

- Incentives should not discriminate between domestic and foreign firms, as this disadvantages local firms and is likely to promote investment round-tripping.
- Incentives regimes should be highly transparent, both as a means to discourage their abuse and to improve the ability of tax authorities to monitor the effectiveness and costs of different policies[32].

Overview of Policy Environment

Like many developing nations, Ghana provides a relatively broad range of tax incentives to promote investment. These include incentives for particular types of investment, and for investment in relatively disadvantaged areas. A general set of incentives exists, along with special incentives for those companies that qualify for Free Zone status.

Incentives regimes should be highly transparent

General tax incentives are captured by the Internal Revenue Act, 2000 (Act 592) and the Ghana Investment Promotion Act, 1994 (Act 478). Additional incentives for the tourism industry were created through Ghana Investment Promotion Centre (Promotion of Tourism) Instrument, 2005 L.I. 1817. Appendix 2 provides a break down of the major tax incentives that exist in Ghana.

The Free Zone regime was created by the Free Zone Act, 1995 (Act 504). Under the Act the imports of a free zone company are exempt from the payment of all indirect taxes and duties. In addition free zone companies enjoy a tax holiday of ten years from the payment of income tax on profits. Thereafter a free zone company pays corporate tax on profits at the reduced rate of 8%, while shareholders are exempted from the payment of withholding taxes on dividends arising out of free zone investments.

While the Ghanaian Free Zone Act is generally similar to standard EPZs, three aspects of the Ghanaian law are at least noteworthy. Unfortunately, the lack of existing research on the Ghanaian policy regime means that these observations are somewhat speculative.

- Companies are only required to produce 70% of the output for export, while the rest of their business can be carried out within the domestic market upon payment of relevant taxes. The fact that Free Zone companies carry out domestic business likely increases the monitoring challenge to prevent goods from being illicitly channelled into the domestic market.
- The Ghanaian regime provides an initial tax holiday, followed by a low rate after 10 years, which increases the risk that companies will seek to exploit the tax holiday and then close their operations after the tax holiday has expired.
- While a dedicated Free Zone territory exists near the Tema port, companies can also apply for free standing Free Zone status. While this law is meant to encourage Free Zone companies to locate in disadvantaged areas it also complicates monitoring.

In assessing the overall effectiveness of the tax incentive regime it is useful to treat the GIPC and GFZB separately, given the unique institutional arrangements for each. In both cases the analysis focuses on five aspects of best practice with respect to tax incentive regimes:

- The appropriateness of the types of tax incentives offered
- Legislative and Discretionary Incentives
- Balancing Investment Creation and Revenue Needs
- Transparency and Monitoring

32 Zee, Stotsky and Ley 2002, Klemm 2009, Morisset and Pirnia 2000

Ghana Investment Promotion Centre

The GIPC

The GIPC was created in 1994 with the dual goals of promoting investment and enforcing rules related to foreign owned businesses, including monitoring economic sectors that are reserved for Ghanaians, ensuring compliance with minimum capital requirements and ensuring the employment of Ghanaians in foreign firms. Investment promotion is pursued through a variety of channels, including participation in the formulation of tax incentive regimes. In 2005 the GIPC had a budget of slightly more than GHc1 million, over half of which was financed by the World Bank. While data is not available for more recent years, the recent shift to a more modern office space suggests an expanded budget allocation in the last years.

Legislative vs. Discretionary Powers

The incentives regime in Ghana is generally rule-based, with the different tax incentives enshrined in legislation. Incentives are overwhelmingly contained in the Internal Revenue Act, 2000 (Act 592), the Value Added Tax Act, 1998 (Act 546), the Customs, Excise and Preventive Service[33] and the Ghana Investment Promotion Centre Act, 1994 (Act 478) the last enhanced by Legislative Instrument 1817, which introduced new incentives for the tourism industry. On the whole, the generally rule-based character of the incentive regime is praiseworthy, as it reduces the scope for discretion, and thus the scope for rent-seeking activities and corruption. In this respect Ghana's starting point is better than that which exists in many countries.

Despite the generally rule-based character of the incentives regime, the issuing of the Legislative Instrument (LI 1817) in 2005 has been a source of significant controversy within the tax agencies. They note that LI 1817 was issued with virtually no consultation and without any assessment of the potential revenue implications, which they argue have been significant and partly the result of excessive scope for abuse. On a legal front, they question the constitutionality of LI 1817 because it was signed by the then Chairman of the GIPC Board rather than by the Minister of Finance, who is meant to have final authority in such matters. On a more procedural front, they argue that while LI 1817 received parliamentary approval parliament, the reality is that parliament generally acts as a rubber stamp on issues of tax incentives. While it is beyond the scope of this paper to review the entire scope of these complaints, it is minimally clear that there is a troubling lack of consultation, cooperation and coordination across agencies on these matters.

33 Management Law, 1993

There are also several avenues for the GIPC to exercise discretion in applying incentives. Within legislation, Muller, Frans and Tudler[34] note that,

> For purposes of promoting strategic or major investments, the GIPC Board may, after consultation with other State agencies and with the President's approval, negotiate specific incentives with investors.[35]

As an example, they cite special tax concessions that were negotiated with AngloGold Ashanti in 2003, in exchange for an equity holding in the Obuasi Deeps project for the government.

Aside from discretion in granting new incentives, there is a widespread feeling the GIPC is able to exercise significant discretion in interpreting the written law and assessing the eligibility of different firms. For example, prior to 2004 the GIPC gave Telecom companies the right to apply for exemption from the payment of customs duties and excise duties on various inputs. However effective 2004, the GIPC refused to grant approvals for these exemptions. Indications are that this decision was taken by the incoming GIPC CEO in 2004 but Telecom companies have not been able to receive a full explanation for the change in policy.

Without passing judgment of the validity of this particular decision, it certainly points to the ability of the GIPC to interpret the law and thus exercise a certain amount of discretion. While such discretion is an inevitable reality with any law, it is unclear to what extent the GIPC has attempted to audit and track the entire range of discretionary choices that are made. During interviews the GIPC provided a blanket denial of any cases of discretion being exercise, and actively resisted request for additional data, both of which lead to scepticism

34 Muller, Frans and Tudler, 2004: 107

35 This is provided for by Section 25 of Act 478

about the level of monitoring that occurs.

Types of Tax Incentives

Existing literature on tax incentives is almost universally wary of tax holidays, which are generally believed to create greater risks of abuse and attract less desirable forms of investment than other types of incentives. Despite this, Ghana relies heavily on tax holidays within its tax incentive structure. Existing reports have documented evidence that firms benefiting from these tax holidays use changes in ownership and other questionable means to extend their access to these tax benefits[36]. Tax officials equally decry the ability of companies to use modest new investments as a justification for claiming revenue reducing tax holidays, pointing particularly at such abuses by the tourism sector under LI 1817. Again, the absence of detailed data on the activities of firms over time makes it impossible to empirically assess the extent to which tax holidays are abused. Again the lack of cooperation from GIPC lends itself to some scepticism, as do widespread concerns among tax administrators and business people.

It is an unfortunate reality that establishing the overall costs and benefits of a tax incentive regime is extremely difficult.

Monitoring and Evaluation of Impact

It is an unfortunate reality that establishing the overall costs and benefits of a tax incentive regime is extremely difficult. A recent IMF report[37], while reiterating general scepticism about most tax incentives, stresses the complexity of assessing the benefits of tax incentives in the absence of some type of General Equilibrium Model. The complexity of the problem stems from several factors:

- It is extremely difficult to establish with certainty that a particular investment was caused by tax incentives or - put another way - it would not have happened in the absence of the incentive.
- Similarly, incentives may affect the size of investment, rather than the occurrence or non-occurrence of the investment, which further complicates attribution
- Even if new investment is attributed to tax incentives, quantifying the benefits involves estimating both direct and indirect benefits, including intangible factors such as technology and skills transfer (which are often an important motive for investment incentives).
- Recent research has argued that even where incentives spur investment in priority sectors, these new investments may "crowd-out" alternative investments by absorbing scarce capital, skills, credit and other factors. Thus aggregate benefits may be smaller than sector-specific benefits[38].

Bearing in mind these caveats, two studies have looked explicitly at the impact of tax incentives in Ghana, the second of them with the active support of the RAGB[39]. The broad conclusions of both studies are consistent with international predictions about the inefficiency of many tax incentive regimes. They conclude that taxes do not play a dominant role in the investment decision and that a significant share of those firms benefiting from incentives would have behaved the same way in the absence of incentives. Both imply that the incentive regimes are damaging to the overall welfare of the country and propose that the country would be better off investing in infrastructure and training, rather than attempting to rely on incentives to attract investment.

The GTZ study goes so far as to estimate that tax losses amounted to 9-12% of total tax revenue collected from companies, though this should be taken with extreme caution given a survey response rate of only 40%. Meanwhile, Muller, Frans and Tudler document both specific instances of the incentives being abused, as well as more general perceptions about the existence of such abuse. They note, among other things, reports of:

- companies being 'sold' to related business interests in order to renew access to tax incentives available to new investment;
- evidence that most firms enjoying tax holidays were already making large profits, and
- evidence that those firms were also largely engaged in activities that rely on local resources, particularly agricultural products and fish, that make them less subject to international competition to attract investment.

During interviews and data gathering for this study CEPS provided an additional list of abuses:

- Diversion of the goods for purposes other than which exemptions were granted;
- Diversion of Temporary imports onto the local market;
- Diversion of manufacturing raw materials with multiple uses onto the local market. E.g. diversion sugar meant for manufacturing onto the consumer market.

GIPC officials generally concede that some such abuse occurs, but argue that a) monitoring is improving, b) monitoring is primarily the responsibility of the tax agencies and c) a small amount of abuse does not invalidate the overall benefits of the program. Unfortunately, the uncooperativeness of the GIPC in providing data to any outside researchers makes it impossible to verify, or feel confident about, either the first or last of those claims. With respect to monitoring, the tax authorities accept that they are primarily responsible for monitoring, but contend that a) the unwillingness of GIPC to be a constructive partner in this effort is hugely problematic and b) any tax incentive regime must be designed in light of a realistic assessment of existing monitoring capacity. At a minimum, the need for much greater cooperation across agencies, and much closer attention to revenue losses and abuse, appears to be needed.

Transparency for Monitoring Purposes

The most damaging conclusion of the GTZ report was that: "No serious monitoring and evaluation processes for the various tax incentives in the country were in place"[40]. Virtually no systematic data[41] on the scope, impact or cost of incentives was available from either the IRS or the GIPC. The absence of data includes such straightforward items as full lists of those firms benefiting from particular tax incentives, or relatively simple estimates of the foregone revenue, or 'tax expenditures', associated with those incentives. While GIPC has begun publishing quarterly reports on the total amount of new investment, these reports contain no data on the tax incentives or their costs. More generally, a list of new investments is in no way comparable to an estimate of the role of incentives in attracting additional investment.

"No serious monitoring and evaluation processes for the various tax incentives in the country were in place"

Previous studies, anecdotal evidence from interviews and the generally secretive stance of the GIPC creates grounds for concern about tax losses associated with tax incentives. Yet, in the absence of systematic data on the impact of the tax incentive regime, it is impossible to evaluate effectively the costs and benefits of the system. It is likewise extremely difficult to identify instances where the system is being abused and to take corresponding efforts to improve the system. In this sense it is the absence of any credible monitoring of the impact of tax incentives, or any sharing of relevant data, that are arguably the most problematic element of the existing regime.

Ghana Free Zones Board

Institutional Overview

The Ghana Free Zones Board (GFZB) came into existence with the passage of the Free Zone Act, 1994 (Act 504), with the aim of attracting additional export oriented investment to the country. Free Zone companies are expected to operate as virtual islands with any goods entering the Free Zone from Ghana or leaving the Free Zone into the domestic market required to cross a customs point and pay all relevant taxes. The GFZB in-

36 GTZ 2006, Muller, Frans and Tudler 2004
37 Chai and Goval 2008
38 Klemm 2009
39 Muller, Frans and Tudler 2004 and GTZ 2006
40 GTZ 2005
41 Muller, Frans and Tudler, 2004

cludes a National Technical and Monitoring Committee that is responsible for monitoring Free Zone companies and preventing abuse.

Structure of Tax Incentives

Similar to the general tax incentives administered by the GIPC, the activities of the Ghana Free Zone are clearly defined in the existing laws. Eligibility for Free Zone status is a function of the ability of a company to prove that it will export a minimum of 70% of its production, and that it will not violate any other statutes under the Free Zones Act. This basic framework ensures that there should be no discrimination against domestic, or any other, firms. The law calls for a ten-year tax holiday followed by taxation at a lower rate "not greater than 8%". While the subsequent rate leaves some space for discretion, the default rate to be applied is 8% and can only be amended by a Legislative Instrument following deliberations by the Board. In principle the Free Zone Act dictates that "the Board may attach such conditions as it considers appropriate relating to skills, job opportunities and degree of export orientation," but in practice the 70% export criteria seems to be far and away the dominant issue.

