

TAXING FOR THE STATE?

Politics, Revenue and the Informal Sector in Ghana *

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I. Introduction

The governments of many developing countries have reformed their tax systems in recent years. But there is still very little progress on the old problem of the tax-exempt status of the informal sector. How to tax the informal sector remains a pressing question. Fiscally constrained governments undertaking liberalizing economic reforms are looking for new ways to augment state revenues. The informal sector is an obvious focus of attention as it forms a significant and growing proportion of the economy in developing countries, yet pays little in the form of taxes. Ironically, the interest in taxation of the informal sector is not restricted to governments. Increasingly activists and representatives from the informal sector are themselves demanding that they be part of formal systems including taxation. Such demands are emerging out of two main considerations. First, the informal sector already pays significantly to stay in business, but to corrupt public officials. Many would rather pay these sums legitimately to governments rather than to corrupt officials whose actions can be arbitrary and uncertain.¹ Second, it is also clear that contrary to popular belief, many within the informal sector are not in marginal occupations. They choose to remain informal not to avoid taxes, but due to other considerations such as the high transactions costs of being formal and the lack of accessible legal alternatives (Cross 1998). They are often willing to pay in exchange for legal recognition and the right to make demands upon local government for improved services.

Despite this emerging consensus on the need to tax the informal sector, little is known about how to do it. Traditional understandings of the problem point to two principal constraints. The first is administrative. The tax bureaucracies of many developing country governments do not have the resources or the personnel capacity to implement, monitor and enforce tax laws (Stella 1993; Kiser and Baker 1994). The characteristics of the informal sector exacerbates these problems. The informal economy is characterized by transience and uncertainty. Cash transactions dominate. There is indifference to formal accounting due to high levels of illiteracy and a shortage of affordable accountancy services. In some areas of the informal economy such as transportation or street vending, the mobility of the operators makes it difficult to enforce compliance. The large number of people engaged in the sector and the relatively small amounts of tax payable pose an additional logistical problem for collection. Thus, taxation based on formal systems of income calculation, accounts, and payment options are not suited to the informal sector.

The second constraint is political. Several observers have suggested that taxing the informal sector is politically problematic because the informal sector forms a substantial vote bank for politicians [Cross, 1998; Tandler in this volume]. State officials and politicians turn a blind eye to activities in the informal sector in order to retain their support base; simultaneously, organized informal sector workers pressurize government officials to reduce enforcement. Such a dynamic is likely to operate in countries where the informal sector forms a substantial part of the economy.

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¹ This is particularly true of informal settlements that see paying taxes as a route to eventual formalization.

These general constraints emphasize important obstacles to taxing the informal sector. But they neglect specific contextual factors. In this paper we present a case in which political and administrative constraints did not prevent the government from institutionalizing tax collection in the informal sector. Since 1987, the Ghanaian government has delegated the responsibility for collecting income tax from informal passenger transportation operators to their unions, primarily the Ghana Private Road Transport Union (GPRTU). This arrangement has been relatively successful in increasing the revenues generated from the sector. Although the GPRTU's role in income tax collection (and enforcement) originated in the politics of its corporatist relationship with the Jerry Rawlings regime (1981-2000), the arrangement has continued under the present government of the New Patriotic Party (NPP). We argue that the case study is of particular interest because first, in contrast to the prevailing views in the literature that blame inefficiency in the public sector to political interference, the arrangements for tax collection were intricately linked to politics. Second, the arrangement is an administrative innovation for income tax collection in the informal sector. Finally, contrary to expectations, the collection of income taxes by the informal sector unions has outlived its corporatist relationship with the ruling party that initiated it. The resulting system of taxation has been a relatively stable relationship between two main actors with strong incentives to cooperate. The Ghanaian case suggests that there are real possibilities to tax the informal sector, but doing so is politically and organizationally complex.

In the next section contextual information about the structure of private sector passenger transportation in Ghana and the role of the GPRTU is provided. The third and fourth sections discuss the political and administrative reasons behind the new taxation arrangement. In the fifth section we assess the ability of the arrangement to survive the change of government. Finally we conclude with some thoughts about the potential for taxation of the informal sector in other countries.

