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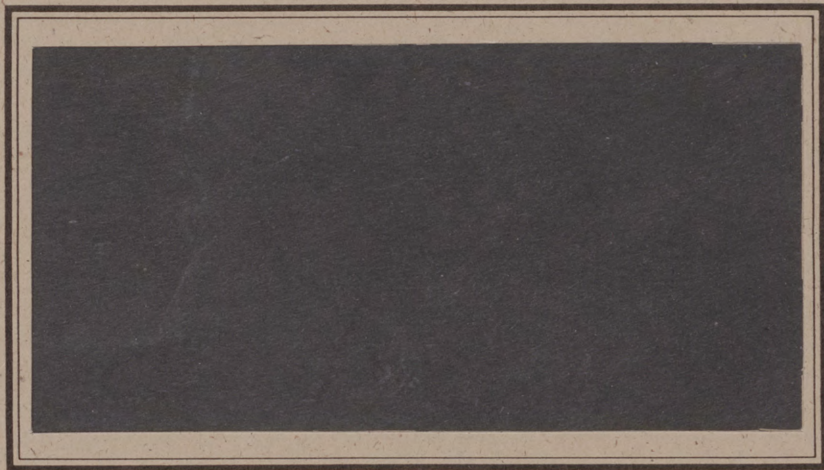

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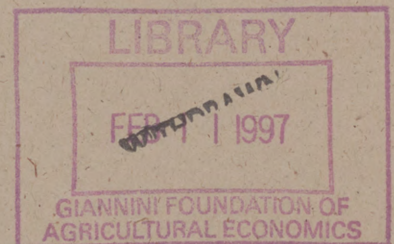

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Harvard International Tax Program
Harvard University
Pound Hall 400
Cambridge, Massachusetts 02138
617-495-4406
Fax: 617-495-0423

Harvard Institute for International Development
Harvard University
One Eliot Street
Cambridge, Massachusetts 02138
617-495-2161
Fax: 617-495-0527
http://www.hiid.harvard.edu

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ABSTRACT

In March 1995, the Value Added Tax (VAT) became operative in Ghana. Yet, within three months the country's parliament had passed two separate laws to reinstate the flawed sales and service taxes, which the VAT was originally meant to replace. The decision to cancel the VAT was unique in many respects.

First, Ghana had become only the second country to make such a major turnaround. The VAT had become a widely acceptable tax, implemented by over one hundred countries by the end of 1995. This meant that there was no dearth of experience in either advanced or developing countries for the design and implementation of the tax. Second, Ghana itself had pushed through a number of major tax reforms since 1985 as part of its structural adjustment program. It was thought, therefore, that Ghana had gained enough expertise in implementing this tax. This VAT program itself had taken two and one-half years of careful planning by the consultants and tax officials in the country.

The objective of this paper is to highlight the factors that led to the cancellation of the tax. The author mentions the inability of the legislature to adhere to the implementation schedule as the main factor that derailed the program. Other observations include the unbridled institutional rivalry among the country's revenue institutions, the lack of coordination of other fiscal policies with the VAT, and a poorly implemented public education program.

For many developing countries, especially those in sub-Saharan Africa that continue to introduce the tax, the documentation of Ghana's experience comes as a timely warning against complacency in the implementation of tax reform.

Seth Terkper is a Research Fellow of the International Tax Program, Harvard University, and a member of the Institute of Chartered Accountants in Ghana. He is a member of the National Revenue Secretariat in Ghana, and was also the coordinator of Ghana's VAT Project.

VAT in Ghana: Why It Failed

by
Seth Terkper

Ghana is probably the only exception to the observation that, aside from a short-lived value added tax (VAT) in Vietnam in the early 1970s, no country has ever repealed VAT legislation.[1] In October 1992, the government of Ghana established a project office responsible for the design and implementation of a tax to replace the sales tax regime that had been in existence since 1965. After two years of careful planning by a technical committee, a supervisory body to this committee and consultants from Crown Agents (UK), Parliament passed the Value Added Tax (VAT) Act, 1994 (Act 486) in November 1994.[2] The VAT Regulations (Legislative Instrument No. 1598) were subsequently passed by the House in February 1995. The instrument actually became effective in March 1995 after a 21-day statutory notification period. (For prior coverage of VAT developments in Ghana, see Tax Notes Int'l, July 24, 1995, p. 195, or 95 TNI 138-6).

Although the VAT Act became effective on January 1, 1995, actual collection of the tax commenced on March 1, 1995. In May 1995, Parliament moved with dispatch to reopen debate on the fate of what had become Ghana's first real effort at implementing a comprehensive domestic indirect tax regime.[3] In effect, the efforts to have the VAT law and regulations repealed were orchestrated within two months of the effective date of commencement of collection of the tax. The decision eventually taken by the House to repeal the laws clearly contradicted the current trend in global tax reforms,[4] and appears to have taken many informed technical advisers by surprise. Two separate laws, the Customs, Excise and Preventive Service [Management] [Amendment] [No.2] Act 1995 (Act 500) and the Service Tax Act, 1995 (Act 501) were passed to repeal the VAT law and regulations. These

two laws effectively restored the previous sales and other indirect tax regimes to their original status, with virtually no consideration given to the experience gained from the design and implementation of the invoice-credit mechanism under the short-lived VAT system. In other words, the new laws did not incorporate the recommendations of any of the previous studies, which had been critical of the sales tax regime.

The objective of this article is to highlight some of the difficulties in implementation that led to the repeal of the law and suspension of the tax. Most of these problems are discussed in the second section, in which aspects of the policy, structure, and administration of the tax within the review period are considered. The first section deals with an appraisal of the plan drawn to implement the tax, and the third section of the article relates to the political economy at the time the VAT was introduced. The article concludes with suggestions for the reintroduction of the tax over the next three years. It is hoped that this discussion will shed some light on what is probably the only known instance of the actual repeal of a VAT law and its replacement, in a full turnaround, with a flawed sales tax regime.

I. RATIONALE FOR VAT IN GHANA

Much of the planning phase for the VAT was taken up by the desire of consultants and local committees to justify formally the introduction of the tax by policymakers. It involved the organization of seminars and consultations with academics, private sector groups, and senior government officials. The planning phase also was used to educate officials from the existing revenue institutions on the basic mechanics of VAT. These officials constituted the core group that would later help implement the tax.

Even though this period has been criticized as having been devoid of contact with the general public, it would have been extremely difficult to carry out a meaningful public awareness program without a precise definition of the broad outlines of the tax. As such, the planning stage basically involved the definition of a policy framework for the tax with the

assistance of mainly professional groups. However, not publicizing some of the important discussions, negotiations, and subsequent conclusions reached with trade associations and other categories of taxpayers was probably a tactical error in the education campaign. It made it easier for the leaders of some of these groups to disown the negotiations when they were faced later with mounting pressure from their members.

A. Why a VAT for Ghana?

There are many reasons why Ghana needed to introduce a tax such as VAT to revamp its revenue structure. The reforms of the 1980s were not comprehensive enough in incorporating appropriate measures to expand and diversify the tax base.[5] To a large extent, they served to resuscitate the base of the traditional sources of revenue that had been eroded over the years because of the general decline of the economy. In particular, the introduction of VAT could be seen as a long-delayed effort to implement a more effective general consumption tax.