As with the use of tax holidays by the GIPC, there is reason for concern that the use of time limited tax holidays will lead firms to invest only so long as the incentive remains in force or that they will use questionable ownership transfers or modest new investments to seek to renew the tax holiday indefinitely. This study has been unable to secure any systematic data on this question from the GFZB, though complaints about this issue from other stakeholders are primarily levelled against GIPC tax incentives. Given that the Free Zone status has only been an option for fourteen years such problems would, if anything, still be in their infancy.

Monitoring and Evaluation of Impact

As with the GIPC, only few systematic studies of revenue impact are available[42]. These reports are particularly harsh in their assessment of the Free Zones regime and imply that it has been subject to particularly large amounts of abuse. While the GFZB strongly contests this characterisation, and rightly argues that these studies were far from systematic, it was unable or unwilling to provide significant data or studies to shed additional light on the issue largely due to claims about the confidentiality of company data.

Critiques of GFZB focus on two issues: whether the Free Zones have been legitimately investment creating and the extent of abuse of tax exemptions by Free Zone firms. With respect to the challenge of investment creation both studies point to the fact that a significant number of Free Zone firms were active in Ghana prior to the creation of the Free Zones regime. Those studies suggest that at least ten companies fall into this category but precise data from the GFZB was not available. While it is possible that the shift to Free Zone status may have subsequently led to additional future investment, there is good chance that these cases represent a net welfare loss as large firms ceased paying taxes.

That said, this is not sufficient evidence to conclude that the Free Zone regime has been a failure, as it is the very nature of rule-based incentives regimes that some firms that do not need incentives will receive them. The challenge is to determine whether the revenue loss in those cases is justified by the benefits of new investment that is created in other cases. At a minimum, there is certainly anecdotal evidence that some Free Zone companies would absolutely not have invested in the absence of the existing incentives.

The second area of criticism in the existing reports relates to the question of abuse. The most commonly cited issue is companies that import goods into the Free Zone and illegally divert those goods for sale within the domestic market. Any goods that are illegally sold domestically by Free Zone companies imply a loss of all of the applicable sales and profit taxes on that sale, while such sales also represent unfair competition for domestic firms. Muller, Frans and Tudler[43] claim that such abuse was widespread as recently as the first half of the decade, and support this claim with evidence that almost 50% of Free Zone imports were of consumer goods, largely by companies that were ostensibly re-exporting the goods.

There is little doubt that overall monitoring capacity is limited, with GFZB attributing this largely on understaffing by CEPS and CEPS attributing it to poor monitoring and cooperation by GFZB. Yet, the scale of the problem is unclear, while neither CEPS nor GFZB seems eager to provide transparent estimates of the likely scale of the revenue loses. In defence of monitoring efforts, the GFZB claims that it periodically de-lists Free Zone companies on account of consistent abuse of the established regulations, though – again - requests for a list of such cases was not readily provided. Assuming some meaningful amount of delisting, it would be indicative both of a fairly widespread problem and of a regulatory body that continues to make at least some efforts at enforcement.

The grounds for criticizing the GFZB lies in the fact that comprehensive and credible studies of the impact of the Free Zones regime have not been carried out or - if they have - have not been made public. Muller, Frans and Tudler[44] report that the IRS did conduct studies in 2001 and 2003 but also conclude that due to capacity constraints these studies fell far short of a comprehensive evaluation. The reality is that in the absence of active and transparent efforts by the GFZB to evaluate the impact of the incentives regime outside observers are likely to remain sceptical. In the absence of greater transparency and collaboration in this effort, any debate over the effectiveness of the Free Zones is liable to be shaped by predispositions and the tendency of both sides to look at those cases that support their position.

Any goods that are illegally sold domestically by Free Zone companies imply a loss of all of the applicable sales and profit taxes on that sale

Recent Developments

On a more positive note, the GFZB has recently taken meaningful measures to curb abuses. Whether this is a new found commitment or indicative of a longer standing pattern is unclear, but there is certainly cause for some optimism, and an opportunity to build on this progress. The specific action was the passing of Legislative Instrument 1618 in 2007, which eliminated plastics companies and timber companies from eligibility for Free Zone status. The plastics companies were denied Free Zone status based on a widespread perception that they had been engaged in significant efforts to divert imported goods into domestic customs territory. This action implicitly concedes that significant abuse was occurring previously but is clearly a positive step for the future. The timber companies were removed from Free Zone eligibility owing to a much more fundamental concern about the justification for granting an extractive industry such status. This is discussed at significantly greater length in the case study of the Forestry sector, but is an undoubtedly positive development.

Tax Evasion and Avoidance

Poor Income Tax Collection

The defining feature of tax systems across the developing world is their inability to collect a significant share of revenue through income taxation of individuals and corporations. Developing countries overwhelmingly collect far less direct tax than developed countries, both as a share of total taxation and as a share of GDP[45].

Yet it is not all elements of direct taxation that are equally problematic. Whereas corporate taxation comprises a modest share of total income tax collection in most developed countries, in most developing nations corporate tax collection is comparable to, or even higher that, personal income tax collection. This indicates that formal sector firms in developing countries often bear significant tax burdens, despite the high level of tax avoidance and evasion in the rest of the economy.

By contrast, it is personal income taxes that perform particularly poorly. While data is very problematic, Bird and Zolt[46] make the general claim that:

> In developed countries, personal income tax revenues are about 8-10% of GDP. In developing countries, personal income tax revenues are often less than 1-2% of GDP.

42 notably studies by Muller, Frand and Tudler 2004 and GTZ, 2006

43 Muller, Frans and Tudler, 2004

44 Ibid.

45 Bird and Zolt 2005

46 Ibid.

Within this limited income tax base, the overwhelming majority of revenue, sometimes as high as 95%, is raised from withholding taxes on formal sector wages, implying an almost total failure to tax the self-employed and employees of firms that escape the withholding tax system[47].

It is possible to point to four general areas of significant revenue loss, though precise estimates of tax incidence are notoriously problematic. The first is a general inability to tax large informal sectors that have most recently been estimated at between 30% and 60% of total economic activity in most developing countries[48]. The second is an inability to tax professionals who provide difficult to monitor services, such as consultancy or legal advice. The third is the difficulty of taxing capital income. This is particularly true when capital income is held overseas, as it is hugely unlikely that such income will be reported, while the tax administration generally lacks the capacity to pursue such cases effectively[49]. The final issue is the inability to tax rental income and property, both of which would be progressive and yield significant revenue[50].

Ghana is generally no different from this overall story, with reasonable levels of corporate tax collection and low levels of income tax collection overwhelmingly drawn from withholding taxes. As outlined in Appendix 1, Tables 1-2, income tax from the self-employed, which encompasses all non-PAYE taxpayers, accounted for only 11% of total income taxation in 2007. That said, it is worth noting that during the 1980s, when the government was collecting taxes very aggressively, sometimes in the absence of concrete accounts, collection of income taxes from the self-employed were almost equal to those from PAYE, though this was partially a function of lower levels of PAYE collection. In the realms of capital gains taxation and property taxation neither is large enough to justify a separate category in the national accounts, while available data indicates that total property tax collection at the local level amount to at most 0.04% of GDP.

At the base of this inability to collect income tax lies a desperate lack of information about taxpayers, which is linked to poor internal record keeping and very limited information sharing across agencies. The absence of effective income taxation reduces revenue and almost certainly robs the tax system of much of its redistributive impact. Finally, and related to poor record keeping, it is important to note that in this setting individual tax commissioners have significant powers to grant discretionary tax concessions or one time tax relief, for example when agreeing payment plans for accumulated arrears. While one does not regularly encounter claims of widespread abuse, the lack of transparency, which is to a large extent a symptom of the broader weakness of record keeping within the IRS, is a cause for some concern.

Tax Evasion by TNCs

On the one hand, large formal sector firms in developing countries comprise a disproportionately large share of the total tax base. This results from their high visibility and the consequent difficulty of avoiding taxation in the absence of high-level corruption. Many large firms consequently complain that they are unfairly targeted by tax administrations that are eager to reach revenue targets and are more inclined to pursue readily available large firms than make the effort to tax many smaller firms. In this respect there is a strong case to be made for expanding the tax base, as is discussed later in the paper.

Despite the reasonably significant overall level of corporate tax collection, there is reason to believe that there are also significant tax abuses undertaken by larger firms. Some of these abuses occur through the systems of tax incentives that exist, as discussed in the previous section. The other potential source of abuse is the use of false invoicing and transfer mispricing to shift profits out of the country and thus lower tax liabilities. False invoicing occurs when local firms report higher prices paid for imports and/or lower prices received for exports, both in an effort to reduce reported profits and thus tax liabilities. Transfer mispricing occurs when subsidiaries of multinational firms misprice the exchange of goods and services with the parent company or other subsidiaries of the same company allowing them to illegally shift profits to low tax jurisdictions.

47 Bird and Zolt 2005, Zee 2005

48 Schneider and Klinglmair 2004

49 Bird and Zolt 2005

50 Kelly 2000

While both activities are hard to detect and even harder to prove, there is little doubt of their prevalence. It is equally clear that developing countries are particularly vulnerable to such tax evasion due to their limited monitoring capacity. A report in 2008 by Christian Aid, drawing on research by Raymond Baker[51], estimated that low-income countries lose US$22.4bn in tax revenue annually to false invoicing and transfer mispricing[52], which was comparable to the total amount of foreign aid received by these same countries.

At the base of this inability to collect income tax lies a desperate lack of information about taxpayers, which is linked to poor internal record keeping and very limited information sharing across agencies.

Tax Evasion by TNCs in Ghana

It is, unfortunately, extremely difficult to estimate the scope of such abuses, or identify specific cases, precisely due to the fact that tax evasion is an illegal, and hidden, activity. Perhaps the most interesting such effort has been conducted by Simon Pak, who estimates the extent of false invoicing and trade mispricing by looking at trade statistics and estimating the deviation of reported prices from the arms length value of the transactions. His work, which so far focuses only on trade with the EU, estimates that tax losses to Ghana from these two methods during the years 2005-2007 averaged between 30.7 and 51.4 million Euros per year, though 2005 was dramatically lower than the two subsequent years. The 2007 value of 62.4 million Euros amounts to roughly 3.4% of total tax revenue in 2007 at current exchange rates, which, while not overwhelming, is equivalent to almost 27% of the total corporate income tax that was collected in 2007. If, as is likely, trade with the rest of the world is subject to similar patterns, it is probable that total corporate tax losses amount to more than 50% of total collections. While even western countries lack the ability to entirely curb such abuses, any significant improvement in enforcement would represent a significant revenue windfall.

The basic policy framework for addressing such avoidance is relatively adequate. There are sections of Ghanaian law that address specific forms of tax avoidance, including false invoicing and transfer mispricing, as well as a general anti-avoidance clause. The challenge facing the revenue authorities is one of capacity. Most staff lack thorough understanding of complex tax avoidance schemes and very few have the ability to detect effectively such schemes. It remains the case that no African country has been able to successfully challenge a case of transfer mispricing with a TNC under existing Double Taxation Treaties (DTT). Ghana has signed such treaties with France, Germany, the United Kingdom, South Africa, Italy, Belgium and most recently with the Netherlands. Further treaties are either under ratification, while it is negotiating with Switzerland and Sweden or under negotiation[53]. There is also a problem of capacity with respect to policy formulation. Thus, even when regular tax avoidance strategies are identified there are no effective channels in place to introduce amendments to the relevant law. For example, those at the Large Taxpayers Unit point to a number of companies that are reducing their tax bills by financing themselves heavily through debt and claiming very large deductions for interest paid. In many countries this would be illegal due to rules covering thin capitalisation but in Ghana the thin capitalisation law only covers debt on equity. This has allowed firms to continue to rely on debt financing, sometimes secured from partner firms, in order to reduce their tax bills. Despite awareness of this challenge there is no indication that amendments are forthcoming.

Ultimately, it is clear that there is a significant amount of tax avoidance that takes place through relatively common, but difficult to enforce, channels[54]. The revenue that could realistically be gained by closing

51 Baker 2006

52 Christian Aid 2008

53 PWC 2008

54 SOMO 2008

various loopholes would be meaningful, and would in principle have a positive impact on competitive dynamics by rewarding those firms that follow the law. That said, it is important not to condemn large international firms on the revenue front, as most tax administrators are adamant that while such firms are not above certain firms of tax avoidance, they are less likely to engage in aggressive tax evasion than are many local firms. This is consistent with the broad observation that relative to some parts of the economy formal sector business actually contributes a reasonably large share of national revenue. This is not to discourage efforts to reduce tax avoidance, but a reminder that the worse cases of tax evasion, and the potentially largest revenue gains, likely lie in other forms of income taxation. From an equity and competitive perspective it is certainly not clear that TNCs are more guilty of avoiding tax than are other firms. The one glaring exception to this general statement is in the realm of extractive industries like oil, mining and timber, all of which are subject both to large revenue losses and a variety of other dubious practices on the part of multinational firms.