II. Private Passenger Transportation in Ghana

Any discussion of the role of private passenger transportation in Ghana needs to be prefaced by the understanding that there is almost no form of publicly run passenger transportation, particularly within urban areas. A majority of the urban and rural population relies on the private passenger transport sector comprising mainly taxis, minibuses and light buses. Partly as a result of this, the private passenger transport sector is very powerful and highly organized.

Of the various unions that represent informal transport sector workers, the Ghana Private Road Transport Union (GPRTU) is the largest. The GPRTU has a membership of 55,000 of which 60 percent are vehicle owners (mostly owner-drivers), 35 percent are drivers alone and 5 percent are porters who assist in terminal operations. The GPRTU was legally established in 1967 at Accra as one of the seventeen founding members of the Trades Union Congress (TUC). All transport owners, owner/drivers, trainers, lorry park guards and porters engaged in the road transportation industry are eligible for membership. The barriers to entry into the private transportation sector are relatively low—anyone with a commercial driving license and access to a vehicle can operate as a transporter. The main task of the GPRTU is to organize the operators in the sector and to negotiate transport tariffs with the Ministry of Transportation (MOT) and since 1987, the collection of income tax on behalf of the National Revenue Service (NRS). Historically, power within the GPRTU has been centralized with the National Secretariat.

The private passenger transport system in Ghana revolves around lorry parks—the terminals from which services are operated and where passengers are picked up and dropped off. There are several lorry parks in the larger cities and towns, each of which only serves certain designated routes. Consequently, passengers often have to walk long distances or change transportation at least once in order to reach their destination. Lorry parks are nominally owned by the Metropolitan, Municipal or District Assemblies that, in theory, license different unions to operate out of them. In practice each lorry park is monopolized by one union, which then controls particular routes. As we shall see in the next section, because of its size and political dominance, the GPRTU has wrested control of most of the lorry parks in the country.

These features of the transportation system—the absence of publicly-funded transportation, the widespread coverage, strong and centralized nature of the union and the organization of all transport around lorry parks -- are significant in understanding how the GPRTU was able to establish a close relationship with the ruling party from 1981-2000 that led to the new arrangements for taxation.

III. Politics--a Constraint? The Rawlings Regime and the GPRTU

It has long been argued that state policies towards the informal sector have been guided by political logic. Informality allows politicians to provide piecemeal support to the informal sector in exchange for votes. Unrealistic standards and cumbersome procedures give public officials wide discretion over enforcement that facilitate corruption. Such political logic explains for example, the prevalence of contradictory policies of eviction and formalization. Thus, it is generally expected that politics is the principal constraint that prevents governments from taxing the informal sector. The Ghanaian case contradicts these expectations as it was precisely the close relationship between the political elite and the GPRTU during the Rawlings regime (1981-2001) that enabled the government to successfully tax the transportation sector.

Prior to the emergence of Rawlings' Provisional National Defence Council (PNDC) government in 1981, the GPRTU was not a significant actor in Ghanaian politics. The high political profile of the GPRTU began in early 1981 with the takeover of the leadership by Nana Kofi Aikins. Kofi Aikins had been closely linked with Rawlings and riding the wave of populism brought by the return of Rawlings to power, he took over as the national chairman of the GPRTU, subsequently holding the position until 1994. During this period, the GPRTU played an important part in the PNDC's political mobilization and party activities. The PNDC designated the GPRTU as 'patriotic' and 'progressive' and even called it an 'organ of the revolution.' It figured prominently in important ceremonies of state (e.g. Independence day) and of the regime (e.g. anniversaries of June 4 and December 31).

The GPRTU's new-found affinity with the PNDC government can be explained in part by PNDC's macro-economic policies since 1983. The liberalization of markets and imports under the Economic Recovery Programme, particularly the near-lifting of controls on passenger transport fares, the increased availability of spare parts and the massive rehabilitation of the road infrastructure, were welcomed by the GPRTU. Liberalization also led to a growth in the private transportation fleet and consequently an increase in GPRTU's membership. Between 1984 and 1991, the number of private passenger transport vehicles increased on average by twenty percent per annum (Fouracre, Kwakye et al. 1994).