1. The Revenue Objective

It is well established that the replacement of sales tax regimes with VAT systems in many developing countries should not be in sole pursuit of revenue-raising objectives. Nonetheless, the critical fiscal situation implied by the 1995 budget presented to Ghana's Parliament resulted in over-emphasizing to the country the revenue objective of VAT.[6] The general impression that VAT was being introduced as a subtle means of generating additional (and excess) revenue for the government had a negative effect on the VAT implementation process. First, other crucial nonrevenue reasons for introducing the tax in many Sub-Saharan African (SSA) countries were completely sidelined in the ensuing national debate.[7]

Second, though relevant to an evaluation of any effective tax system, discussions were often overshadowed by an extremely distracting review of the pattern of government expenditure or, by implication, a judicious use of tax revenues. Finally, the critical fiscal situation appears to have made it extremely difficult to implement compensating fiscal measures to minimize the effects of what many considered to be the adverse socioeconomic impact of introducing a broad-based tax like VAT. Even if it were assumed that the current

level of taxation was adequate, Ghana certainly had other important objectives that VAT could help achieve. Incidentally, few, if any, SSA countries can boast of an adequate level of revenue generation. The lack of buoyancy in the domestic revenue mobilization effort has been identified as critical among the main weaknesses of their tax systems.[8] Therefore, in spite of whatever objectives may be stated for the introduction of VAT in SSA countries, the revenue-raising objective can never be underestimated.

2. *Improving Domestic Indirect Tax Administration*

The principal objective of VAT in Ghana was to replace a flawed sales tax regime with an improved collection mechanism. The sales tax was levied only on goods, and was collected as a single-stage tax at either the factory gate or at the point of importation. The exclusion of the retail and service sectors from the base of indirect taxation suggested that a buoyant revenue system could not be evolved, even with a gradual development of the economy.

The main feature of the sales tax collection process was the deferral or suspension of the tax on primary raw material imports for a number of registered manufacturers (the "ring system"). Since this privilege excluded other taxpayers (e.g., nonregistered manufacturers and the entire distribution chain), the regime was bound to result in tax cascading and severe economic distortion. These distortions are made worse by the different varieties of concessionary, standard, and luxury rates administered by Customs, Excise, and Preventive Service (CEPS). Another weakness of the sales tax system was the exemption of a large number of supplies and end-users from the tax, distorting and eroding the revenue base of the tax system.

Next, the dichotomy in administration of domestic indirect taxes in the country suggested that the base of the tax could not be easily expanded and the ring easily converted to an invoice-credit mechanism without a major review of the institutional setup of the existing revenue agencies. The sales tax levied only on goods was administered by CEPS. In addition, the Internal Revenue Service (IRS) collected other domestic indirect taxes on only a narrow range of services, namely, entertainment, gaming and betting, hotel accommodations and

restaurant meals, and advertisement charges. The exclusion of other services from the indirect tax base made the whole system inequitable and less buoyant.

The foregoing issues implicitly define the primary goal of VAT as tackling the fundamental problems of a distorted indirect tax regime, together with the bottlenecks exhibited by an ineffective administrative machinery. Many reviews of Ghana's tax regime (notably, a joint study by Crown Agents (U.K.) and the Harvard Institute for International Development) have been unambiguous in suggesting an overhaul of both the structure and administration of the sales tax regime.

3. Diversifying the Tax Base

For a long time, the general system of taxation in Ghana was characterized by a very narrow revenue base. Prior to the reforms carried out in the early 1980s,[9] over 33 percent of total revenue was collected from export duties on cocoa and other primary commodity exports such as minerals and timber.[10] Currently, nearly 15 percent of the revenue is derived from levies imposed on exports of cocoa only, and another 25 percent is raised from excise duty on petroleum products alone. Given that the excise duty on alcohol and tobacco generate another 12 percent of the revenue, it may be inferred that over 50 percent of the country's tax base has become dependent on only four products. Tariffs or import duties account for more than half of the remaining 50 percent of total revenue.

On the other hand, the taxes that were originally designed to feature a broader base contribute a relatively small fraction of total revenues. Corporate and individual taxes constitute about 17 percent of total revenue, whereas import and domestic sales taxes account for a meager 12 percent. These features of Ghana's tax regime are characteristic of the "tax handle" principle underlying most SSA tax systems. However, the volatile nature of primary commodity prices such as cocoa and crude oil clearly imply that the current tax base is vulnerable to any adverse trends on the global market. Moreover, a number of developing countries with similar features of underdeveloped tax systems have embarked on a serious review aimed at diversifying the sources from which revenue may be generated. Given the

wave of these reforms on the continent and Ghana's own pioneering role in this effort, the country needed no further prompting to pursue a stable revenue base.

4. Simplification of the Tax Regime

A principal objective of tax reform is the rationalization of the objectives of tax instruments, with a view to simplifying tax administration and compliance. Ghana's inability to expand significantly the direct and indirect tax base to cover the retail and service sectors is a major factor contributing to the loss of momentum in the reforms launched during the 1980s. These earlier changes combined retention of the progressive structure of the individual income tax regime with steep reductions in the personal and corporate income tax rates. The individual tax brackets have since been adjusted annually (though not fully indexed) to account for inflation, thereby minimizing "bracket creep." Also, a number of export duties and ad hoc tariffs have been eliminated, in addition to reductions in the rates of other indirect taxes.

However, the momentum for further elimination of unwanted taxes and reductions in tax rates has stalled as a result of the strong reliance on the traditional methods of taxation for generating revenue. Thus, Ghana's tax system continues to be inadequate in many respects. The original design of VAT was kept simple to assign principally a revenue-raising goal to the tax. It also was hoped that this would ease significantly the burden of administration and compliance. The nonrevenue objectives of the original sales tax regime were to be assigned to other taxes, such as excise duty, import duty, and the income tax. However, by the time the VAT bill was retabled in Parliament in November 1994, most of these objectives had been either completely eroded or altered at various stages of review of the bill. This was the principal reason for the difficulty in maintaining a fairly wide tax base, simplified structure, and a reasonably low rate for the tax.

B. Basic Features of Ghana's VAT Regime

In spite of the problems enumerated in this article, the plan to introduce VAT retained quite a number of the original features recommended by the consultants and technical committees.[11]

1. Tax Rates

The multiple rates of the sales tax were replaced under VAT by a single positive rate of 17.5 percent, and the zero-rating of exports only. Indeed, by 1994 the numerous sales tax rates had been gradually reduced under previous tax reform programs to only two (15 and 35 percent) in anticipation of the introduction of VAT. The zero rate of VAT was not extended to domestic supplies because of the need to simplify the administration of the tax.

2. Tax Base -- Exemptions

The initial design of the VAT provided that exemptions would be limited to only a few basic goods and services (e.g., education, health, and foodstuffs), financial services, and some categories of machinery and equipment. As noted previously, a principal objective of VAT was the restoration of the broad indirect tax base that had been whittled down by the incremental expansion of exemptions over the years. However, intense lobbying from business and consumer groups made it extremely difficult to implement this policy to the level originally envisaged.

3. Tax Base -- Coverage

In addition to reducing the number of exemptions, VAT was designed to cover the retail and service sectors as part of the scheme to expand the base for domestic indirect taxation in the country. Nonetheless, most small-scale business operations were to be eliminated by fixing a registration threshold based on a minimum annual turnover of 25 million cedis.[12] This measure was the first major attempt at integrating these traditionally "untouchable" sectors into the tax base. It is therefore not surprising that, subsequently, the determination of an appropriate level of registration threshold became one of the contentious issues that influenced the decision to review the entire VAT system.

4. Collection Mechanism

Ghana's invoice-credit VAT system replaced the ring system with a credit scheme. In theory, registered traders would automatically offset the tax paid on inputs against the tax on output, and the difference would be paid to the tax administration. The benefits of eliminating cascading under VAT for the manufacturers who were registered for sales tax was obvious. However, because the tax also meant an extension of indirect taxes to the retail and service sectors for the first time, it was not generally appreciated that it was merely replacing the sales tax regime. For this reason, the view that the additional impact of the tax would not be significant was hotly contested by both retail and manufacturing groups.[13] It was made worse by the general feeling that VAT was a sophisticated system that, contrary to the evidence, is imposed more frequently in developed than in developing countries.