Revenue From Extractive Industries

Extractive Industries, Revenue and Development

As with many developing countries, Ghana relies to a significant degree on income generated from natural resource industries. Mining and forestry accounted for 8.6% of GDP in 2004, while oil production is expected to begin as early as late 2010, with even larger implications for the economy. The defining feature of natural resource sectors is that they generate economic rents, which reflect the underlying value of the resource and amount to windfall profits available to those who own the resource. The extent of the economic rent is the difference between the selling price and the cost of getting the resource to market. Economic theory dictates that when the resource is extracted, the extracting company should pay most or all of its rent value to the government. As a result, natural resource industries are expected to yield significant revenues for government, above and beyond normal income taxes, sales taxes and customs duties.

Globally oil and mining activities have gained the bulk of international attention, owing to the potentially enormous revenue flows, and growing concerns about the possibility of a "resource curse" for political and economic development. From a revenue perspective, oil revenues are by far the most dramatic, and provide more than 50% of the total budget revenues to roughly 20 non-island economies, of which several receive virtually the entirety of public revenues from their oil wealth.[55] While systematic data on the contribution of mining to total revenue is not readily available, it comprises at least 10% of exports, and likely comparable shares of total revenue, in sixteen countries in sub-Saharan Africa, excluding South Africa. In Botswana the revenue contribution of mining fluctuates significantly but averages in the neighbourhood of 50% of revenue.

Despite the potential for natural resources to be a source of significant wealth they have been a source of major controversy in many developing countries. The critiques argue broadly that the benefits arising from natural resource extraction are much smaller than they should be and are outweighed by the significant environmental, economic and political costs.

Exceptionally generous mining regimes that were put in place under structural adjustment reforms in the 1980s and 1990s have deprived countries of necessary revenues

That said, the revenue contribution of mining has been a source of significant controversy. Many observers argue that exceptionally generous mining regimes that were put in place under structural adjustment reforms in the 1980s and 1990s have deprived countries of necessary revenues, despite the high environmental costs and limited direct economic benefits of mining activities. It is equally clear that high-level corruption has contributed to low revenue yields from mining and other resource sectors, with officials willing to grant very favourable terms to investors in exchange for personal benefits. While it is difficult to quantify the impact of such dynamics, recent reviews of existing mining contracts in Liberia and the Democratic Republic of Congo suggest that the revenue costs may be enormous in many countries[56].

55 At exact figure is problematic because many oil-producing nations do not provide government financial data to the IMF on a regular basis.

It is essential that revenue sectors provide significant and transparent revenues to government due to the potentially large costs of extractive industries. At the most basic level, there have long been concerns about the often disastrous environmental impacts of extractive industries and particularly of activities like open pit mining. There have likewise been concerns that local communities have generally suffered most directly from extractive activities, through everything from environmental damage to displacement, while reaping very few of the rewards[57].

More recently, research has turned to the more indirect but potentially more insidious consequences of resource wealth. The earliest such research pointed to the role of resource wealth in promoting and perpetuating conflict, as natural resource wealth provided an incentive for rival groups to seek to seize the state, while some types of resources - like alluvial diamonds - also provided the funds to sustain those conflicts[58]. Later research turned to the potential for access to resources to lead to increasingly autocratic and unaccounz forms of government. These studies focused on the fact that resource rents provided governments with huge and un-transparent revenues, thus allowing governments to retain power through a combination of investing in repression and buying political support through patronage[59]. More recently researchers have argued that the availability of resource revenues removes the need for governments to rely on tax revenues, thus reducing incentives for governments to be responsive and accountable to citizens. This dynamic is discussed in greater detail in the final section of this paper[60].

56 Prichard forthcoming

57 Campbell 2004

58 Collier and Hoeffler 1998, 2004, Ross 2004

59 Dunning 2005, Collier 2004, Snyder and Bhavnani 2005

What follows provides a more detailed look at the mining and forestry sectors in Ghana, with special attention to the fiscal regimes that exist in both sectors. The oil sector is not addressed here, as it has recently been the subject of a large number of studies[61].

The Case of Mining in Ghana

That mining society in Ghana accounted for 4.6% of GDP and more than 30% of total exports in 2004. Gold provides the vast majority of the income in the sector, though Ghana is also a producer of diamonds, manganese and bauxite. Ghana was a leading global producer of gold as long ago at the 15th century, and this continued throughout the period of European colonial rule.

Ghana witnessed a sharp decline in gold production during the 1970s and 1980s as the country experienced a much broader economic collapse fuelled by political instability, macroeconomic imbalances, excessive regulation and growing corruption. This decline was reversed in the late 1980s, while enormous gains in production were experienced throughout the 1990s. These gains followed major liberalising policy reforms under the new mining law (PNDCL 153) of 1986, which was heavily sponsored by the World Bank and IMF as part of the broader program of structural adjustment. Among the most important aspects of the new legislation was the reduction of state involvement in mining activities, major reductions in various taxes and a dramatic increase in capital allowances. A new mining law was promulgated in 2006 and maintained most of those changes while reducing the maximum royalty rate and eliminating the additional tax on windfall profits.

There is no denying that the liberalisation program contributed significantly to the dramatic expansion of mining production in the 1990s. Yet critics of mining in the country have remained vocal. As was noted earlier these critiques have centred on the major environmental costs of mining, the fact that huge tracts of land that could be used for other purposes have been granted as concessions and the fact that benefits to local communities have often been far less than what was expected.

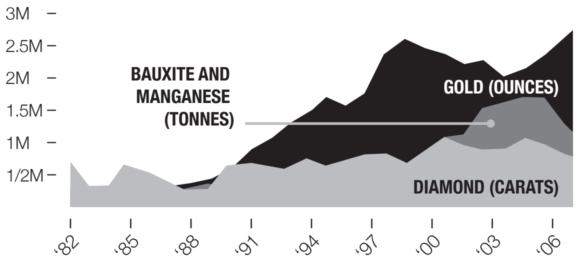
60 Moore 1998, 2008, Ross 2001, 2004b

61 Oxfam America 2009

Akabzaa and Ayamdoo[62] report that local communities are increasingly frustrated by the distribution of community payments. Wastage of these funds by local chiefs and district assemblies has led to growing conflicts with citizens in the areas. This latter point relates to the broader concern that the lack of transparency surrounding the use of mining revenues may contribute to the erosion of political accountability and the expansion of corruption, similar to what has been more widely documented in oil producing nations[63].

Critics also argue that the local economic benefits of mining are very limited. Mining is a highly capital intensive industry, and therefore creates relatively little employment, of which the even smaller number of highly skilled positions are generally reserved for expatriate staff. Equally troublingly, there are exceptionally few upstream and downstream opportunities created by the local mining sector. The overwhelming majority of inputs are imported, generally through global sourcing contracts that further erode opportunities for local firms. Downstream, Ghana exports almost exclusively raw minerals, without any value added activities occurring in the country.

Production of Major Minerals, 1982-2007 (fig. 4)



Source: Akabzaa and Ayamdoo 2009

The lack of direct local economic benefits has long been a feature of mining in developing countries, and the policy debate has centred on the capacity of countries to provide skilled labour and efficient value added services. While it is not frequently noted, a central facet of the liberalisation programs of the 1980s and 1990s was a conclusion by the World Bank that countries lacked such capacity, and thus should focus on benefiting from mining through tax revenues. A major World Bank report argued that:

> The recovery of the mining sector in Africa will require a shift in government objectives towards a primary objective of maximising tax revenues from mining over the long term, rather than pursuing other economic or political objectives such as control of resources or enhancement of employment. This objective will be best achieved by a new policy emphasis whereby governments focus on industry regulation and promotion and private companies take the lead in operating, managing and owning mineral enterprises. That is not to say that only investors should benefit from mining. But in the new policy environment governments should obtain a fair share of the economic rent of the sector through fiscal arrangements that are stable, competitive and fair, rather than through ownership and operation[64].

The question of what capacity exists locally remains a challenging one that demands careful analysis, yet it does seem clear that there should be efforts to promote local value added as capacity evolves over time.

What is particularly troubling, in light of the explicit evidence that the goal of policy liberalisation was to expand government revenue, is the fact that revenue from the sector remains remarkably low. Under the liberalised regime, firms are largely exempt from import duties, and thus revenue is expected to come from a combination of corporate taxation, royalties, dividends, capital gains taxes and income tax payments by employees. Yet, in practice, the overall contribution of mining firms to income taxation, at 10% of the national total, appears to be less than that of large firms in other sectors, though precise data is obviously unavailable[65]. Given that 10% of income tax amounts to only about 3% of total taxation, and that mining firms pay very little in customs duties, the overall contribution to national revenue is very minimal.

There are multiple reasons for this extremely poor revenue performance, and they represent a combination of poor policy, weak implementation and questionable activities by firms. The most important, and also the

62 Akabzaa and Ayamdoo 2009
63 Ross 2001, 2004
64 World Bank 1992: x
65 Prichard forthcoming

Table 3: Mining Taxation by Component 1990-2006

Year	Corporate income	Royalties	PAYE	NRL	Total mining Taxes	Mining as % of IRS collections
1990	2.83	1.89			4.72	8.9
1991	0.82	3.02			3.84	6.3
1992	4.56	4.55			9.10	12.2
1993	4.39	7.49	2.65		14.54	12.8
1994	7.21	12.78	4.81		24.81	14.9
1995	20.39	20.91	7.95		49.29	17.9
1996	9.16	35.49	16.83		62.74	14.8
1997	9.87	34.59	25.02		77.85	12.9
1998	14.45	49.84	31.02		95.31	12.1
1999	31.12	48.62	27.84		107.58	11.9
2000	15.79	118.74	59.24		193.77	13.7
2001	24.81	127.36	76.11	4.25	232.53	11.9
2002	23.50	153.45	101.46	26.47	304.89	10.7
2003	68.14	194.39	141.05	16.78	420.36	11.0
2004	100.33	215.74	134.36	53.19	503.62	9.4
2005	235.95	269.90	154.37	19.52	679.73	11.0
2006	215.66	316.25	182.71	15.83	730.50	9.66

Source: Akabzaa and Ayamdoo 2009; IMF Statistical Appendices

most reliable, revenue source is minerals royalties, which are collected at 3% of the total value of production, and are thus administratively straightforward. The controversy around royalties lies in the fact that by law the rate is meant to escalate for more profitable firms to a maximum of 6% (formerly 12%). Yet, in practice, all firms appear to have continued to pay 3%, even during the recent minerals boom, owing almost certainly to manipulation of profit figures by the firms and the lack of effective monitoring capacity at IRS. According to IRS officials it is sufficiently complicated to calculate the profitability formula for increasing the royalties rate that officials are resigned to sticking with the lowest value. This warrants review.

The second area of taxation is corporate taxation and this is the area in which existing policy and enforcement is most glaringly inadequate. Based on royalty payments, mining firms as a group paid a maximum of 2% of turnover in tax and a minimum of less than 0.5% of turnover during the period 2002-2006. These values are extremely low given the large profits achieved by these firms particularly in recent years. The low level of taxation appears to be in large part the result of an exceptionally generous system of capital allowances, which allows virtually all expenses to be claimed under capital. Tax payments by these firms appear to be further reduced by illegal forms of tax avoidance, including transfer mispricing and the overvaluation of capital goods for purposes of claiming capital allowances. Akabzaa and Ayamdoo[66] argue that the system of capital allowances is in urgent need or review, as it is far more generous than the systems that exist in comparable mining destinations.

A final area of tax losses is the non-payment of PAYE by expatriate staff of the mining firms. The report[67] interviews "revealing" that many mining companies have reached agreements with the government such that expatriate staff pay little or no income tax, despite receiving salaries that are orders of magnitude larger than most local staff. The overall revenue losses that result are unclear, but this is an area that clearly warrants greater attention and transparency.

Recent years have seen greater acknowledgement in international circles of the limited benefits that are accruing to many developing countries. Most telling, perhaps, is a recent World Bank report that explains that,

66 Akabzaa and Ayamdoo 2009
67 Ibid.

> Gold production and value of minerals produced have reached an unprecedented peak; however, it is unclear what their true net benefits are to Ghana. Large scale mining by foreign companies has very high import content and produces only modest amounts of net foreign exchange for Ghana after accounting for all its outflows. Similarly, its corporate tax payments are low, due to various fiscal incentives necessary to attract and retain foreign investors. Employment creation is also modest given, the highly capital intensive nature of modern surface mining techniques[68].

The reference to limited foreign exchange is indicative of the deception inherent in the tendency in international circles to point to large foreign exchange earnings to establish the benefits of mining. In practice net exchange earnings are often small, as the Central Bank reports that an average of over 70% of the export earnings from minerals sales in Ghana never even enter the country, as the law allows them to be held in external accounts used to pay for imports and similar requirements.