The growing size and reach of the GPRTU increased its political importance for the PNDC.

The GPRTU was one of the few organizations with a base in every village and district and had enormous potential for contributing to political mobilization. During election campaigns the GPRTU provided buses to transport supporters to rallies. Further, GPRTU members could disseminate political propaganda to a captive audience during long distance journeys. Finally, given the limited publicly funded transportation in Ghana, the GPRTU could paralyze the Ghanaian economy if it chose to strike. Gaining and retaining GPRTU support was important for the PNDC.

As a result the PNDC placed the GPRTU in a privileged position. The organization not only gained importance and greater access to the state and regime, but it also overshadowed rival road transport unions. The clearest evidence of its influence lies in the monopolistic privileges accorded the GPRTU. In 1987, the PNDC government gave it sole control of all lorry parks.² In addition, the GPRTU was given the right to recruit, train and employ guards who patrol the lorry parks and streets to monitor violations of the Road Traffic Act. The location of such guards within the GPRTU, gave it enormous powers over members of other unions, who could be harassed. Further, the government also favoured the GPRTU in its disputes with rival unions, subnational governments, the police and even the army.³ In other cases, such as disputes with rival unions, the GPRTU has frequently managed to secure settlements in its favour. It was also the recipient of government patronage. Between 1984-88 the GPRTU was supplied with subsidized inputs such as tyres and lubricants (despite the general policy of market liberalization). The PNDC government facilitated the acquisition of a fleet of vehicles by the GPRTU through loan guarantees. Rival unions got no such benefits.

In turn, the GPRTU supported political positions of the Rawlings government (both military and civilian), even those that were contrary to those of the Trades Union Congress (TUC) of which it was a member. In fact, the government sometimes used the GPRTU to divide the ranks of the TUC and render the latter weak and manipulable. For example, the GPRTU declared its support for the district level elections held in 1988-89, even though the TUC as a body had declared opposition to them in an earlier resolution. It was the GPRTU member's vehicles that helped convey officers and voters to and from polling stations, thereby ensuring a high turnout in the elections. Thus the relationship between the Rawlings government and the GPRTU has to be viewed as one of mutual benefit. For the government, the GPRTU was an organization of political importance and maintaining its support was a key task. For the GPRTU, the close connection with the government gave it access to benefits of material and strategic importance.

IV. Innovation in Tax Administration—the role of the Unions

The increasing closeness between the Rawlings government and the GPRTU in the mid-eighties led to a somewhat unusual arrangement—the involvement of the GPRTU in the

² Until 1989, local government units managed lorry parks. Circular No. MLG./ADM/087 dated 17th October named the GPRTU as “the sole organization to control and regulate the movement and operations of all vehicles at lorry parks.” When questioned, many interviewees within the GPRTU denied the charge of favouritism and suggested that they were given control only because they were the largest union in the country. In practice, rival unions started their own lorry parks in other areas, or negotiated space within GPRTU controlled terminals.

³ In 1988 there was a standoff between the GPRTU and the Accra Metropolitan Assembly (AMA). The AMA's chief executive initiated a major traffic and sanitation exercise. Members of the Traffic and Sanitation Task Force were posted at various points in the city to check motorists for valid driving licenses, insurance coverage, roadworthiness certificates, and compliance with road regulations. The operation resulted in the impounding of a number of vehicles and the arraignment of several drivers. The GPRTU reacted sharply with a daylong strike, accusing the AMA of corruption, negligence, and abuse of powers. The PNDC finally intervened and forced the AMA to back down.

collection of income taxes from its members. Having undertaken radical liberalization, the government was under pressure to raise revenues and broaden the tax base. Simultaneously, it faced pressures to downsize. So, increasing the size of the tax administration was not a viable option. At the same time, the informal sector was an attractive source of potential revenue. Since liberalization, the sector had grown significantly and returns to investment were high, particularly in the transportation sector. The problem was to find an effective way to tax the sector.