5. VAT Administration

The problems confronted by the VAT implementation team went beyond the definition of an appropriate structure and policy framework for the tax. A number of bottlenecks were experienced in establishing an effective machinery to administer the tax.

(a) Recordkeeping Anxieties

The invoice-credit VAT mechanism is widely credited with improving tax compliance because of features such as the audit trail left by purchase or sales invoices and the self-policing check inherent in the input tax credit. However, the extent to which VAT's potential to improve recordkeeping also could contribute to intense resistance by taxpayers to the implementation process may have been seriously underestimated in Ghana. The only mandatory recordkeeping requirements included in the VAT regulations were the retention of sales and purchase invoices. It was anticipated that this basic rule would facilitate compliance by small-scale businesses.

In the case of retail outlets for which keeping sales invoices for numerous transactions would be cumbersome, a notebook for recording daily sales could replace the keeping of such

invoices. Nevertheless, there was apprehension in most business circles that even these simple measures would in fact lead to more cumbersome procedural requirements. It was the prime cause for the false charge that VAT would result in excessive recordkeeping beyond the capability of most small-scale traders in the country.

(b) Creation of the VAT Service

While the apprehension about compliance with the recordkeeping requirements of VAT was clearly observable in the general debate, the issue that raised the most rancor among the revenue institutions was the creation of the VAT Service as a third revenue institution. As noted earlier, the main flaw in the administration of domestic indirect taxation in Ghana was its division between CEPS (sales tax on goods only) and IRS (indirect taxes on selected services). Thus, the creation of the VAT Service was meant to consolidate the administration of all domestic indirect taxes, including the excise duty on local output. The specific problems associated with the establishment of the new Service are highlighted below.

II. IMPLEMENTATION DIFFICULTIES

The timetable adopted for implementing VAT in Ghana mirrored the Critical Path Analysis Chart outlined by Holland in Tait,[14] with some modifications. The program that was put into effect in November 1992 was to culminate in the introduction of the tax on January 1, 1995. The primary reason for picking January was to ensure that the changes proposed would become part of the comprehensive fiscal measures to be incorporated in the budget for that year.[15] Even though the program itself experienced only one major hitch (i.e., late enactment of the VAT Act), it virtually spelled doom for the whole implementation process.

A. Legislation

- Parliament's inability to pass the VAT Act as planned in May 1994 caused the first and probably most significant dislocation to the program for implementing the tax. It was anticipated that passage of the law for a minimum period of six months prior to the effective date of the tax in January 1995 would attain the following objectives:

- provide legal backing to the new VAT Service to appoint a new board;
- top management and senior staff appointments would be made to help stabilize the position of the new VAT Service;
- put the content of procedures and programs in place to make training, publicity, and education more precise;
- provide a firm basis for compliance by tackling an early taxpayer registration exercise; and
- allow the legislature enough time to consider the draft VAT
- regulations that could only derive from the primary law.

After the draft act was tabled, Parliament took the unusual step of setting the bill aside and requesting that the VAT Management Team engage in a national education campaign to sensitize the population to the objectives of the tax. This was in response to the debate on the desirability of passing the law before an intensified public education campaign. Needless to say, the education that took place between May and November 1994 was virtually ineffective because it lacked precision and the legal backing to prompt any serious interest among the general public. Moreover, by the time the law was passed in December 1994, the beginning of the actual collection of the tax on January 1, 1995, was no longer feasible. Unfortunately, the new date of March 1, 1995, made the timing for the whole project critical, because it fell into a traditionally difficult period on the fiscal calendar of the nation.

B. Timing Difficulties

The VAT Law, Act 486 (1994) became effective for establishing an administrative machinery and registration of taxpayers from January 1995, but the actual collection of the tax commenced on March 1, 1995. In theory, the registration of businesses for VAT could have begun in January, but the VAT regulations that specified the limit or threshold for registration did not become effective until March 1995. Apprehension about VAT was experienced mostly among retailers, because this sector, together with service providers, had never been part of the previous sales tax regime. Therefore, the inability to make the criteria for registration definite in good time tended to undermine the effort to register taxpayers among the most vulnerable groups during the early days of implementation. The one-month effective period used to register eligible retailers created a lot of panic and rendered the planned

education visits to business sites before the onset of actual collection of the tax practically impossible. Thus, the attempt to cram so many activities into the short period between January and March 1995 may be cited as one of the major errors that seriously undermined public confidence in the entire program. Another effect of changing the effective date of VAT from January to March 1995 was the general perception that fiscal policy for that year was disjointed and somehow not properly coordinated. The budget that was read in February 1995 increased the rate of sales tax from 15 to 17.5 percent, in addition to further increases in petroleum excise rates of about 20 percent. Also, since the other nonpetroleum excise duties were defined in the law as forming part of the value for computing VAT, the lack of adjustment to a revenue- neutral excise duty rate resulted in an implicit increase in the rates.[16] Finally, the period between January and March is the most difficult for food production in the country. Anti-VAT sentiment had been orchestrated to the point that the tax was blamed for inflation in the country. The public simply ignored the normal general price increases observed during this period.

C. Policy Framework

The basic policy framework for the tax was defined as early as February 1994. However, by the time it emerged from Parliament in December 1994, it had gone through many serious alterations. The principles on which the basic framework had been founded included a broad base, neutrality in applying the tax to imports and domestic output, a low tax rate, and exclusion of basic supplies and vulnerable business enterprises such as retailers from the tax.

1. Rate of Tax

As noted in the preceding paragraph, the 1995 budget increased the standard rate of sales tax from 15 to 17.5 percent for January and February 1995. However, it did abolish the luxury rate of 35 percent. It was this standard sales tax rate of 17.5 percent that became the single positive rate of VAT in March 1995. In other words, this rate had been in operation for a whole month before the introduction of VAT. However, it is significant to note that the decision to raise the rate to 17.5 percent was actually a reversal of the trend toward reducing sales tax and tariff rates since 1986.[17] Indeed, the 1994 budget had actually lowered the

standard rate from 17.5 to 15 percent "in anticipation of the introduction of VAT."[18] However, the luxury rate of 35 percent was retained until 1995 when VAT was introduced. Therefore, even if the decision to revert to 17.5 percent made fiscal sense at the time,[19] it certainly had an adverse effect on the VAT implementation process. First, the public education campaigns cited the statement in the 1994 budget and therefore strongly suggested that the single positive rate of VAT would at worst not exceed the standard rate of sales tax, which in 1994 was 15 percent. The increase in rate appeared to undermine public confidence in the credibility of the education program. Second, the general view in the country that VAT rates in many countries did not exceed 5 or 10 percent, although inaccurate, was difficult to change during the publicity campaign. Even the elimination of the 35 percent luxury rate in February 1995 did not make any impact on the opposition to what was perceived to be a high VAT rate.

The confusion over the appropriate rate levels is thought to have emerged from two main sources. First, the fact that the rate of VAT in Nigeria, which introduced the tax during the previous year (1994), was only 5 percent was usually cited by those who engaged in cross-border trade in the subregion. The arguments advanced for a lower rate based on the Nigerian situation were so forceful that it became extremely difficult to convince even well-informed commentators that the circumstances in Nigeria could not be compared to Ghana's.[20] Another factor that appears to have confused the debate even more was the general view that Parliament may have missed the opportunity to debate extensively the rate because it was passed under a certificate of urgency, and that a lower rate of VAT was a feasible option.[21] It created an unfortunate rift between the executive branch and the legislature on what should have been a uniform governmental position on policy issues.