While the reform of mining regulation is a complicated matter that must be approached prudently, particularly in light of the cyclicality of the mining industry, the overview provided here makes very clear that the sector is not delivering the expected benefits, even in the narrow realm of revenue generation. While it may be argued that an extremely liberal policy regime was needed in the mid-1980s to generate renewed confidence in the mining sector in the country after a decade of decline, there is good reason to believe that the context has now changed. In Indonesia, for example, early reforms put in place an extremely investor friendly regime, but these regulations were progressively tightened in subsequent years as investor confidence returned and political stability was strengthened. While these subsequent regulatory changes were criticised at the time,[69] a recent World Bank study argues that the progressive tightening of regulation as other investment conditions improved was highly effective, in part because it was part of a systematic and ongoing process of policy impact analysis.[70] There is ample opportunity for such a process to be undertaken in Ghana, particularly given the growing strengthen of the Extractive Industries Transparency Initiative (EITI) and the initiation of a new World Bank project on Natural Resources and Environmental Governance (NREG), which has revenue enhancement in the mining sector as an explicit goal.

68 World Bank 2003
69 World Bank 1992
70 Otto et al. 2005

Forestry in Ghana

Unlike the mining sector, which has received significant international attention including widespread criticism over low levels of revenue collection[71], the forestry sector has received relatively limited attention despite the exceptionally poor performance of existing regulations and taxes. That said, one study conducted in the Democratic Republic of Congo estimated tax avoidance by logging companies annually at $12 million.[72] This poor revenue performance is consistent with international experience, with the EU Forest Law Enforcement, Governance and Trade (FLEGT) action plan estimating that developing countries as a group lose 10-15 billion euros annually to illegal logging alone[73].

Forestry regulation has two very broad objectives: ensuring sustainability and capturing economic rent for the government. At its simplest level sustainability demands ensuring that the level of logging does not exceed the rate at which the forest is replenished. This demands that the government establish a sustainable level permitted logging and then enforce it through the allocation of logging rights to firms, communities or individuals. Securing economic rent means taxing forestry activity at a rate equal to the difference between the market price and the actual cost of production (logging, milling and transport). If taxation is maintained at this level, firms will still have a profit incentive to enter the market, while the government will secure revenues for investment in ensuring sustainability and broader government activities. The laws governing forestry in Ghana are captured in the Timber Resources Management Act, 1997 (Act 547) and the Timber Resources (Amendment), Act, 2002 (Act 617), both of which are viewed as effective policy frameworks but have so far lagged far behind with respect to implementation.

Within the realm of sustainability there is little doubt that the existing legal regime in Ghana has been an abject failure, as total logging has far exceeded sustainable levels.

71 Prichard forthcoming, World Bank 2003, Gary 2009
72 Greenpeace 2008
73 Birikorang, Hansen and Trueu 2007, Hansen and Treue 2008

While the annual legal harvest is set at 1 million cubic meters, Hansen and Trueu[74] estimate the total actual harvest in 2005 at 3.3 million cubic meters, of which about 650 000 is attributed to underreporting by the formal sector and the remainder is illegal logging by informal operators known as chainsaw operators. This implies consistent and dramatic depletion of forest resources, and it appears that future sustainability will require a rate of logging below the current legally permitted level[75].

The fiscal regime for forestry has three major components: stumpage fees, export taxes and timber rights fees (TRFs). Stumpage fees are a fixed rate charged per volume of wood extracted and vary depending on the value of the particular species. In principle these stumpage fee should be revised regularly to reflect the amount of rent accruing to each species but in practice revisions have been infrequent throughout Ghana's history. Export taxes are a theoretically less desirable means to tax forestry products, as they only affect exports and thus fail to secure rent from domestic logging. Export taxes were initially introduced as an indirect service charge, but currently play a more general revenue raising role. Finally, TRFs were introduced in 2003 in order to circumvent difficulties in collecting the other taxes and in order to inject transparency into the allocation of logging rights. In theory, timber rights are to be allocated on the basis of competitive bidding with the selling price reflecting the level of rent available from logging activities in the country. Yet, while this system has enjoyed some success in Cameroon and other countries, it has yet to be effectively implemented in Ghana six years after the legislation was passed.

Existing legislation should, in principle, provide an effective legal framework for taxing forestry but in practice revenue collection has been far below expectation. This has resulted from weak collection of the taxes from registered firms, as well as very high levels of illegal logging that are beyond the reach of the tax system. Birikorang, Hansen and Trueu[76] estimate that total collection of forestry specific taxes in 2005 was US$14 million, as compared to estimated total rents of US$60million on an official harvest of 935 000 cubic meters.

74 Hansen and Trueu 2008
75 Birikorang, Hansen and Trueu 2007
76 Birikorang, Hansen and Trueu 2007

According to the EU developing countries as a group lose 10-15 € billion annually to illegal logging alone

This alone is a very large revenue loss, but the actual revenue loss is much larger, given the estimated actual harvest of 3.3 million cubic meters[77]. If we assume that the illegally logged forests have the same rent value as the official harvest, then the total rent would be US$211 million, which would have been equivalent to more than 10% of total tax revenue in 2005. This level of revenue is unrealistic both because forest sustainability demands an annually cut of less than 1 million cubic meters and because it is unrealistic to imagine that the government can secure the entirety of the rent value given the complexity of enforcement. Yet, even a moderate improvement in the enforcement of a sustainable level of logging would imply revenue gains of US$15-25 million.

Aside from these forestry specific taxes, which have gained the greatest academic attention, timber firms are expected to be liable for standard consumption and income taxes, including corporate income tax, PAYE, VAT and import duties. Yet, while centralised data is not available it is clear that forestry firms as a group pay very little in standard taxes. For example, data obtained from the Kumasi IRS office, which handles many of the major logging firms, indicates that that in 2005 forestry firms paid income tax equal to 0.2% of total turnover. By way of contrast, firms with a 10% profit rate (which is not at all unreasonable given the level of rents available in the forestry sector), would be expected to pay 3.5% of turnover in income tax – almost 20 times more than is actually paid.

This is partly accounted for by apparently low profit rates across all firms only one of which exceed 0.8%

77 Hanson and Trueu 2008

of turnover in income tax and this seems likely to be a function of systematic underreporting of profits. Yet, the more glaring reason for low tax payments is that six of the fifteen firms, accounting for 72% of turnover, were registered as Free Zone companies, and are thus not liable for any tax at all. To provide a *very* rough estimate of the potential losses, forestry makes up 4% of total GDP, while at a national level roughly 20% of GDP is captured by taxation. Thus, the forestry sector should be expected to contribute in the very rough neighbourhood of 0.8% of GDP in taxation. If something approximating 72% of forestry turnover is subject to free zone status, and exempted from all taxation, this might amount to as much as 0.5% of GDP in lost taxation if it were well enforced. While these are exceptionally rough calculations, they are minimally indicative of very large fiscal losses in the sector.

Of course the granting of Free Zone status to forestry firms would be reasonable if it was necessary in order to attract investment, but this does not appear to be the case. In general tax incentives for investors are very difficult to justify in the case of any location specific resource, and are theoretically impossible to justify in cases were resource rents exist. Such resource dependent activities are inherently location specific and thus don't engender strong tax competition, which is the primary justification for creating Free Zones. The existence of resource rents only makes the logic of Free Zone status more elusive, as these rents virtually guarantee profitability for efficient firms. If there is a lack of investment in such sectors it almost certainly derives from broader business conditions such as weak infrastructure or regulation that demand attention.

Further issues arise from the fact that Free Zones status is specifically targeted at firms that are solely for export and have no interaction with the domestic economy. Such firms are legally compelled to act as an island, cut off from domestic activities by customs points. Yet, forestry firms are *intimately* connected to the domestic economy, from which they secure the bulk of their inputs for milling and processing. While those companies granted Free Zone status were generally registered as timber processing firms for export, the reality appears to be that they were often integrated firms gaining tax exemptions for domestic activities as well. At a minimum, Free Zone status for even the processing activities of larger firms inevitably introduced major opportunities for profit shifting into the tax exempt entity, as the border between the Free Zone activities and all other activities appears to have been very porous.

In a positive step, legislation passed in 2007 explicitly forbids granting Free Zone status to forestry firms and appears to be an implicit acknowledgement of prior abuse of the system. The GFZB argues that firms that already have Free Zone status cannot have that status removed retroactively but increased monitoring of these firms by the GFZB has already led many forestry firms to revoke their Free Zone status willingly. This is an implicit acknowledgement of the fact that when the Free Zones laws are properly enforced many forestry activities that were previously covered do not qualify.

These recent changes in the Free Zones Act are indicative of some willingness at high levels to improve enforcement of forestry taxation. That said, the overall weakness of forestry regulation and taxation is indicative of a highly dysfunctional political economy. It is widely felt among experts that forestry firms wield significant political influence through a highly effective patronage network. It is suggested that the large profits that are made possible by questionable timber rights allocations and weak enforcement of the law tend to benefit not only the firms but also those influential individuals that support the continued weakness of the regulatory regime. There is thus an obvious opportunity for public mobilisation to demand the more effective enforcement of forestry laws.

Taxing the Informal Sector

In many respects the greatest challenge to tax administrations around the world has been, and remains, the difficulty of taxing the informal sector. While it i s difficult to estimate the precise size of these sectors owing to the fact that they are, by definition, hidden from official scrutiny, most estimates put the size of the informal sector at 30-60% of official GDP and at substantially higher shares of total employment[78]. A recent study by Schneider and Klinglmair[79] estimates the size of the informal sector in Ghana at 38.4% of official GDP, while a recent report in Ghana estimates that over 80% of employed individuals are in the informal sector[80]. While the revenue potential of this sector is relatively smaller than in the formal sector, owing to low average incomes, the sheer size of the informal sector, and the undisputed presence of some very large operators, implies that significant revenue collection is possible.

In practice there are three major reasons why taxation of the informal sector has been almost universally unsuccessful. The first is capacity constraints. Informal sector operators are actively seeking to avoid taxation, and even at the best of times have limited capacity to keep high quality financial records for tax purposes. Meanwhile, tax administrations lack the manpower to effectively enforce taxation within the sector and face significant challenges of income estimation even after identifying potential taxpayers. The second challenge relates to notions of equity. The vast majority of informal sector operators have very low incomes, and this creates a strong argument for near total exemption from taxation. On the other hand, many informal sector operators have very substantial incomes and should rightly be asked to pay significant income taxes. In the absence of effective record keeping, the need for equity in the treatment of the low-income group almost certainly makes it more difficult to target those with higher incomes. The final challenge is political. Because low-income taxpayers contribute relatively little revenue, but have a potentially large political voice, politicians have potentially strong incentives to exempt low-income individuals from taxation in exchange for political support. Put another way, efforts to tax the informal sector are expected to have high political costs for relatively modest revenue benefits. Judith Tendler[81] has termed this the "devil's deal", and it likely goes a long way to explaining the disproportionate focus on taxing a smaller number of formal sector operators.

Overview of Relevant Taxation

The most common methods for taxing the informal sector fall within the broad category of presumptive taxation. These are pre-determined taxes to be paid on the basis of easily identifiable characteristics of the business in question such as the sector, location and size. These taxes are adopted in the absence of effective bookkeeping that would allow for effective income estimates for the purposes of standard income taxation. These taxes are often formally payments on account, meaning that those paying are meant to also submit income tax returns at the end of the year but in practice they generally function as final taxes.

Ghana's first introduced presumptive taxation in 1963 with all business operators paying a lump sum tax based on the industry in which they operated. This system was beset with complaints and low compliance and it appears that actual implementation became increasingly limited as the tax system declined during the 1970s and early 1980s. In 1987 the government introduced a system of Identifiable (Occupational) Groups taxation, beginning with the transport sector and eventually extending to over 40 sectors. It operated on the same principle of collecting pre-determined payments from informal sector operators but decentralised collection to the industry associations and allowed for payments to occur daily or weekly rather than relying on large one-time payments. This system was initially more successful, as it was negotiated with small business associations and catered to the economic reality of the businesses. That said, it ran into progressively greater problems as the business associations appropriated a growing share of revenue, leaving both members and the government less well off[82].

A recent report in Ghana estimates that over 80% of employed individuals are in the informal sector

When the NPP government came to power in 2000, they replaced the identifiable groups system with a Tax Stamp system. This called for all informal sector operators to purchase a quarterly Tax Stamp, which was to be displayed on the premises of the business, and the price of which was based on the sector and the observable size of the firm. This has brought some improvement in the revenue yield, but the overall collection from the informal sector has remained small, with the exception

78 Bird and Zolt 2002, Schneider and Klinglmair 2004

79 Schneider and Klinglmair 2004

80 GNCCI 2008

81 Judith Tendler 2002

82 Joshi and Ayee 2008, Prichard 2009, GNCCI 2008

of the Vehicle Income Tax, which is a Tax Stamp for commercial transport operators. In the short term the major obstacle to more efficient collection is enforcement capacity. That said, long-term improvements in collection are dependent on improving the overall monitoring capacity of the tax administration and improving the willingness of informal sector operators to comply. The latter is dependent on creating positive incentives for informal sector operators to formalise.