To understand the innovative qualities of the Ghanaian arrangement, at this point, it is useful to briefly recap the options for governments in the literature on tax administration. Governments face three possible contractual choices: a) direct collection, (i.e. to hire waged employees to collect taxes); b) tax farming, in which the state auctions the right to collect taxes to a private agent in exchange for a fixed sum payable in advance and, c) tax sharing, where agents collect taxes with the right to a share of the taxes collected. For most governments, given fiscal austerity, employing personnel to tax the informal sector is not a realistic option. Many scholars argue for tax farming and tax sharing as a means of saving on administration costs while maximizing revenue collection and increasing the predictability and reliability of tax revenues (Kiser and Baker 1994). However, others have argued that tax farming does not avoid the costs of creating a tax bureaucracy: it is simply created in the private sector and its costs are ultimately passed on to the state (Azabou and Nugent 1988; Stella 1993). Moreover, tax farming and tax sharing does not automatically maximize revenues for the state where no effective competition exists. On the contrary, both can lead to over zealous collection and the state becoming dependent on the agent. A feasible administrative option for taxation of the informal sector has to overcome the problems of high administrative costs of collection, monitoring and enforcement of tax laws.

The Ghanaian experience points to one possible solution to these problems. Since 1963, the Government of Ghana attempted to tax the informal sector by using presumptive taxes based on occupation or business activity.⁴ The assessment of tax was based on an estimated average income level of the occupation in question. All businesses including those in the informal sector were liable to pay the Standard Assessment and display their tax clearance certificates in their premises as proof.⁵ However, the weak capacity of tax administration prevented effective monitoring of the scheme. Tax certificate inspectors colluded with business resulting in widespread evasion. Moreover, the annual lump sums of presumptive taxation were too high for informal sector businesses. As they had no real need for official clearance certificates they evaded payment. As a result, collection under the Standard Assessment scheme was minimal.

As a part of the economic reforms in 1985, the Ministry of Finance underwent restructuring to strengthen revenue administration. Two major revenue organizations—the Internal Revenue Service (IRS) and the Customs Excise and Preventive Services (CEPS)—were created as autonomous institutions outside the civil service under a newly established National Revenue Secretariat (NRS). The objectives of the restructuring were to identify potential areas of the informal sector with a potential for taxation, bring taxation closer to the doorstep of the taxpayer, decentralize operations within the tax administration to enhance taxpayer identification and to develop new policies that addressed issues of compliance within the informal sector. For the transport sector, a number of problems were evident. The

⁴ Standard Assessment Act, 205 1963.

⁵ Tax clearance certificates are required to obtain some public services such as the acquisition of a passport or appointment to public office.

standard assessment, payable yearly at first and then quarterly, was not affordable for the informal sector because drivers were required to pay in advance in a lump sum. The tax did not take into account breakdown of vehicles and lost workdays. Corruption was prevalent because drivers had to take tax clearance certificates to the Vehicle Licensing Office before a road-worthiness certificate would be issued. To discuss these problems and possible solutions, in 1986 the IRS held a series of meetings with representatives of GPRTU and rival unions.⁶ The outcome of these deliberations was a reformed system of presumptive taxation called the Identifiable Grouping Taxation (IGT). The new executive agency, NRS, undertook a pilot scheme with the informal transportation sector and its success led to the institutionalization of IGT for 32 groups through the Income Tax Amendment Law, 1987, PNDCL 177.