The fact that seems to have been ignored by these viewpoints was that Ghana was already collecting between 12 and 15 percent of total revenues from the previous sales tax. Thus, any rate that compromised this level of revenue would seriously worsen the critical fiscal situation at the time of the introduction of the VAT. Second, most legislators and commentators failed to see a connection between the tax rate and the base to which it is applied. The efforts to add

to the exemption list under Schedule 1 of the VAT Act were clearly incompatible with the desire to lower the rate of the tax. They contributed to serious erosion of the tax base.

2. Tax Base -- Exempt Supplies

The main problem confronted by the legislators with regard to the tax base was pressure to include a large number of goods and services on the exemption list -- Schedule 1 of the Act. Even though the VAT Team had aimed to reduce drastically the number of exemptions granted under the sales tax regime, the number of goods that eventually made it to the schedule suggests that this goal was virtually defeated. The exemptions granted to the education, health, agricultural, and mining sectors in particular were the most pervasive. Most of these requests were granted under a curious presumption that an exemption from one form of tax meant exclusion from the payment of all other taxes. Thus, the inability of the Ministry of Finance to stick to the anticipated coverage for goods and services may have contributed to the decision to increase the rate of tax from 15 to 17.5 percent. The task for the future is to convince taxpayers and the general public that it is perfectly normal to grant an exemption from import duty or other taxes without necessarily extending it to a general consumption tax such as VAT.

3. Tax Base -- Registration Threshold

As noted earlier, the introduction of VAT was meant to expand the tax base to cover the retail and service sectors. However, it was acknowledged as part of the design of VAT that it would be practically impossible to cover every retail outlet, since most of these business units, irrespective of size, operate in the informal sector of the Ghanaian economy (as is the case in many other countries). The characteristics of this sector in SSA countries include illiteracy and operations that are spread over wide and often inaccessible rural areas. The direct consequence of this feature of underdeveloped economies is lack of recordkeeping, a serious factor contributing to the problems that impede the setting up of an effective tax administration machinery in many developing countries.

Nevertheless, the attempt to cover fairly large retail outlets under the VAT regime was informed by a number of issues related to the gradual evolution of an effective tax system in the country. Moreover, a high general literacy rate may not be the most important factor in developing such a system. First, tax administrators in countries with a relatively high degree of literacy continue to grapple with the peculiar compliance issues associated with the "hard-to-tax" category -- mainly retail and service enterprises.[22] Thus, even if developing countries were to increase their literacy rate overnight, the problem of tax compliance in these sectors will not necessarily be eliminated. Second, VAT administrations in both developed and developing countries seriously consider excluding small retail and other businesses from the tax. This measure is specifically taken to ease and reduce the cost of administration and compliance. In this regard, coverage of the retail sector under VAT does not necessarily imply that the very small retail outlets that pose the most difficulty in third-world tax administration would be automatically included.

Therefore, the practice of fixing turnover limits for registering taxpayers for VAT is not aimed solely at accommodating deficiencies or difficulties in third-world tax administrations. Even though the principle was accepted in Ghana, the appropriate level of the registration threshold was never completely settled until the repeal of the VAT law in June 1995. Initially, the regulations had pegged the limit at 25 million cedis.[23] However, in the course of reviewing the tax between May and June 1995, the Ministry of Finance proposed an increase to 30 million cedis, and later made a further concession to revise it to 50 million cedis. The proposed revisions appear to be direct attempts to minimize the influence of the opposition forces and soothe the powerful retail lobby. Given the fact that only 9,000 businesses (including retail and services) were registered for VAT in Ghana, there is no doubt that the VAT Service could have managed a program to educate registered traders who had genuine difficulties in completing the monthly returns, maintaining purchase or sales invoices, and compiling adequate records of daily cash sales.

Most analysts are prone to associate retail and small-scale business operations in developing countries with illiteracy. This perception often is exploited successfully by both

large and small retailers opposed to reforms that improve tax compliance. In Ghana, a number of grassroot retail organizations emerged as frontrunners in race to lead the opposition to VAT. There is clear evidence in every developing country that the operations of some retail and service outlets are not only large but formal and sophisticated. Indeed, most of these outlets keep records, including income tax records, that go beyond the basic requirements of VAT systems.

4. Meaning of Exemptions

Much controversy was generated by the fact that, under VAT, the word "exempt" does not mean complete waiver of all taxes paid on a supply. In Ghana, the confusion was heightened by a VAT Service advertisement on national radio and television that suggested that a popular rice staple called wakye would be exempt from VAT because of the threshold. This advertisement clearly backfired when members of the public could not be convinced by the explanation that under VAT, the imported rice used in preparing the wakye would be subject to tax. Therefore, the unrelieved tax would automatically increase the price of the end product. Ironically, imported rice had always been subject to sales tax, and the introduction of VAT would make no material difference to the price of the product in question.

This literal interpretation of exemptions extended to cover all items in Schedule 1. It resulted in a number of representations being made to the VAT office for a waiver of the tax paid on inputs. The solution to this nagging problem lay in zero-rating some domestic supplies of goods and services. Since it was agreed that domestic supplies of goods and services would not be zero-rated, to ease administration of the tax, the public view of what constituted exemption grew even more cynical, and gradually became contentious and a major source of pressure on legislators and the staff of the VAT Service.

Finally, the existence of many import-substitution industries in Ghana created another peculiar problem. The output of some of these firms (e.g., health and education materials) was exempted under the law. However, most of these industries were heavily dependent on imported raw materials that were taxable under VAT. In some cases, the so-called raw

materials were even classified as final products in the Harmonized Systems (HS) Tariff Code used by Customs. It should be recalled that under VAT, input tax credit is disallowed on nontaxable supplies (output). This situation resulted in some imported finished supplies being completely relieved of tax, whereas the price of similar, locally manufactured goods were loaded with the VAT paid on "raw materials."

For the brief period that the VAT was in existence, the VAT Service was inundated with requests for waivers of taxes on these inputs to accomplish a neutral position for domestic and international trade. The fact that some of these waivers had been granted under the previous sales tax regime made VAT appear onerous to some local manufacturers. Thus, it became difficult to reconcile two basic principles under most VAT regimes -- neutrality (application of the same rate for imports and domestic output) and exemption (blocking of input tax credit for exempt supplies). Indeed, a similar problem arose with the export of exempt supplies.

5. *Zero-Rating Exempt Nontraditional Exports*

The provision of the law under which exports were zero-rated also created problems for the implementation process. In principle, only taxable supplies or exports could qualify for the refund of input taxes. Therefore, in practice the input tax credit for exports of exempt supplies (e.g., agricultural produce) would be blocked. However, prior to VAT, the government had been engaged in promoting nontraditional[24] exports, with the aim of diversifying exports to increase foreign exchange earnings. The instruments for this promotion program included waiver of various direct and indirect taxes. This policy made it difficult to reconcile the exemption of agricultural produce under VAT with the zero-rating only of taxable supplies. Eventually, the Ministry of Finance had to bow to pressure and allow exporters of exempt nontraditional supplies (mainly agricultural produce) to file for a refund of VAT under a special scheme that was to be run in association with the Ghana Exports Promotion Council (GEPC).

D. VAT Administration

As noted previously,[25] some of the problems experienced during the implementation phase were associated with the establishment of an effective organization to administer the tax. The main difficulties centered on the creation of the VAT Service itself, and the consequent delay it caused in setting up an effective administrative machinery.