Finally, it is worth highlighting a number of strategies that are being investigated by the tax administration for improving revenue performance. The first rests on automation, which will allow the tax administration to keep a record of the sale of Tax Stamps and thus trace informal sector operators on the basis of their Tax Identification Numbers (TINs). In the long-term this is expected to be a necessary step towards enforcing the submission of income tax returns, rather than treating Tax Stamp payments as final taxes. The second strategy rests on improved information sharing across agencies and rests on the same basis as general efforts to improve revenue collection. If, for example, it becomes possible to compare tax receipts to certain kinds of asset holdings, then the tax agencies will be much more able to identify high earning informal sector operators. A third possibility is to pass legislation dictating that formal sector firms only do business with tax registered firms, which forces informal sector firms to register at least part of the operations in order to conduct business with formal sector entities.

Implications for Business Development, the 'Missing Middle' and Political Inclusiveness

Aside from the potential revenue benefits of taxing the informal sector, there are potentially both economic and political benefits to doing so. Economically, one of the defining features of many developing economies is the relative absence of medium sized firms, and a corresponding middle class, both of which are sometimes termed the 'missing middle'[83]. While this feature of developing economies has myriad causes, at a very basic level it reflects the high costs that are borne by small and medium-size enterprises (SMEs) relative to both larger and smaller firms. Larger firms possess sufficient resources and internal capacity to deal with regulatory, competitive and political challenges that affect the formal sector. SMEs are less likely to have this same capacity and this potentially creates strong incentives for informal sector firms to remain informal. Yet, this makes the expansion of such firms more difficult due both to the need to avoid government scrutiny and the inability to access certain forms of credit and certain lines of business activity. In this simplified story, informal sector firms remain small and this inhibits the natural growth of these firms and the corresponding benefits to the economy.

In principle, one of the major advantages of informality is that firms are able to avoid the payment of taxes. Thus, taxes may be a major incentive for informal sector firms to remain small, rather than growing into formal sector firms, which has potentially large economic consequences in the long-term. While this is certainly an issue to some extent it is important to ask two quite general questions: 1) How large a role is played by taxation compared to other issues, and 2) What changes would improve the situation most dramatically?

It is notoriously difficult to estimate exactly what factors shape the investment and expansion decisions of informal sector firms. Surveys generally indicate that while taxation as such plays some role in shaping the decision to formalise, it is the regulatory environment more generally that shapes the costs of formality. Moreover, it appears that the indirect costs of formality, in terms of compliance costs, are at least as burdensome as the direct costs of business registration and taxation. Thus, for example, the time required to register a business, the potential for officials to demand bribes or additional payments and the costs of maintaining reliable accounts are often the greatest costs to firms. A recent DFID survey in Sierra Leone, which had a special interest in taxation, broadly echoes these findings[84].

More importantly, the DFID survey, as well as experiences elsewhere, point to the fact that many informal sector firms would be willing to formalise in the face of a more favourable environment. Informality is far from costless, as the benefits of evading taxation and regulation are balanced against direct costs, such as harassment by the police and the need to pay bribes and indirect costs of new opportunities lost, including restricted access to credit. Moreover, the DFID survey suggests that an important barrier to formality is a simple understanding of the rules, and ability to navigate them. To take one example, the Kenyan government has recently made overtures to the informal sector, including a focus on regulatory simplification. While progress has been slow, the informal sector has certainly been willing to engage, while the process, supported by formal sector associations, has strengthened the overall level of organisation in the sector. Given that a recent survey found that most small firms in Ghana do not belong to trade associations, this holds the potential to contribute to important improvements[85].

This begins to point to the potential political benefits of reforming taxation and regulation to facilitate formalisation: formalised forms are much more likely to become a valuable constituency for accountability and responsiveness in government. This reflects three things. First, it is much easier for these firms to be an effective political constituency once they have come out of the shadows and can rightly claim to be fully compliant with the laws of the country. Second, formalisation will facilitate the development of medium sized firms, and the growth of the middle class, which is widely felt to be an important force for democratisation[86]. Third, there is important and growing international evidence that tax paying may lead to expanded engagement in national politics, as taxation provides a basis for citizenship and making demands on the state. This is discussed in greater detail later in the paper.

Informality is far from costless, as the benefits of evading taxation and regulation are balanced against direct costs, such as harassment by the police and the need to pay bribes and indirect costs of new opportunities lost, including restricted access to credit.

83 Birdsall 2007

84 Everest-Phillips 2009

85 GNCCI 2008

86 Birdsall 2007

Ghana as an Emerging Offshore Banking Centre

Offshore Financial Centres (OFC) are jurisdictions that welcome banking, investment and business registration from individuals and businesses that are based outside of the host country.

They generally offer a combination of low tax rates, limited regulatory standards and anonymity as an incentive for international capital and business to flow to them in a competitive international market. OFCs rely on "ring fencing", which separates offshore facilities from the domestic economy. Thus residents cannot establish accounts or businesses in the offshore jurisdiction, while those listed in the offshore jurisdiction cannot engage in transactions with resident individuals or businesses.

In official circles OFCs have become increasingly controversial in recent years owing to two factors: the fact that secrecy laws facilitate international money laundering and other illegal activities and the fact that many OFCs function as tax havens that facilitate tax avoidance and evasion by foreign firms. The Tax Justice Network currently identifies approximately 70 tax havens world wide, which manage over US$11 trillion of global wealth. Given that there are few reasons to make use of such OFCs other than for purposes of tax avoidance and evasion or for disguising illegal activities, it is fair to assume that the enormous stock of wealth held in OFCs represents a major cost to global welfare. Indeed, the existence of ring fencing is - in the view of many observers - clear evidence of the anti-social character of OFCs, as governments are unwilling to suffer the costs of allowing residents to participate.

Yet, from the perspective of an individual OFC the story appears much less clear cut. While OFCs may be destructive in aggregate, for an individual country they represent an opportunity to generate significant new economic activity within national borders. Throw in the fact that western nations are at least complicit in the persistence of this system - it is small wonder that small and developing nations would take an interest in getting their piece of a major economic market. It is this logic that has led Ghana to take steps to establish itself as the first fully-fledged International Financial Services Centre (IFSC) in sub-Saharan Africa. This forms part of the efforts to "make Ghana the financial hub of the West African sub-region"[87], and the government expects to create employment, increase GDP and deepen the skill base in the financial sector.

While there is a temptation to condemn this policy choice on the basis of the global costs of OFCs, the reality is that Ghana represents a small player in a

87 Kufuor 07.09.2007

much larger problem. It is more useful to consider the impact of Ghana's decision more narrowly, in terms of its domestic impact and likely impact on the immediate West Africa region. While the government has tended to portray the new IFSC as an avenue towards major economic gains with few risks, the reality is that the expected economic benefits are uncertain, while the risks to both Ghana and the region are significant. Unfortunately, the existing stock of research on these questions is extremely limited and as such this report does more to raise important questions and concerns than to provide definitive answers. What follows presents a brief background to the creation of the IFSC and then reviews the potential impacts under four headings: domestic benefits, domestic risks, regional benefits and regional risks.

Background to the IFSC

The idea of an IFSC first appeared in the 2004 Financial Services Strategy Paper (FINSSP). By June 2005 the Government had signed a Memorandum of Understanding with Barclays Bank of Ghana, committing both partners to investigate further the potential for creating an IFSC. While Barclays has been involved since this early stage, they are adamant that they were not major instigators of the initiative though this claim is difficult to verify.

After June 2005, consulting firm Grant Thornton of Mauritius was engaged as a consultant to investigate this possibility further, drawing on Mauritian experience as an OFC. During this period the Central Bank also conducted background studies on the potential implications of setting up an IFSC[88]. The consultants' report was completed and approved in February 2006, after which Barclays, the consultants and the government worked together in developing the relevant amendments to the Banking Act, which were passed into law in March 2007. On September 7, 2007 Barclays officially launched the first Offshore Banking facility in Ghana, which was also the first in all of North and West Africa[89]. The event included a keynote address by then President John Kufuor, and was attended by former Nigerian President Olusegun Obasanjo, as well as official delegations from Burkina Faso, Cote D'Ivoire and Togo[90]. The presence of so many eminent individuals is strong evidence of the high level domestic support enjoyed by the initiative.

Following the Amendments to the Banking Act in March 2007, the government was expected to take several further steps to strengthen and refine the regulatory environment. This minimally included (a) updating the Anti-Money Laundering Bill, (b) passing an Anti-Terrorism Law (c)) amending the Exchange Control Law, and (d) updating the Companies Code for business registration. These actions have yet to be taken. The government also planned to pass the Financial Service Act to create the framework for a host of Offshore Financial Services beyond the banking sector. The Financial Services Act was finalised and sent to parliament but was not passed prior to the 2008 election despite the urgings of the President. The new government is expected to re-submit the law to parliament and those involved hope that this will occur before the end of 2009.

There appears to have been relatively limited rigorous analysis of the potential costs and benefits to both Ghana and its neighbours

The current and proposed legislation adheres to the broad characteristics of those OFCs that also function as effective tax havens. This will almost certainly see Ghana added to the current OECD list of tax havens to be considered one under similar previous efforts by the UN, as summarised by Weiner and Auld[91]:

> A low or zero effective tax rate on the relevant income, the regime being "ring-fenced" [available only to non-residents and isolated from the domestic economy], the operation of the regime being non-transparent, and the jurisdiction operating the regime not effectively exchanging information with other countries.

88 Amediku 2006

89 Barclays 07.09.2007

90 Kufuor 07.09.2007

91 Weiner and Auld 1998: 604

More specifically, existing and proposed legislation proposes:

- Fully-fledged ring-fencing;
- Total exemption from taxation for offshore banking entities;
- Total exemption from taxation for businesses listing in the offshore jurisdiction;
- Reduced regulatory requirements and capital adequacy rates for offshore banks, and
- Efforts to expand secrecy provisions, despite some tension with Ghana's extensive anti-money laundering laws.

Evaluating the Impact of the Ghanaian IFSC

Despite the rather dramatic legal changes that are required to create the IFSC there appears to have been relatively limited rigorous analysis of the potential costs and benefits to both Ghana and its neighbours. More rigorous analysis of these potential costs and benefits is sorely needed but it is beyond the scope of this research.

Domestic Benefits

Assessing the potential economic benefits to Ghana is difficult due to a lack of cross-country research on the general topic and due to tremendous uncertainty about how much business the IFSC will attract. With upwards of 70 countries worldwide offering similar incentives to prospective clients, often coupled with significantly more experienced workforces and sophisticated infrastructure, there are good reasons to wonder about the ultimate scale of business.

Assuming the OFC attracts a reasonable scale of business, there is surprisingly little detailed evidence about the economic impact of establishing OFCs. What evidence does exist is difficult to apply to Ghana, given that, unlike so many OFCs, it is not a small island economy. Troublingly, there is no evidence that the government has developed detailed estimates of the likely impact under different scenarios. If such evidence exists in past consultants' reports, it is certainly not readily available, nor has it been seen by many key stakeholders in the public and private sectors.

In conducting the initial planning for the creation of the IFSC the government was strongly influenced by the case of Mauritius, where Barclays has long been active. In promoting the IFSC Barclay's pointed to the following benefits enjoyed by the Mauritian economy:

- Over 1500 direct jobs, and additional business for "accountants, lawyers, chartered secretaries, among other"
- Significant skills and knowledge transfer in the financial sector
- Profits of US$10 million on assets of US$859 million in 1997
- Broad based contributions to the tourism sector
- Direct annual fees of US$15 million in foreign currency
- US$30 million in total value added on gross revenues of US$77 million
- Direct contribution of 0.85% of GDP with the direct and indirect contribution estimated at 2.5% of GDP

These findings are consistent with limited data from the Caribbean, and thus provide a rough guide to what might be expected[92]. In terms of direct economic impact it is important to note that while OFCs have transformed many small island economies economically, similar benefits to a much larger country like Ghana amount to a relatively small improvement in overall economic performance. While estimation is obviously speculative, evidence from other countries suggests that if Ghana were to emerge as a leading global OFC it might, in a very optimistic scenario, create as many as 5000 jobs, which is still relatively modest in a workforce numbering more than 10 million. Knowledge and skill transfer could potentially broaden the effective benefits dramatically but such effects are difficult to measure and must be balanced against the fact that a successful IFSC will draw skilled labour away from other productive sectors.