Officials and ex-officials of the GPRTU claim that they were at the forefront of the innovative new system of IGT as a means of reducing their members “tax burden”. Under the previous Standard Assessment scheme members of the GPRTU were required to pay taxes on a quarterly basis and display their tax clearance certificates in their vehicles. Unlike other occupations in the informal sector however, evading taxes was difficult. Informal transporters plied throughout the country and were subject to regular checks by various public authorities. At each checkpoint, if they did not have the tax clearance certificates, they were harassed. Thus paying taxes was, at least for some routes, less costly than paying bribes at the numerous checkpoints. But the actual payment of tax was also difficult. Those who wanted to pay had to go to their local internal revenue service office. Between finding the right files, negotiating the taxes owed and the invariable waiting, typically a driver would have lost a whole day of work. Further, members found the system of payment unfair—they were required to pay irrespective of the fact that they might not have worked because of illness or vehicle repairs.

Thus, Identifiable Grouping Taxation (IGT) was an advance on the old system of taxation in many ways. First, it used the informal sector unions as agents for state income tax collection. The unions had intimate knowledge of the activities of their members and could collect taxes without much additional effort. Given the government’s inability to go down to the “road level” and its weak capacity, the scheme was simple and easy to administer. Second, the taxes were collected daily (at first, and later weekly to reduce the high costs of printing and monitoring daily receipts) making the payments small and affordable to most members.⁷ Third, the taxes were only payable when the drivers earned. If a vehicle was out of action, taxes were not paid. Finally, by offering the unions a share (2.5%) in the total revenue collected, incentives were aligned to maximize revenue collection.

Initially, the scheme was centralized. Under the IGT, the National Secretariat of the GPRTU (in addition to PROTOA and the GCTS) would collect receipt books from the central office of the IRS. These were then sent to the Regional Secretariats and Branches of the GPRTU. The money collected, along with the used receipt books, was returned to the National Secretariat, which then turned them over to the NRS. The NRS paid the commission of 2.5 percent at the end of the year to the GPRTU. All receipts had to be accounted for not later than the end of the week following the week in which taxes were collected. With the decentralization of the IRS operations in 1992, the NRS handed over the task of income tax

⁶ Personal Interview, Commissioner NRS, 22 June 2001.

⁷ Taxis and intra-city commuter services paid a specific amount related to vehicle capacity. Long distance vehicles paid a percentage of their gross revenue per trip.

collection to the Regional Secretariats. Further decentralization occurred in 1994 when the IRS decided to deal directly with the GPRTU branches in the districts.

V. New Challenges

The Ghanaian attempt at taxing the informal sector using unions has been relatively successful. The IGT system has significantly improved tax revenues from the passenger transportation sector. However, several problems remain. First, the system still requires high administrative capacity on the part of the National Revenue Service as well as the unions. Payment of taxes on a weekly basis leads to high volumes of receipt books that need to be stored and audited. Due to the haphazard systems of storage, in many cases, receipt books have gone missing. Moreover, auditing the numerous receipt books generated would require more personnel than the NRS has. Thus, despite its simplicity, the cost of collection is high. Second, the scope for corruption remains. Weak administrative capacity makes accurate monitoring of weekly payments difficult. In many branches, executives of the GPRTU are allegedly investing the tax money collected in the overnight market before handing it over to the NRS. There have also been instances of embezzlement of moneys collected by corrupt executives. For example, the NRS was reported to have lost over 270 million cedis (approximately 0.05 percent of total tax revenue in 1993) in fraudulent deals between 1993 and 1995 in the Tema and Ashaiman branches (Daily Graphic, April 6, 1997). Another avenue for corruption is the collusion between drivers and GPRTU guards to evade taxes. There are also allegations that fake receipt books are being used and that the money collected never reaches the NRS coffers. As a result it appears that while the system is very efficient at making rank and file pay income tax, it is relatively weak in enforcing the handing over these payments to the NRS.⁸ Thus, although the collections through IGT are an improvement over Standard Assessments, they fall far short of the actual potential of the sector. Currently, NRS considers the possibility of canceling the agency agreement with the GPRTU if tax targets are not met.⁹