1. Establishment of the VAT Service

Prior to the August 1994 decision to establish a VAT Service, it was assumed that the tax would be administered by CEPS. There appear to have been two main reasons why the decision to create the new Service did not seem an extraordinary move at the time. First, the theoretical basis for establishing a separate unit to plan and possibly administer VAT is extensively discussed in the tax literature.[26] Among other factors, Tait cites the potential tug of war between the customs and income tax authorities, and the possibility of making these institutions too dominant by adding VAT to their portfolios as the primary reasons for establishing a new department to administer VAT. This option, together with those for either IRS or CEPS administration of the tax, was debated at length at various technical committee meetings of the project team.[27] Given the benefit of hindsight, the hints given in the literature should have put the ministry on guard about some of the problems that were likely to arise from this move. For example, Tait observes that...there are dangers in this solution (i.e. establishment of a new unit): staff may be reluctant to be transferred from income tax or customs and excise to a new sales tax (VAT); the personnel of the existing agencies may unreasonably resent the new organization; and there may be problems of cooperation among staff.[28]

Neither did his observation that "...in any case, customs will collect usually a fourth (and sometimes much more) of the VAT revenue (on imports)" do much to mitigate the intense institutional rivalry that arose in Ghana.[29] The situation in the country had degenerated to the point of polarizing opinion on the appropriate institution to administer the domestic VAT.

The second reason for probably underestimating the damage that the institutional restructuring could inflict on the process was that Ghana was part of an emerging trend in tax administration reform on the continent.[30] The main features of this reform include the removal of revenue agencies from the civil service, and the creation of revenue boards to administer separately domestic indirect tax, customs duty, and income tax. Thus, by 1995, this new structure had either emerged or was being planned in countries such as Ghana itself, Kenya, Uganda, Tanzania, Zambia, and Nigeria (where VAT was put under a separate directorate accountable to the Board of Inland Revenue).[31] It is possible that some of these extensive administrative reforms carried out in previous years may have lured policymakers and the VAT Team into complacency in not anticipating the opposition that could arise from the existing revenue agencies.

Indeed, the rivalry between CEPS and the new VAT Service adversely affected the successful implementation of the VAT assignment.[32] It resulted in the dissipation of a lot of energy on sparring for attention and seeking a justification for nullification of a number of policy and administrative measures designed to make the tax effective. It became increasingly difficult in some instances to separate the resentment against the new VAT Service from the rancor against the tax itself. To many, abolishing the tax was merely a means of getting rid of an emerging rival institution. It was a trend that would affect the effectiveness of arguing the case for continuation of the VAT program in Parliament in June 1995. The rivalry was clearly the basis for the consolidation in many circles of a misguided belief that the previous (and flawed) sales tax regime could be relied upon.

2. Delays in Appointing a VAT Governing Board

The second major factor that contributed to the inability to set up an effective administration was the delay in making appointments to senior management positions and the establishment of a board for the VAT Service.[33] This was partly the direct consequence of not passing the VAT Act and regulations on schedule. The VAT Oversight or Steering Committee that was established in 1993 became the de facto board. However, it was dominated by the top management of CEPS because of the initial assumption that the Service would administer

the tax. Therefore, after August 1994, when the decision was taken to separate the management of the new tax from CEPS, the possibility existed that the enthusiasm and commitment of some members of the committee would wane. Again, given the benefit of hindsight, it would have been expedient to reorganize immediately the steering committee responsible for the implementation of the tax prior to the appointment of the board. For example, the presence of representatives of the private sector on such a committee would have been extremely helpful in promoting general understanding of its objectives. Unfortunately, the board for the VAT Service was not appointed until May 1995; in fact, it was never even inaugurated. The situation was compounded by the fact that the failure to appoint members of senior management robbed the Service of the image of an entrenched institution.

3. Staffing Problems

The delay in passing the VAT law and, subsequently, the absence of a governing board for the new Service, resulted in undue pressure on the skeleton staff at their post (in effect, members of the VAT Planning Team) at the time the tax became effective. In fact, virtually no middle-level management appointments were made for the new Service. The staff of the Service was to come from two main sources -- new recruits and staff on transfer from the existing revenue institutions, notably those on sales tax schedules. While the transfer of staff from CEPS in particular did not materialize for obvious reasons, there was delay in recruiting new staff because of the lack of legal backing for the new Service. The VAT Project Management Team is often made to share in the blame for the late recruitment. It is argued that the Finance Bill (1994), which allocated funds for the preparatory work, implicitly authorized the recruitment of enough staff to tackle the assignment. As with the skeleton staff on the Project Team, the VAT Act would have made adequate provision for their absorption into the new VAT Service. The main drawback of the inability of VAT officers to be at their post as scheduled was the ineffective manner in which the education visits to new traders was carried out.

E. Other Implementation Difficulties

There were other economic and sociopolitical issues that contributed to the cancellation of the tax after only three months of implementation.

1. Public Education Campaign

The lack of public education has been cited in more instances than any other factor as the main factor for the demise of VAT. To understand the problems confronted during the implementation process, it is important to categorize the education required in a VAT campaign into two classes: technical and general public education. Technical education was needed to prepare the staff of the administration for the task of implementing assignments such as registration, processing of tax returns, and examination of taxpayer records. A second aspect of this education relates to the need to keep registered taxpayers abreast of the operation of the tax and the relevant sections of the law. This type of education is required to ensure maximum compliance with, and effective administration of, the tax.

As noted previously, the main setback to the technical education was the delay in passing the act, and the subsequent bottlenecks created by the slow recruitment process. However, given that there were only 9,000 registered taxpayers, and that adequate technical and logistics support had been provided by both the government and donors such as the World Bank and the Overseas Development Association,[34] the task of overcoming most of the initial setbacks and succeeding in carrying out an effective technical education was not insurmountable. Indeed, the implementation process could not have been devoid of hitches.

Thus, the debate could be seen as centering on the adequacy (or lack thereof) of a high-profile public or general education. The main defect in the publicity drive appears to be the belated involvement of government machinery in explaining the benefits of an improved tax and fiscal system to the population at large. The absence of any visible involvement of top government officials in the VAT education drive at the initial stages probably did not encourage enough participation by other government functionaries. Some critics have placed the blame on the inability of the technical team to prepare them for any such assignment.

Consequently, a clear strategy for tackling the opposition's immediate exploitation of the apprehensions about VAT appears to have been lacking. It is important to emphasize that the political underpinnings of some of the criticism and misconceptions about VAT made it absolutely necessary for senior government appointees to have endeavored to counteract the negative image it cast on the fiscal intentions of the government. Most of the misconceptions about VAT discussed in previous and subsequent paragraphs have been well researched by countries that preceded Ghana in implementing a VAT. Therefore, it was never beyond the competence of the technical staff of the project to assist in developing a program to explain the primary objectives and benefits of VAT to the economy. Early in the implementation process, an effort was made to keep enough facilitating agencies, notably the media and government information officers, abreast of the broad intentions underlying the introduction of the tax. Unfortunately, no effective follow-up programs were put in place to disseminate the information passed on to the facilitators.

2. General Misgivings About the Impact of VAT

There were a number of other common criticisms leveled against VAT that are mainstream issues to many fiscal experts. These include the impact of the tax on prices (inflation), regressivity of the tax, its demands for a sophisticated form of recordkeeping, and charges that it would make the overall tax system more burdensome.