92 Bardouille 2002, Barclay's no date

Barclay's has also argued that,

> The Barclays Offshore Banking Unit will attract foreign deposits in foreign currencies. The more deposits are attracted the more lending solutions Barclays can provide to Ghana's private sector to help generate employment and create wealth.[93]

Yet, without further detail this seems to be a problematic claim. While additional domestic credit is desirable, the idea that Barclay's will use OFC funds to expand lending domestically violates the principle of ring fencing. This implicit acknowledgement of the imperfect nature of ring fencing arrangements points towards the domestic risks of this venture.

Domestic Risks

Because Ghana is in the unique position of setting up an IFSC in a relatively large country but with relatively low levels of supervisory capacity, there are few, if any, cases from which to draw entirely comparable lessons about potential risks. That said, we can sensibly point to three risks that seem particularly important.

First, there is a risk that Offshore Banking facilities could contribute to financial instability. Ring-fencing is meant to reduce the risk of instability from rapid inflows and outflows of capital, but if the ring-fencing is incomplete, and the presence of the IFSC expands the availability of domestic credit, then the risk of reversals will be very real. It is widely believed that capital flows in and out of the IFSC established in Bangkok contributed significantly to the East Asian financial crisis in 1997. Despite an official policy of ring-fencing, the IFSC was financing 17% of all private sector lending in the country while being subject to very lax regulation to manage risk. Kaufman[94] writes that risks of destabilising capital flows are:

> Of sufficient importance that they should give domestic policy-makers, particularly of smaller and emerging economies, reason to pause before they commit their countries to policies intended to gain IFC status. Smaller IFCs in effect surrender some control over their domestic economy.

93 Barclays Bank 07.09.2007

94 Kaufman 2000

Even in the absence of risks related to domestic lending, offshore banking is a highly competitive and volatile industry and the role of any particular OFC may vary dramatically over time, thus creating instability at a smaller scale.

The second risk is that, in the absence of effective regulation to enforce ring-fencing, local businesses and individuals will succeed in using the offshore facilities to avoid tax and/or to engage in illicit activities. The risk of illicit funds finding their way into the OFC is particularly acute given the extensive cocaine trade in the country and the massive resource flows from oil that are expected in the near future, but which have been a source of large-scale corruption in many countries. If the OFC inadvertently facilitated either the drug trade or oil related corruption this would likely outweigh any direct economic benefits. While the issue of domestic residents accessing offshore facilities illegally has not been a major issue in many existing OFCs this reflects the fact that they are generally small, lack significant domestic economies and have very sophisticated regulation. Larger economy and weaker regulation in Ghana would seem likely to dramatically expand potential risk.

Finally, banks involved in the OFC will almost certainly seek to persuade resident Ghanaians to access OFCs elsewhere, as different OFCs work in a highly integrated fashion. This seems certain to expand the extent to which local actors are involved in harmful tax avoidance through the use of offshore facilities, with important consequences for revenue if corresponding efforts to strengthen monitoring are not put in place.

International Benefits

Putting aside the ideological argument that any mechanism that reduces tax burdens, even illegally, is positive, one can discern two likely avenues by which the IFSC could potentially benefit the region.

First, the IFSC may smooth the functioning of business across borders in ways that sidestep antiquated legal provisions and regulations - and in some cases difficult to navigate bureaucratic requirements - but do not undermine the spirit of important laws such as those surrounding taxation. That said, this is a highly abstract argument and it is incumbent on proponents of the Ghanaian IFSC to provide compelling evidence of precisely the types of economic activities that will be beneficially facilitated within the spirit of existing national laws.

Second, there is anecdotal evidence from elsewhere in the world that IFSC can serve to deepen regional capital markets and expand access to finance. Unlike claims that this will occur within Ghana, it is entirely consistent with the institutional set up of the IFSC for local capital to be channelled towards regional opportunities.

International Risks

While it is the balance of domestic risks and benefits that appears to be driving the policy process, it is essential to note the potentially adverse consequences for the region. These potential consequences include undermining the ability of states to collect revenue and contributing to the profitability of illegal activities and official corruption. It seems highly likely that geographic proximity, coupled with inevitable initial weaknesses in regulation, will encourage those in the region to exploit the services of the new IFSC, be it for tax avoidance or more illicit activities.

It is relatively clear that a major target for the banks is wealth originating from regional oil states, led by Nigeria. Given that these regional petro-states are already plagued by extremely high levels of corruption, major problems monitoring oil wealth and exceptionally weak revenue collection agencies, it is not hard to imagine the potential costs of further facilitating these social ills. While there is no doubt that much of the illicit wealth from these regions has already found its way into offshore bank accounts elsewhere, targeting this wealth seems to be an implicit goal of the IFSC. While those involved in the initiative should be given every opportunity to provide evidence that monitoring will be effective and that such resource flows are modest, no such effort appears to have been undertaken as of yet.

If Ghana were to emerge as a leading global OFC it might, in a very optimistic scenario, create as many as 5000 jobs, which is still relatively modest in a workforce numbering more than 10 million

Taxation, development and the good governance agenda: key concerns and advocacy issues

Taxation has figured prominently in the evolution of states in Europe and North America[95]. Yet, it is only recently that the development field has begun to take seriously questions about taxation and its relationship to the performance of government. Many of these studies centre on a provocative hypothesis, captured succinctly by Mick Moore[96] who proposes that: "The more government income is 'earned', the more likely are state-society relations to be characterised by accountability, responsiveness and democracy." Translated into simpler terms, the hypothesis is that governments that rely heavily on tax revenue are likely to be more accountable than those that rely on non-tax revenue sources, most notably natural resource rents or foreign aid.

The claim rests on one of two logics. The first is that the collection of tax revenue relies on both coercion and a degree of willing compliance by citizens - a combination that has been termed "quasi-voluntary compliance"[97]. Given the need for some degree of willing compliance, a government that is reliant on tax revenue to sustain itself will be forced to make implicit or explicit concessions to citizens in order to secure their compliance, whereas financially independent governments will not face the same pressure. The second logic argues that the experience of paying taxes may give rise to a feeling of ownership of the state, leading citizens to make greater demands for public accountability[98]. Thus citizens that are confronted with large or new demands for taxation will be more likely to mobilise politically.

This reasoning has frequently been used to account for the apparent fact that states with access to high levels of natural resource rents tend to be less accountable to citizens[99]. It has, likewise, been used as an argument about the risks of dependence on foreign aid[100]. There is, unfortunately, relatively little evidence that has addressed this question directly but what does exist, points towards the fact that taxation can be an important catalyst for greater political responsiveness and accountability[101]. That said, there is also strong evidence that taxation often remains highly coercive and ineffective in rural sub-Saharan Africa[102] and that taxation is only likely to be an effective catalyst for change in the presence of organizations or individuals that can aid in crystallising public demands[103].

The detailed qualitative study of these questions in sub-Saharan Africa looks at Ghana, Kenya and Ethiopia and finds significant evidence of a relationship between taxation, responsiveness and accountability, subject to

95 Tilly 1990

96 Moore 1998:95

97 Levi 1988

98 Moore 2008

99 Ross 2001, 2004

100 Brautigam and Knack 2004

101 Hoffman and Gibson 2005, Chaudhry 1997, Gervasoni 2006, Brautigam 2008, Timmons 2005, Ross 2004

102 Fjeldstad and Semboja 2001, Fjeldstad and Therkildsen 2008, Juul 2006, Hoffman and Gibson 2005

103 Prichard 2009

the caveats noted above[104]. Ghana provides arguably the most clear-cut illustration of this dynamic, in the context of efforts to introduce a Value-Added Tax in 1995. At the time the opposition parties remained outside of parliament amid unverified accusations of electoral fraud, while the political climate remained relative closed and hierarchical. When the VAT was introduced it gave rise to massive street demonstrations that were larger than any demonstration of the previous fifteen years. While the protests centred on the VAT, they became a forum for the opposition and citizens to voice much broader grievances, ultimately forcing leaders within the government to withdraw the tax, and, more importantly, begin efforts to introduce greater openness in politics[105]. In a nutshell, when the government was forced to introduce the new tax, the opposition was able to use it as a catalyst for a broad based and transformative public mobilisation for change[106].

The Ghanaian case provides a wide range of other examples in which the government has made political concessions in response to the need to raise greater revenue. When the government increased the VAT rate to 12.5% it earmarked the new funds for the Ghana Education Trust (GET) Fund in an effort to prevent a public backlash. When the government sought to increase the VAT rate to 15% it went so far as to create an ostensibly new tax, the National Health Insurance Levy, though for all practical purposes it is identical to a VAT. More recently, the government secured the support of the Ghana Union of Traders Associations (GUTA) in order to ease the implementation of the Flat Rate Scheme for VAT payment, while in earlier days the government allowed different commercial associations to act as agents for the collection of taxes from their members, in order to gain their acceptance of new taxation. Most recently, the government earmarked part of the funds from the communications tax to support the Youth Employment Scheme, a response to an initial public outcry against the tax. In this same vein, the inability of government to secure the political support necessary to increase taxation was an important cause of the deficits of the late 1990s, which figured prominently in the replacement of the NDC government.

104 While the research from Ghana has been published as a Working Paper, which is cited in the References, evidence from Kenya and Ethiopia is as yet unpublished.

105 Osei 2000

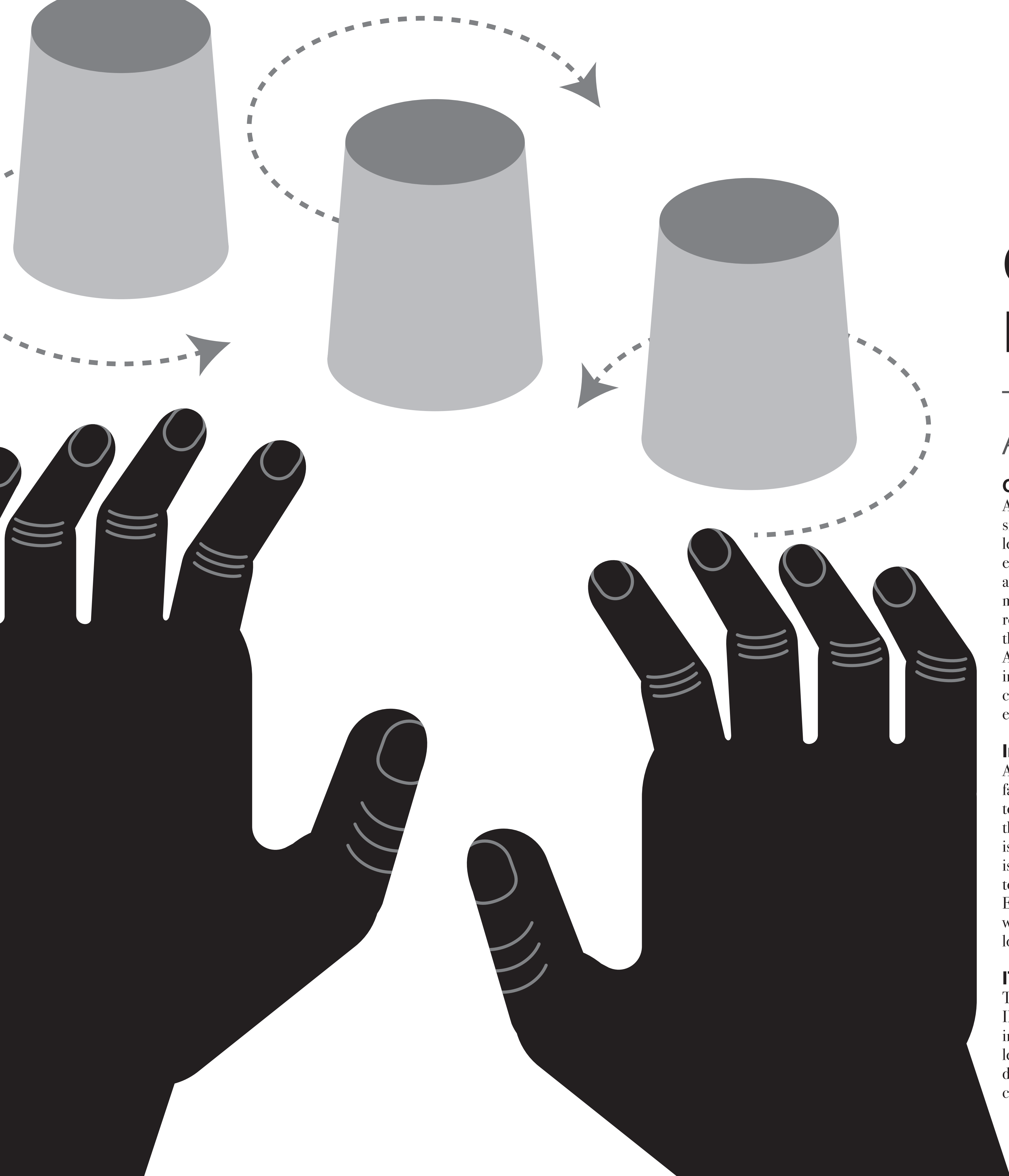
106 Prichard 2009

The overall picture is one in which the need for tax revenue has led the government to be more responsiveness and accountable than it would otherwise have been. Yet it is important to also note the limitations of these outcomes. Taking the example of funds that have been earmarked for specific purposes, there are significant doubts about how effectively these new funds have been managed. This owes to a continuing lack of transparency, limited civil society monitoring capacity and lingering doubts related to the fact that the new taxes were collected prior to the programs for which they were earmarked being put in place. In the case of the communications tax the public was actively misled, with many observers believing that the entire tax was earmarked for youth employment, while in practice only 20% of the revenue was designated for that purpose and only in very vague terms at that. This is not to say that more rigorous earmarking is the correct answer, as this has negative implications for long term budget management but simply that government concessions are only as good as the capacity of citizen groups to monitor those promises over time. This is equally true of the whole range of government concessions linked to taxation, as the initial bargain is only a starting point for future progress.

