

Research Summary #14 - Taxing for the State? Politics, Revenue and the Informal Sector in Ghana

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Introduction

The informal sector forms a significant and growing proportion of the economy in developing countries. There is increasing interest – from governments but also from informal sector workers themselves – in the potential benefits of taxing the informal sector, but little is known about how to do this. It is commonly assumed that there are two main constraints: administrative and logistical problems, and political obstacles (the informal sector forms an important vote bank for politicians). However, the experience in Ghana, where the Ghana Private Road Transport Union (GPRTU) has been collecting taxes from informal workers on behalf of the government since 1987, suggests that, in certain contexts, these problems can be overcome. The case is of particular interest because, contrary to prevailing views that political interference leads to inefficiency in the public service, success was intricately linked to politics. But the arrangement outlived the particular political circumstances in which it was initiated. The case also offers an example of administrative innovation which could be of wider interest in taxing the informal sector. The conclusion highlights the generic relevance of the Ghanaian case.

Private Road Passenger Transportation in Ghana

Certain features of the transportation system in Ghana are significant for understanding how the GPRTU - the main union representing informal transport workers - was able to establish a close relationship with the ruling party (the PNDC), that led to the new taxation arrangements. There is virtually no public passenger transport in Ghana. The private transport sector is powerful, well-organised and informal. All private passenger transport is organised around lorry parks, which serve particular routes. Starting from the mid 1980s, economic liberalisation led to a big growth in private transport, and a consequent increase in GPRTU's membership. The growing size and reach of the GPRTU increased its political importance, giving it the potential to paralyse the economy if it chose to strike.

The Political Basis of the GPRTU-PNDC Taxation Arrangement

Thus, gaining and retaining support of the GPRTU was important for the PNDC government. The government placed the GPRTU in a highly privileged position, giving it sole control of all lorry parks, and allowing it to employ guards to patrol them, and to monitor traffic violations. This gave the GPRTU dominance over smaller, rival unions. It also received subsidised inputs and loan guarantees. In return, the GPRTU gave the government political support (sometimes in opposition to the Trades Union Congress (TUC); provided transport for political rallies and elections; and disseminated

government propaganda. The relationship between the GPRTU and the PNDC was thus based on strong mutual interests.

Innovation in Tax Administration

Conventional options for taxing the informal sector include direct collection, tax farming and tax sharing. None of these overcomes the problems of high costs of collection, and difficulties of monitoring and enforcement. In the mid 1980s the government of Ghana faced the need to increase revenues and broaden the tax base, but was also under pressure to downsize – so increasing the size of the tax administration was not an option. Instead, the Internal Revenue Service negotiated an arrangement with the GPRTU and other unions, using the unions as agents for state tax collection. The new scheme - known as the “Identifiable Grouping Taxation” (IGT) - was seen by union members as an improvement on the previous arrangements for several reasons. The earlier scheme of presumptive taxation required members to pay a lump sum quarterly in advance, whether or not they were working. The arrangements for payment were time-consuming. Members were subject to harassment if they did not comply. The new scheme was simple and easy to administer. Taxes were collected daily (later, weekly), making payments small and affordable; and were only payable when drivers were actually working. The system has significantly improved tax revenues from the sector; and the unions retain a 2.5% share of revenue collected, providing incentives to maximise collection.

This attempt at taxing the informal sector has been relatively successful, but several challenges remain. The cost of collection is still high (both for the National Revenue Service (NRS) and the unions), and there is scope for corruption (for example collusion between drivers and GPRTU guards to evade taxes). Some of the money never reaches the NRS coffers – so while more tax is collected than under previous arrangements, the amounts still fall far short of potential collections.

Conclusion

The change of political party at the 2001 elections significantly changed the balance of power within the transportation sector, but the arrangements for collection of tax have so far survived. Is the Ghanaian case unique, or does it have more general lessons to offer about taxing the informal sector? Clearly the taxation arrangements emerged from a particular context, including the close relationship between a single political party and a dominant union. But the case does suggest that - particularly in the service sectors, where businesses are visible to the public - there may be scope for taxing the informal sector. Workers themselves may see advantage in paying tax if this gives them some protection from illegal and arbitrary informal charges. Organisations within the informal sector can be used to collect taxes. Finally, the entanglement of politics in taxation is not always negative, and may actually lead to innovative taxation arrangements.