(a) Apprehensions About Pricing

The effect of VAT on prices was probably the thorniest issue in the macroeconomic debate. The introduction of the tax coincided with a number of factors that accelerated the increase in general price levels in the country. A number of studies emphasize that even though VAT by itself may not result in sustained price increases, the general apprehension about its negative impact could propel other factors to accelerate price increases.[35] The 1995 budget had increased the excise duty on fuel products, while at the same time the central government was under pressure to yield to wage increases from various workers' groups. Also, the economy was experiencing poor food harvests during this period because of the lack of rainfall in most parts of the country. Finally, for a country that depended heavily on

imports, the fast depreciation of the local currency against major convertible currencies, such as the dollar and the pound sterling, meant an upward pressure on the cost of imported goods and services.[36] These were the real factors contributing to the sustained increase in prices experienced after VAT became effective. Notwithstanding these external pressures on general price levels, the one-time increase in prices that is often associated with the introduction of VAT[37] was inevitable after the start of the tax in Ghana. In the first place, the rate of sales tax had been increased from 15 to 17.5 percent under VAT. Since VAT was not merely replacing the manufacturing-cum-import-stage sales tax but was being extended to the retail and service sectors, the additional coverage was bound to worsen the pricing situation. Second, most registered traders, notably the retail outlets in particular, could not produce evidence of the sales tax paid on the stocks they held. Therefore it was impossible for them to take advantage of the clause in the VAT Act which allowed them to take a credit for sales tax as though it were input VAT.[38]

The obvious outcome from this latter situation was a cascading of the tax and therefore increases in prices whenever VAT-registered traders were compelled to charge output VAT on stocks held.[39] It is probably too simplistic to assert that all these problems were normal transition difficulties which the passage of time and a careful review of the situation could have curtailed. It is sufficient to say that VAT received a lot of the blame for the increasing price trend observed at the time despite the clear empirical evidence that the tax by itself does not result in inflation or sustained price increases.

(b) Problems With Regressivity and Level of Recordkeeping

The other two criticisms regarding regressivity and sophisticated recordkeeping are also well known to tax experts and VAT administrators.[40] Therefore, it was always possible to examine their peculiarities and proceed with strategies to correct any false impressions that may have been created by the introduction of the tax. The problems created by the level of accounting records required under VAT had already been discussed in relation to the need to fix an appropriate registration threshold.[41] In most cases, the level of VAT records fall far below what is required under income tax. Even though most of the debate on regressivity

occurred at a relatively higher level of academic discourse, it was often not discussed within the context of the general structure of taxation in the country.

At the time VAT was introduced, the rationalized tax structure adopted since the 1980s strongly suggested that the tax basically would be used to generate revenue and that its design would be simple enough to make the structure, administration, and compliance efficient but not necessarily equitable in a strictly vertical sense. The nonrevenue objectives of the overall tax system could then be assigned to other tax instruments.[42] In particular, the design of VAT would in theory not be allowed to unduly confuse the welfare (distribution) and tariff (or protection) policies of the government. Even though the simplicity of Ghana's VAT was never expected to come close to, say, a New Zealand-type VAT system, the primary law never made the anticipated sweeping changes to the previous sales tax regime.

Nevertheless, the single positive rate to replace the previous multiple-rate sales tax regime was implemented. Unfortunately, it was this change that led to the charges of regressivity and intense lobbying from affected interest groups (e.g., the pharmaceutical industry) to revert to concessionary regimes. Also, the familiarity with, and occasional references to, the rather complex structure of exemptions and domestic zero-rating under the EU-or U.K.-style VAT systems added to the general impression that Ghana's VAT regime was probably too regressive. The reaction of the legislature to these claims and pressures was the granting of further concessions under the Schedule 1 exemption list, instead of reintroducing a multiple tax regime.

The debate over the regressivity of VAT did not consider adequately the comparative status of the sales tax that the VAT was replacing. The sales tax was principally levied on goods at the import and manufacturing stages. Given that only four service categories were covered by the IRS-administered domestic indirect tax regime, it could be argued that the VAT had an improved progressive structure. It is well established that the propensity to use services often increases with the level of income of consumers. Therefore, the exclusion of most services from the previous sales tax regime made it a relatively more regressive tax.

(c) The Tax Burden

It was seriously alleged during the implementation phase of VAT that Ghanaians were already heavily taxed. The efforts to put a discussion of the issue in proper perspective did not appear to make a serious impact on the negative trend in public thinking. Ghana's tax/GDP ratio until 1993 was on average 12.4 percent, compared to approximately 17.7 for SSA.[43] The comparatively large inflows of nontax revenue (external aid and grants) to the economy during the structural adjustment era has often raised the revenue/GDP ratio to about 15 percent.[44]It is this latter figure that, though lower than the SSA average, is often quoted to confuse the discussion about the country's overall tax burden. Even then the argument that a low tax/GDP burden is a desirable objective for every economy may not nullify the need for the introduction of VAT. As previously noted,[45] the narrow base of the tax system makes it necessary to implement measures that will improve the diversity and equity of even a desirably low tax burden.

(d) Political Situation

The adverse impact that the general political situation could have on a tax reform process is succinctly described by Goode as follows:

> Political obstacles are important barriers to tax reform. Loosely defined, they include the clash of values or objectives, the influence of the desire of government leaders to remain in power, the activities of interest groups and the efforts of bureaucratic elites to retain and enhance their power and perquisites.[46]

Given the real changes that had occurred in the political landscape in Ghana since 1991,[47] it would have been naive to assume that fiscal policy could be insulated from these pressures. As noted previously, it is probably the propensity to confuse the impact of VAT with other economic factors in the economy, coupled with the intensity of the opposition to the program, that may have been underestimated by those responsible for implementing the tax.

The transition to a multiparty regime in 1992 clearly pointed to the fact that government policy could be subjected to more intense scrutiny or even open distortions by opposition groups. Given the misconceptions highlighted in the preceding paragraph, it did not come as

a complete surprise that some public dissent was recorded. Thus, the ferocious street demonstrations against VAT in May 1995 should be seen for what they really stood for: a proxy for the growing perception that generally the cost of living in the country was becoming unbearable. Indeed, the introduction of VAT merely consolidated the festering discontent regarding the perceived adverse effects of the entire structural adjustment program initiated in 1983.

Later, the difficulty in achieving a wider consensus on government policy would be cited as a major cost for many SSA countries experimenting with open democratic governments. The practice had the potential to impede decisionmaking in many of these countries.[48] Even then, the political stakes were raised at the time of introducing VAT in 1995 because 1996 had been earmarked for presidential and parliamentary elections. It seems that Parliament's decision to repeal the law had more to do with political expediency than any insurmountable flaws in the technical aspects of the program. As noted in a previous report, [49] the primary motivation for the cancellation of VAT appears to have been the removal of antagonism toward the fiscal policies of the government in the period prior to these elections.

III. THE WAY FORWARD FOR GHANA

The decision to repeal rather than amend the VAT Act is still intensely debated in light of the preparation and investment in material and human resources that had gone into planning the project over a period of two and a half years. It is therefore important to assess the implication of the decision by Parliament to repeal the VAT Act in June 1995 and recommend possible options for reintroducing the tax in the future.

A. Restoration of the Sales and Service Tax Regimes

Parliament passed two separate laws to replace the VAT Act. The first, the Customs Excise and Preventive Service [Management] [Amendment] [No 2] Act 1995 [Act 500], restored the previous sales tax regime to its original status. It is regrettable that the credit

mechanism was not saved to strengthen the machinery for collecting this manufacturing-stage sales tax. By restoring the tax to its ring status, the country will have to revisit all the steps required to reform the defective sales tax system.

Also, the argument by the business community that such a conversion implied major changes in their liquidity plans would remain a thorny issue in any future program. The few manufacturers who were registered under the ring system were gradually adjusting to the payment of taxes upfront. Similarly, the second law passed to repeal the VAT Act, the Service Tax Act, 1995 (Act 501), also merely restored the status quo by reinstating the scope of the tax to the four services that were levied previously (entertainment, hotel accommodations and restaurant meals, advertisement, and gaming). Since the sector that posed the greatest challenge to the implementation process was retail distribution, the decision to exclude the services sector from the base of the domestic indirect tax regime was equally surprising. The only progressive point in this Service Tax Act is the power given to the minister to expand the scope of services to be covered by the act. However, given the difficult political situation and the elaborate process needed for enacting subsidiary legislation to give effect to this power, no significant changes may be anticipated in the near future.