Thus, these examples provide evidence of the potential for taxation to catalyse political engagement but also point to the need for taxation to be a catalyst for long term engagement, rather than short-term responses to new taxation. This has yet to emerge effectively in Ghana but recent developments in Kenya have provided a potential model for transforming the politicising potential of taxation into sustained pressure for improved governance. Kenya has long been the most efficient tax collector in Africa, and in 2007 a National Taxpayers' Association (NTA) was founded in an effort to mobilise taxpayers to engage in more effective expenditure monitoring. This advocacy effort focused initially on the Constituency Development Funds (CDFs), which are dedicated local development funds administered by MPs. While still in its infancy, the NTA has found that linking the issues of taxation and accountability has been a powerful strategy for mobilizing urban and rural constituencies alike. There is every reason to think that something similar could be possible in Ghana. In the words of one civil society leader in Ghana: "Taxes have always provided a focal point for public mobilisation and a momentum for the resistance."[107]

Paying taxes may give rise to a feeling of ownership of the state, leading citizens to make greater demands for public accountability

107 Prichard 2009



Conclusion and Recommendations

Tax Policy and Administration

Greater Focus on Income Taxation

As a group developing countries struggle to collect significant amounts of income tax. Particularly problematic are individual income taxes from the self-employed and professionals and taxes on rental income and property. Improved collection performance would make the tax system significantly more progressive and reduce the burden on those parts of the formal sector that currently shoulder the entire tax income burden. A focus on these taxes would likewise imply significant improvements in data collection, which would aid in curbing corruption and in rationalising the local property and housing markets.

Integrating National and Local Taxation

Across sub-Saharan African there has been a glaring failure to look simultaneously at national and local systems of taxation. While the national system generates the majority of total revenue, the local system of taxation is of greatest importance to the majority of citizens and is often characterised by arbitrariness, abuse and the total absence of any rationalisation with national taxes. Effective advocacy in this area will likely need to begin with significant research into the actual application of local taxes and public perceptions of those taxes.

IT Reform to Enhance Transparency

The absence of an effective IT system for managing IRS taxation is an important constraint to improving income and informal sector taxation. At a more general level, effective automation of the tax authorities would dramatically improve overall fiscal transparency and the capacity of the government to monitor illicit activities. This is particularly important in light of the major oil revenues that will enter the system from 2010 or 2011.

The failure to achieve these goals is strong evidence of a lack of political will to tackle these challenges, as automation and improved information sharing have been on the reform agenda for at least a decade. This reticence is almost certainly a reflection of the fact that some individuals profit from the absence of transparency. While the successful revival of the E-Ghana project would entail large benefits, the uncertainty surrounding the implementation of such a large project, with a high level of foreign content, makes it essential that the government simultaneously focus on consistent, incremental improvements in automation.

Tax Incentives and Revenue Protection

Transparency, Monitoring and Evaluation

Relative to many tax incentive regimes in the developing work, the Ghanaian example stacks up reasonably well. It is rule based, incentives need to be passed by parliament and there have been meaningful, if incomplete, steps taken to improve performance in recent years. That said, there is no doubt that there are large revenue leakages and significant abuses that still demand attention. It is widely held that the tax incentive regime, including Free Zones, is the cause of major revenue loses and abuse.

More troublingly, neither the GIPC nor the GFBZ has undertaken a systematic, balanced and credible study of the overall costs and benefits of the existing incentives regime. The GIPC, and to a lesser degree the GFZB, is likewise very hesitant to divulge the type of transparent data that would facilitate such analysis. As public institutions with a clearly defined mandate, both institutions should be urgently pushed to improve transparency and much more rigorously undertake research into the costs and benefits that they generate. Failure to achieve such transparency about activities and outcomes gives reasonable grounds for scepticism about the effectiveness of the current regime.

It is widely held that tax incentive regimes, including Free Zones, is the cause of major revenue loses and abuse

Investigate Tax Holidays and Location Specific Industries

In studying the impact of the current incentives regime theory suggests that special attention should be paid to tax holidays and location specific industries. Tax holidays, while appropriate in some cases, are particularly prone to abuse and likely to generate the types of short-term investments that provide limited long-term benefits. Incentives, and particularly tax holidays, that focus on industries that make use of location specific resources - be they agriculture, fish, timber or the coastline - warrant particular scrutiny given that such investments lack the mobility that is generally cited as the reason that tax competition is necessary. In these location-specific industries it seems likely *a priori* that investment in accompanying infrastructure and skills would be a more effective strategy.

Collaboration Across Agencies

One of the most troubling aspects of the current incentives regime is that there is little cooperation across agencies. The revenue agencies express significant frustration at the existing incentive regimes and this stems from the absence of sufficient consultation between those granting incentives and those responsible for generating revenue. A forum, which brings the different agencies together to conduct a thorough needs assessment, is needed.

Tax Avoidance by TNCs

Improved Capacity and International Cooperation

There is evidence that while TNCs are generally not engaged in aggressive tax evasion and pay a significant share of income taxes, tax avoidance is a significant issue, including through false invoicing and trade mispricing. The root of the problem is a lack of capacity to monitor and audit firms, and to amend exiting laws when loopholes are identified. International cooperation - both to share information and build capacity - is needed. In the case of capacity building, training courses too often become politicised and fail to target the appropriate staff, so international cooperation should focus on placing international staff within the tax administration and providing opportunities for local tax officials to train in foreign offices.

Strengthened Role for the Tax Policy Unit and/or RAGB

At a more general level, there is far too little capacity for analysing the scope of aggressive tax avoidance and for developing strategies to combat it. There is a need for a specialized focus on these challenges, likely coordinated by the RAGB or by the Tax Policy Unit at the Ministry of Finance. The latter unit should be playing an important role on a variety of issues but remains weak in practice.

While TNCs are generally not engaged in aggressive tax evasion and pay a significant share on income taxes, tax avoidance is a significant issue

Revenue Generation in the Mining Sector

Reviewing the Policy Regime

Despite the fact that a new mining law was introduced in 2006 there appears to be a lingering need for a wholesale, transparent and inclusive evaluation of the policy regime affecting mining. In the specific realm of fiscal issues at least three elements appear particularly in need of consideration: a) reducing capital allowances in order to increase corporate tax collection, b) reforming the royalties system, either by facilitating implementation of the escalating scale of rates or implementing a single rate at 4-6%, and c) ensuring that expatriate staff contribute an equitable share of taxation.

Improving Enforcement

Along with policy weaknesses, there are major problems of enforcement. The first is the failure to implement royalty rates above 3% in cases where it is justified by law. While in the long term changes to the law appear justifiable, there is an urgent need to improve implementation of existing regulations. Second, there is widespread awareness of the fact that mining firms are engaged in aggressive tax avoidance and evasion, largely through trade mispricing and claiming excessive capital allowances. This needs to be urgently addressed. One strategy for addressing both problems would be to create a specialised tax unit to monitor mining firms, as such a unit existed previously but has since been eliminated.

The Forestry Sector Fiscal Regime

Implement the Existing Regulations

The forestry sector underwent major policy reviews in 1997 and 2002, and the existing regulatory and fiscal framework appears to be generally adequate. The problem is the almost total failure to effectively implement the existing regulations, most notably with respect to competitive bidding for land rights and the ability of officials to prevent widespread illegal logging. With these regulations already in place, any failure by the government to make significant strides in their implementation must be viewed as a failure of political will and a reflection of the political influence of those who benefit from the existing system.

Highlight the Large Revenue Losses

From an advocacy perspective a useful strategy is likely to lie in simply highlighting the very large lost revenues. The absence of benefits for local communities is already a source of significant frustration in those communities, and could likely be an effective platform for public engagement.

Pressure the Beneficiaries of the Existing System

Given a widespread belief among stakeholders and observers that the continuing problems of the forestry sector are the result of political consideration, civil society has the potential to pressure the primary beneficiaries. The availability of data on what companies operate in the sector and on what officials shape the regulatory framework should make such inquiries possible.

Taxing the Informal Sector

Increasing Formality

There is a similar need to continue with efforts to improve taxation of the informal sector. This stands to improve revenue generation, reduce disincentives for firms to expand and formalise and more fully integrate the informal sector into national political processes. In achieving these goals effective enforcement will be a necessary condition for success but there is a need to focus on a strategy that provides positive incentives for informal sector firms to engage. More generally, any relevant reform is likely to integrate changes in tax policy and administration with broader efforts to continue to ease the regulatory burden on SMEs and improve the overall benefits of formality.

Understanding Potential Benefits for the 'Missing Middle'

There are potentially large benefits to easing the tax and regulatory costs of formalisation. However, there is very little that is currently known about exactly what changes would be most beneficial to such firms and about what new measures would provide meaningful incentives for firms to formalize. There are likely to be substantial benefits to bringing together relevant stakeholders to initiate a dialogue on this question, and there is evidence from other countries that informal operators would be very willing to participate in such a forum.

Offshore Banking

Improved Analysis, Transparency and Cooperation

The creation of an International Financial Services Centre (IFSC) may create meaningful domestic and regional economic benefits. On the other hand, it will almost certainly facilitate tax avoidance and illicit financial flows in the region, while there is a significant risk that it will directly or indirectly exacerbate these problems within Ghana as well. Relatively limited local capacity and high levels of competition from similar offshore centres are certainly grounds for worrying that the costs will be relatively high and the benefits low.

If the government is committed to going ahead, two conditions should *minimally* exist before proceeding with these developments: First, the government should produce and disseminate credible and well-researched evidence relating to the magnitude of potential local benefits and the extent and nature of potential risks. Second, personnel from the relevant government agencies, including the Central Bank, the Registrar General and the tax agencies, should be extremely well versed on the relevant law, while working closely together to minimise risks. To date the government has not produced any credible estimates or discussion of the potential costs and benefits, while overall understanding and communication within the civil service seems to be exceptionally limited.

Special Monitoring Tools

If the government does go ahead, there is every reason to believe that a large share of the funds that will be attracted will be from regional oil producing states. Such funds are of notoriously questionable origin and facilitating their movement may have significant adverse consequences for the region. Special monitoring practices should be developed, potentially in cooperation with the Extractive Industries Transparency Initiative (EITI), and the Task Force on Financial Integrity and Economic Development.

Likewise, it seems likely that holders of illicit funds within Ghana will attempt to access the offshore facilities. This is a significant risk given the large drug trade and the risk of funds being misappropriated once oil begins to be pumped. This similarly implies the need for special monitoring efforts relative to what might be necessary in most OFCs.

Taxation and Governance

Taxation and Political Mobilisation

There is significant evidence that taxation can be a catalyst for political mobilisation demanding improved responsiveness and accountability from government. Over time, major changes in taxation can be sparks for broader political engagement in the presence of effective coordinating bodies and civil society organisation should seek to exploit these opportunities.

More generally, advocacy strategies that emphasise the identity of citizens as taxpayers, and their corresponding right to demand accountability from government, may be highly effective. This lies at the root of the existence of taxpayers' associations the world over, while recent evidence from similar efforts in Kenya suggests that this experience can be equally relevant within sub-Saharan Africa. Efforts to link tax payment to expenditure monitoring - possibly focused on the new MPs Development Funds - appear to be a very useful potential starting point.

Studying Tax Incidence in Local Communities

In seeking to use tax payment as a basis for engaging citizens in public policy debates it is essential that there be a focus on both national and local taxation. For many low-income citizens local taxes are likely the most significant in monetary terms, while it is very clear that such taxes are the most visible and politically salient. Moreover, experience elsewhere suggests that it is the lack of coordination between the two tax regimes that can be of greatest concern to low-income taxpayers. As such, any tax related advocacy should begin with an effort to much more clearly understand the system of local taxation, how much is paid, and how it is perceived.