There are also new challenges to the system—particularly the change of the political party in power.¹⁰ NPP's takeover of power in 2001 significantly changed the political balance within the transportation sector. Some believe that finally GPRTU's control over the lorry parks will be broken and rival unions will gain some power. The NPP, however, seems to be hesitant, fearing a backlash from the GPRTU. These fears seem well founded. In June 2001 for instance, the chairman of the Central Region indicated that the GPRTU would resist attempts by other organizations to operate out of its lorry parks, and called on the District Assemblies to create new lorry parks for other organizations if it wanted to ensure peace and harmony. Despite such strong statements, the GPRTU itself has been aware of its tenuous situation and is attempting to portray itself as apolitical and willing to work with "the government of the day."¹¹ How the NPP government deals with the GPRTU and rival unions

⁸ The rank and file membership is aware of this as is evident from numerous interviews. In mid December 2001, a group called the GPRTU Concerned Members Association led by a former chairman of the GPRTU and chairman of the Ghana Haulage Drivers Association stormed the headquarters of the GPRTU, locked up all the offices and demanded the immediate removal of the national executive from office on grounds of corruption.

⁹ Personal Interview, Commissioner NRS, 22 June, 2001.

¹⁰ The NPP's electoral victory in 2000 put Ghana firmly in the category of a multi-party democracy.

¹¹ Interview National Chairman, 15 March 2001. The GPRTU was clearly aware its own precarious position if the opposition NPP came to power given its previous close links with the NDC. In September 2000, three months before the general elections, it banned its members from displaying symbols of both presidential and parliamentary candidates in their vehicles and withdrew its members from election task forces at national, regional and district levels (Ghanaian Chronicle, December 4-6 2000).

will determine the extent to which these partnerships between the unions and the government are sustainable.

VI. Conclusions.

Is the Ghanaian case unique? Clearly Ghana's taxation arrangement emerged from a particular context, elements of which include the close relationship of the transport union and the political party, the near-monopolistic nature of private passenger transportation in Ghana and its organization around lorry parks, the difficulties faced by transport operators in the payment under Standard Assessments, and a country dominated by well organized, dominant unions and (at least till recently) a powerful dominant political party.

The most significant factor we argue, is the closeness of the ruling political party—the PNDC—and the GPRTU. This close relationship with the GPRTU enabled the PNDC to tax the informal transportation sector in order to generate revenues. The GPRTU supported the PNDC's programme because it gained several other benefits in exchange for being taxed, including a commission on the revenues generated. GPRTU's hold on the transportation sector was consolidated through its monopoly control of the lorry parks and the cadre of guards to police compliance within the sector. Moreover, the GPRTU could legitimately claim that the new system of tax collection was an advance on the previous one for its members.

A key aspect of this relationship was that both the PNDC and the GPRTU dominated politics in their respective arenas. Ghana was, in effect, a single party state with no significant opposition during the 1980s and early 1990s. Simultaneously, the GPRTU was the single largest significant union in the passenger transportation sector till the mid-eighties. For dominant informal sector unions in multiparty states, a close relationship with the ruling party can be problematic if the party falls in the next election. This point is underlined by the fact that with the NPP in power, the GPRTU is already paying the price of its close affiliation with the NDC government. On its part, the NPP is aware of the political importance of the GPRTU and, we argue, is attempting to gain support within it at the grassroots, through its strategy of decentralization of income tax collection and sharing the commission payable directly to the branches and locals.

It must also be emphasized that the initiative for the unions to collect taxes came partly from the unions themselves as it made tax compliance easier for its members. Whether or not such initiatives arise depends partly upon the sector in question. The need to avoid the uncertainty and constant harassment from multiple sources that resulted if one did not pay taxes is probably more characteristic of the service sector where businesses need to be more visible to the consuming public. In the case of transportation, this is even more so as operators are mobile. In other sectors such as manufacturing there may be a greater incentive to evade taxation if detection is unlikely.

Several general implications follow from our analysis of the Ghanaian case. Foremost, we suggest that the outlook for taxation of the informal sector is optimistic. Governments that fear a backlash from taxing the informal sector may find that the informal sector is not as averse to taxation as one is led to believe. Moreover, organizations within the informal sector itself can be successfully used to collect taxes. Finally, the entanglement of politics in taxation is not always negative—in some circumstances it might actually lead to innovative taxation arrangements.

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