B. Dissipation of VAT Expertise

The two laws mentioned in the preceding section abolished the VAT Service created by the VAT Act effective October 1995. Given the long-standing desire of the ministry to strengthen tax administration in the country,[50] it is certain that the decision to abolish the VAT Service may disrupt whatever progress may have been made toward consolidating all domestic indirect taxes. The potential exists for scattering the material assets and skills that the VAT Service (and the preceding project counterpart) had started to accumulate to facilitate the introduction of an invoice-credit VAT based on the self-assessment principle.

The prospects for developing a parallel goods and service tax under the separate CEPS and IRS laws is not a viable option compared to the trend of consolidating domestic indirect tax administration under a single management -- be it income tax (IRS), customs (CEPS), or a

separate organization (a VAT department). Under the IRS, the four taxes mentioned in the preceding section were only peripheral to the administration of direct or income taxes. It is difficult to see how a comprehensive domestic indirect tax base incorporating goods and services could be effectively developed with its administration divided between two institutions.

C. Planning to Re-launch VAT

Notwithstanding the setbacks highlighted in the preceding paragraphs, it actually may be possible to redefine another course of action to incorporate a piecemeal implementation of VAT in the future, in contrast with the comprehensive package attempted between 1992 and 1995. The key factor likely to militate against an early reintroduction of VAT is the holding of national elections in 1996. There is no doubt that the fiscal situation requires a critical assessment of the conditions in the country by any political party that wins this election. Any attempt to outline a feasible option for enacting a new VAT law would be informed by this single event. This point is equally true for the opposition parties that appear to have scored numerous points in opposing the current effort.

1. Revised Timetable

Given that the option for implementing VAT as a single package has already been discounted, a three-year program may be the most attractive. During 1996, which appears to be the most difficult year, an attempt could be made to expand the base of the service taxes by taking advantage of the power of the minister under section 3 of Act 501 to add other services to the list of taxable supplies. The objective of this move is to expand the tax base and prepare the ground for a reintroduction of the credit mechanism to cover a comprehensive goods and services tax base. The reintroduction of the credit mechanism could then be the major change to be effected during the second year of the program in 1997. It is necessary to expand the tax base in order to prevent any revenue losses that may occur from allowing input tax credits in converting from the ring system. The third year may be devoted entirely to covering the retail sector in the tax net and consolidating the conversion of the ring to a credit mechanism.

2. *Intensifying the Education Campaign*

As noted in various sections, there is a widely held opinion in the country that the education and publicity program was not effectively implemented. Therefore, the first and second years of the limited implementation of a new VAT structure would also have to be devoted to planning a more effective taxpayer and public education strategy. In particular, the involvement of the entire government machinery to project policy in relation to the tax should be well planned. Effective strategies will have to be evolved to counteract the specific areas of public apprehension noted in preceding sections: scope of exemptions, effect of the tax on pricing, and an appropriate VAT rate. Nonetheless, the view that "tax reform seldom has a strong and active constituency outside government"[51] is enough indication that it would be naive to anticipate private sector patronage for the implementation of comprehensive tax reforms. In this regard, the full cooperation of, and acceptance by, the private sector of a sweeping tax like VAT should not be exaggerated.

3. *Review of Structure*

A review of the structure of the tax will have to concentrate on three main issues -- conversion to a credit mechanism, the base and rate of the tax, and the pursuit of a revenue objective for a future VAT system. The superiority of the credit mechanism over a deferred system has never been doubted. However, as part of the education campaign, it may be necessary to reemphasize that the main benefit of an input tax credit is the avoidance of cascading. Second, given the intense clamoring for a reduction in the VAT rate, there is need to review the large number of exemptions granted under the original VAT Act. The inclusion of marginal items under taxable supplies and a fairly low threshold could make the base of the tax wider and the implementation of a lower rate possible. Finally, it is important to resist the temptation to introduce a multiple-rate regime as a means of making concessions to pressure groups. Such a policy will complicate unnecessarily both administration and compliance.

4. Institutional Arrangements

The only serious administrative issue to be settled is the institution responsible for collecting the tax. Despite the many arguments that can be advanced for the retention of the VAT Service, there may be a remote possibility that the reestablishment of the Service could be ruled out in a future strategic reintroduction of the tax. Nonetheless, there is no merit whatsoever in continuing the current dichotomy in splitting the administration of domestic indirect taxes between CEPS and IRS. In the absence of a separate unit to administer the domestic VAT, a firm decision will have to be made at the outset to locate the tax in only one of the existing institutions.

IV. CONCLUSION

It is clear from the foregoing that only a few major hitches occurred in the course of executing the elaborate program to introduce VAT in Ghana. Most of the problems that arose cannot be considered serious enough to cause irreparable damage to the implementation process. It is important to emphasize that the primary reason for the failure of VAT in Ghana was the tendency on the part of most critics and sections of the governmental machinery to feed on the apprehensions of the general public about the tax, to the virtual exclusion of any other serious considerations. It required an effective program to counteract the edge that opponents of the tax regime had in capitalizing on controversial issues. In many cases, these anxieties were founded on ignorance, misconceptions, and deliberate distortions about the adverse impact of the tax on the already high cost of living in the country. Therefore, the cancellation of the tax after only three months of actual implementation may best be described as probably too hasty.

ENDNOTES

1. Gillis, Shoup and Sicat, ed., *Value Added Tax in Developing Countries*, A World Bank Symposium, June 1990.

2. For a review of the major features of "Ghana's VAT Regime", see Seth Terkper, *Tax Notes Int'l*, Sept. 12, 1994, p. 787, or 94 TNI 176-3.

3. Ghana's VAT was designed to be neutral and therefore covered imports as well as domestic sales of goods and services at the same rate up to the retail point. The main defect in the old sales tax regime was its relatively narrow domestic coverage. It was a single- stage tax collected at the manufacturing point and on importation only.

4. Khalilzadeh-Shirazi, J., and Shah A., ed., "Perspectives on Tax Reform and Agenda for the Future" (*Tax Policy in Developing Countries*, World Bank 1991); Williams, W.D., *Trends in International Taxation* (International Fiscal Association, British Branch, 1991).

5. See Seth Terkper, "Ghana: Trends in Tax Reform (1985-93)," *Tax Notes Int'l*, May 9, 1994, p. 1267, or 94 TNI 89-13 and "Ghana's Tax Administration Reforms (1985-93)," *Tax Notes Int'l*, May 23, 1994, p. 1393, or 94 TNI 99-18.

6. The budget for 1995 was read in February 1995 and within one month VAT was introduced. The fiscal measures in the budget included an increase in petroleum excise taxes (on average 20 percent) as well as a percent rise in the standard rate of sales tax to 17.5 percent. This rate eventually became the single positive rate for VAT.

7. See Seth Terkper, "The VAT Challenge in Sub-Saharan Africa: Ghana, A Case Study," *International VAT Monitor*, November 1993.

8. See Goode, R., "Obstacles to Tax Reform in Developing Countries" (Bird, R. and Oldman, O., ed., *Taxation in Developing Countries*, Johns Hopkins University Press, 1990).

9. Terkper, supra note 5.

10. Shome, P., ed., *Tax Policy Handbook*, IMF 1995 (Government Finance Statistics; International Financial Statistics and World Tables, Terkper, supra note 2).

11. Approximately US $20,000 at the time the tax became effective in March 1995.

12. Curiously, the Association of Ghana Industries (AGI) also strongly opposed the imposition of the tax, even though most of its members stood to benefit from a tax that improved the neutrality between domestic and imported supplies (see Ghana's Daily Graphic, April 1, 1995).