It seems likely that holders of illicit funds within Ghana will attempt to access the offshore facilities

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Appendix 1: Tax Collection Data

Table 1 Annual Collections by Tax Type

AGENCY	2000	2001	2002	2003	2004	2005	2006	2007
IRS	140.94	212.38	284.47	408.28	538.20	644.65	734.12	910.26
PAYE	48.32	67.74	92.40	142.21	182.62	228.59	315.07	372.22
SELF-EMPLOYED	7.54	11.38	15.83	21.73	27.12	31.30	35.95	45.59
COMPANIES	69.67	96.66	127.11	179.46	251.19	317.62	315.37	423.37
OTHERS	15.41	36.60	27.36	40.61	37.77	35.94	51.91	60.07
NRL	0.00	0.00	19.41	19.42	34.55	24.59	10.26	3.19
AIRPORT TAX	0.00	0.00	2.37	4.85	4.94	6.61	5.56	5.82
VATS	59.98	76.28	109.01	152.68	215.09	279.07	354.74	466.78
DOMESTIC VAT	38.52	50.88	72.31	102.56	143.41	177.33	233.45	337.34
EXCISE	21.46	25.40	36.70	50.12	62.22	66.50	74.72	62.07
NHIL	0.00	0.00	0.00	0.00	9.46	35.24	46.56	67.37
CEPS	240.54	367.04	467.33	717.33	933.21	1,133.88	1,281.96	1,663.19
IMPORT DUTIES	80.79	126.85	162.61	236.72	288.31	340.35	399.01	566.07
IMPORT VAT	88.69	145.53	159.83	230.78	312.12	346.53	389.54	534.62
NHIL	0.00	0.00	0.00	0.00	27.35	68.80	78.19	106.56
PETROLEUM	53.18	64.66	108.00	170.59	300.75	376.30	415.17	455.94
EXPORT DUTY	17.88	30.00	36.89	79.24	4.68	1.91	0.05	0.00
TOTAL REVENUE	441.46	655.70	860.81	1,278.28	1,686.50	2,057.60	2,370.82	3,040.23

Source - RAGB

Table 2 Annual Collections as Percentage of Total Revenue

PERCENTAGE CONTRIBUTION TO TOTAL TAX REVENUE

AGENCY	2000	2001	2002	2003	2004	2005	2006	2007
IRS	31.9	32.4	33.0	31.9	31.9	31.3	31.0	29.9
PAYE	10.9	10.3	10.7	11.1	10.8	11.1	13.3	12.2
SELF-EMPLOYED	1.7	1.7	1.8	1.7	1.6	1.5	1.5	1.5
COMPANIES	15.8	14.7	14.8	14.0	14.9	15.4	13.3	13.9
OTHERS	3.5	5.6	3.2	3.2	2.2	1.7	2.2	2.0
NRL	0.0	0.0	2.3	1.5	2.0	1.2	0.4	0.1
AIRPORT TAX	0.0	0.0	0.3	0.4	0.3	0.3	0.2	0.2
VATS	13.6	11.6	12.7	11.9	12.8	13.6	15.0	15.4
DOMESTIC VAT	8.7	7.8	8.4	8.0	8.5	8.6	9.8	11.1
EXCISE	4.9	3.9	4.3	3.9	3.7	3.2	3.2	2.0
NHIL	0.0	0.0	0.0	0.0	0.6	1.7	2.0	2.2
CEPS	54.5	56.0	54.3	56.1	55.3	55.1	54.1	54.7
IMPORT DUTIES	18.3	19.3	18.9	18.5	17.1	16.5	16.8	18.6
IMPORT VAT	20.1	22.2	18.6	18.1	18.5	16.8	16.4	17.6
NHIL	0.0	0.0	0.0	0.0	1.6	3.3	3.3	3.5
PETROLEUM	12.0	9.9	12.5	13.3	17.8	18.3	17.5	15.0
EXPORT DUTY	4.1	4.6	4.3	6.2	0.3	0.1	0.0	0.0
TOTAL REVENUE	100	100	100	100	100	100	100	100

Source - RAGB

Table 3 Actual Revenue and Targets 2000-08

YEAR	ACTUAL REV.	TARGET	VARIANCE	ACTUAL REV.	EXP. GR. OVER	TARGET
	GH¢'M	GH¢'M	(%)	GROWTH(%)	PRE. YR'S ACTUAL(%)	GROWTH(%)
2000	441.46	423.60	4.2	-		-
2001	655.70	576.50	13.7	49	31	36
2002	860.81	779.50	10.4	31	19	35
2003	1,278.29	1,176.40	8.7	48	37	51
2004	1,686.58	1,599.61	5.4	32	25	36
2005	2,057.60	2,128.36	(3.3)	22	26	33
2006	2,370.83	2,504.81	(5.3)	15	22	18
2007	3,032.76	3,000.00	1.1	28	27	20
2008	-	3,543.72			17	18

Source - RAGB

Table 4 Number of Taxpayers and Amounts Paid

	2007		2008	
	Number	Collection	Number	Collection
		GH¢		GH¢
PAYE	1200000	372220727	1280000	512679839
COMPANIES	18714	418669152	20225	554992961
SELF EMPLOYED	52575	45589162	52978	64084359

Source - IRS

Table 5 Actual and Projected Collections

	Actual	Projected	Deviation	% Deviation
	GH¢	GH¢	GH¢	
2005	644638505	590350000	54288505	9
2006	734135488	726859800	7275648	1
2007	910235784	887680000	22555784	3
2008	1233953102	1122430687	111522415	10

Source - IRS

Table 6 VAT Exemptions Exempt Supplies

Item	Description
Animals, livestock and poultry	Applies to importation or supply of all live animals
Animal Product in its raw state produced in Ghana	Applies to supply in their raw state.
Agricultural and aquatic food product in its raw state produced in Ghana.	Exemption applies to supply in its raw state.
Seeds, bulb rootings and other forms of propagation	Application includes maize and cereal seed and the seed of edible fruits, nuts and vegeztables.
Fishing Equipment	Applies to boats, nets, floats twines, hooks and other fishing gear.
Water	Applies to supply of water by mains (well or tap. The supply of bottled water, packaged, and distilled waters is taxable.

Electricity	Applies to domestic consumption of units of electricity approved by the Minister of Finance. Other domestic and all commercial consumption is taxable.
Printed Matter – books and newspapers	Exclude plans, drawings, periodicals scientific works and technical works
Education	Supply of educational services at any level by an educational establishment.
Medical Supplies and services – pharmaceuticals	List determined by the Minster of Health and as listed in the Harmonised Commodity Codes
Transportation	Applies to the supply of all forms of transportation services(vehicles, train, boat or air)
Machinery	The exemption applies to machinery; apparatus and appliances listed in the Harmonised Code
Crude Oil and Hydrocarbons	Applies to petrol, diesel, liquefied petroleum gas, kerosene and residual fuel.
Land buildings and construction	Application excludes professional services such as architects and surveyors.
Financial Services	Applies to insurance services and operation of any bank (or similar institution) account
Goods for the disabled	Applies to articles designed exclusively fo use by the disabled e.g. wheelchairs, artificial limbs)
Transfer of Going Concern	Exemption applies to the supply of goods as part of the transfer of a business as a going concern by one VAT registered person to another VAT registered person
Postal Services	Exemption applies to the supply of postage

Table of Relief Supplies

Relief for individuals and organizations from the payment of VAT

Organisation	Description
President of the Republic of Ghana	Relief supplies to the Office of the President of the Republic Ghana
Commonwealth or Foreign Embassy, Mission or Consulate	Relief supplies for the use Commonwealth or Foreign Embassy, Mission or Consulate
International Agency or technical assistance scheme	Relief importation by and local supply of goods and services, apart from entertainment (e.g. hotel and restaurant bills) to international agencies and technical assistance schemes
Emergency relief items approved by Parliament	Consignments of emergency relief items that Parliament has specifically approved.

Source - VATS

Appendix 2: General Tax Incentives

General incentives under the Income Tax Act, 2000

S/No.	Industry Specific Concessions	Rate of Tax
1	Income from the export of non-traditional goods	8% against corporate tax rate of 25%
2	Company engaged in the hotel industry	Income tax rate applicable to a company engaged in the hotel industry is 22%
3	Income derived by a financial institution from a loan granted to a farming enterprise or a leasing company	Income tax rate of 20% against corporate tax rate of 25%
4	Income from a manufacturing business other than manufacturing business located in Accra or Tema	18.75% and 12.5% against corporate tax rate of 25% for manufacturing business located in regional capitals of Ghana and elsewhere in Ghana respectively.
5	Agro processing business established in Ghana in or after 1st January 2004	Exempt for five years. Thereafter if located in Accra and Tema corporate tax rate of 20%; located in other Regional capitals except Northern, Upper East and Upper West, corporate tax rate of 10%; Northern, Upper East and Upper West Regions, 0%; Outside Regional Capitals 0%
6	Interest or dividend paid or credited to a person who has invested in a venture capital financing company	Exempt for ten years
7	Income of a venture capital financing company that satisfies the eligibility for funding under the Venture Capital Trust Fund Act, 2004(Act 680)	Exempt for ten years
8	Income from a farming business in Ghana	Exempt as follows: • Tree crops for 10 years; • Livestock(other than cattle), fish or cash crops for 5years • Cattle farming for 10years
9	Income from processing of crops ,fish or livestock into edible canned or other packaged product	Exempt for 3 years
10	Income of a rural bank	Exempt for 10 year. Thereafter attracts corporate tax rate at 8%
11	Income from cocoa of a cocoa farmer	Exempt from tax
12	Income of a company from a business of construction for letting or sale of residential premises	Exempt for 5 years
13	Income of the Ghana Stock Exchange	Exempt for 20 years
14	Income of a company listed on the Stock Exchange in or after 01/01/ 2004	Corporate tax rate of 22% for the first three years

Aside from these incentives several incentives are specified in other legislation, among them:

1.Tourism and Hospitality: Ghana Investment Promotion Centre (Promotion of Tourism) Regualtions, 2005 (L.I. 1817)

a) The following are granted exemption from the payment of customs import duties and other related charges and VAT on the importation of capital equipment, machinery appliances, furniture and fittings;

- Accommodation establishments including hotels, motels, resorts, guest houses and serviced apartments approved by the Ghana Tourist Board (GTB)
- Catering establishments including fast food, specialized restaurants and other catering estblishemnts approved by the GTB;
- Travel and Tour Establishments including operators of a fleet of tourist coaches and or buses approved by the GTB;
- Conference and Convention establishments including management and operation of international conference centres approved by the GTB
- Recreation establishments including night clubs, amusement centres, theme parks and casinos approved by the GTB

b) In addition tourism and hospitality establishments enjoy corporate tax holidays of from 3 to 5 years depending on the location of the establishment.

2. Various other industries are eligible for various degree of relief from import duties and VAT under various pieces of legislation. These sections include:

- Manufacturers – Importation of specified raw materials, plant and machinery
- Mining Companies – Importation of vehicles, plant and machinery
- Contractors and Construction Companies – Importation of plant and machinery
- Persons/Entrepreneurs involved in Trade Fairs and International Exhibitions, Travelers – Imports of Trade Exhibits
- Diplomatic Missions and NGOs – Imports of vehicles

What is the relation between taxation and development? Is revenue collected equally from all residents? Why should companies be given tax concessions?

These and other questions are raised by this Tax Justice Ghana report, which focuses on the ways in which the tax system and revenue collection can be linked to ongoing poverty reduction efforts. The report demonstrates that domestic resources, not loans nor aid, is the largest missing piece in reaching developmental goals.

Revenue mobilisation is at the top of the government agenda, with budget deficit to reach 11% in 2008. There are areas where revenue collection could be improved, for instance, taxing property and rental income could raise an additional 1-2% of GDP in taxes, while also increasing the transparency in land tenure.

Ghana's investment policy relies heavily on tax holidays, while serious efforts to monitor and evaluate their benefits are lacking. Companies often receive a 10-year tax holiday when establishing in the Free Zones. The whole regime of Free Zones needs urgent review in Ghana, as for instance, it has been found that 72% of forestry turnover is subject to Free Zone status.

Extractive industries account for 4.6% of Ghana's GDP, while contributing approximately 3% of government revenues. Utilising existing provisions, royalties could be set at a higher rate, and income taxes could be collected from expatriate workers. In the forestry sector, one sample indicated that firms paid income tax equal to 0.2% of turnover, due to under reporting of profits and Free Zone status. Tax losses in the forestry sector are estimated at 0.5% of GDP.

The establishment of an International Financial Services Centre (IFSC) in Accra presents major risks: tax concessions may be enjoyed by Ghanaian residents as well as foreign nationals, secrecy provisions may hamper Ghana's efforts in fighting corruption and illicit drug trade. Benefits need to be weighted with costs and risks.

While there is much talk about future oil revenues, they cannot be a basis for current expenditure as recent oil price fluctuations demonstrate. Oil will not solve the revenue raising problems of the nation - rather a broad-based and well-enforced tax system will tackle the budget short falls.

"*In matters of taxation, every privilege is an injustice*" – Voltaire

"*Taxes, after all, are dues that we pay for the privileges of membership in an organised society*" – Franklin D. Roosevelt