13. Holland, Graham, "Planning for VAT" (Tait, ed., *Value Added Tax: Administrative and Policy Issues*, IMF 1991).

14. Ghana's fiscal year begins in January with the main event, the reading of the national budget.

15. The products affected were principally beer and tobacco. Sales tax under the previous regime was calculated on the ex-factory price of the commodity, net of excise duty. The VAT basis is an excise- inclusive ex-factory price.

16. Terkper, supra note 5.

17. Budget Statement and Economic Policy, 1994.

18. The former minister of finance strongly suggested that the fiscal pressures at the time of the 1995 budget implied that there was need to tighten the fiscal stance in that year (see *The Financial Times* (Aug. 14, 1995)).

19. Nigeria derives over 90 percent of its revenue from the production and sale of oil. Moreover, the 5 percent rate was a federal rate that did not take into account prevailing state taxes. It should be noted that even though VAT rates in the Francophone West African countries are higher, they were not cited often in the debate.

20. For example, the chairman of the Finance Committee of Parliament expressed this sentiment.

21. Bird and Oldman, ed., *Reaching the Hard-to-Tax, Taxation in Developing Countries,* The Johns Hopkins University Press, 1990).

22. Approximately US $20,000 in March 1995.

23. Traditional exports are Ghana's basic exports, including cocoa, timber, and minerals. Exports of other primary agricultural produce are categorized as nontraditional.

24. .Section I.B.5.

25. See Alan Tait, "Value Added Tax: International Practice and Problems," IMF 1988.

26. It is important to stress that top officials of both IRS and CEPS were represented on the Technical and Oversight Committees that were responsible for planning and implementing the tax. As such, the two institutions were involved in the debate to establish the VAT Service.

27. See Tait, supra note 26, p. 235.

28. Id.

29. Terkper, supra note 5.

30. The National Revenue Secretariat was created in 1985 as the equivalent of the revenue boards that prevail in East Africa. However, instead of a single board headed by a commissioner-general for all he separate institutions, Ghana had independent boards for each revenue agency. The Secretariat is headed by a director who reports to the minister of finance.

31. The commissioner of IRS is on record as telling the Finance Committee of Parliament that the amount of work involved in instituting VAT warranted the establishment of a separate unit. Incidentally, the need for a third agency was influenced by fears of overburdening CEPS with too much indirect tax and preventive responsibility (see Memorandum to VAT Bill).

32. Supra note 31.

33. The Overseas Development Association (ODA), U.K., also financed the activities of the consultants, Crown Agents of U.K.

34. Tait, supra notes 14 and 26.

35. Michael Holman (interview with Dr. Kwesi Botchway, former minister of finance), *The Financial Times* (Aug. 4, 1995).

36. Tait, supra notes 14 and 26.

37. There are many reasons for this phenomenon. Given Ghana's wide land and sea borders, the smuggling of goods was prevalent in the country. Also, some manufacturers who were registered for sales tax purposes did not issue the prescribed customs invoices for the items sold to their customers.

38. The fact that traders may have bought goods at sales-tax-inclusive prices is no proof that the tax was paid. Most goods were sold at prices dictated by the free market, and, therefore, the vendors who did not charge sales tax sold at prices that presumed that the tax was actually paid. In the process, they often made enormous windfall gains.

39. Tait, supra notes 14 and 26.

40. See section I.B.5 and II.C.3.

41. See section II.

42. Shome, P., ed., supra note 10.

43. In some cases, the large doses of foreign aid during the structural adjustment period increased this ratio to approximately 20 percent.

44. See paragraph II.A.

45. Richard Goode, supra note 8.

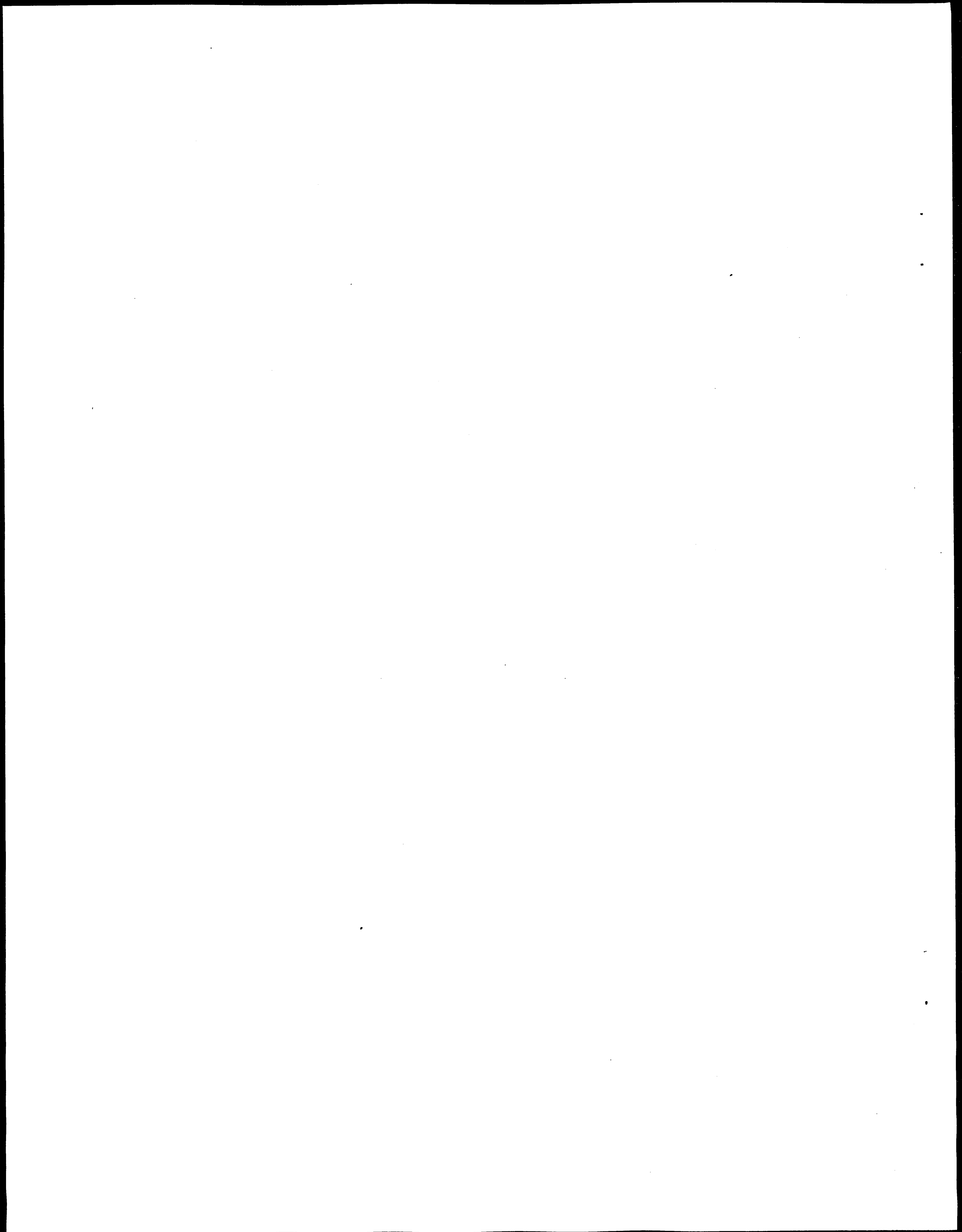
46. In January 1991, a new constitution was promulgated and the multiparty system of government adopted. Parliamentary and presidential elections were held that same year. The previous government ruled by decree.

47. Holman, supra note 36.

48. Terkper, supra note 2.

49. Terkper, supra note 5.

50. Goode, supra note 7.



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