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Mobilizing Adequate Domestic Revenue to Support Ghana's Development

1. Introduction

Rising public expenditures in a context of persistently weak revenue performance has undermined the stability of the country's fiscal account in recent years. To stabilize the economy and shore up public finances, the government adopted a fiscal consolidation program in April 2015, with support from the IMF and the World Bank. After achieving some degree of fiscal consolidation in 2015, the government missed its 2016 fiscal targets by large margins, due to revenue shortfalls and rising expenditure pressures in the run-up to the December 2016 elections. The new government which assumed office in January 2017 was thus confronted with significant challenges and risks that called for an ambitious adjustment and reform agenda. The government's fiscal management strategy is therefore aimed at restoring fiscal discipline, reversing the fiscal deterioration that occurred in 2016, and putting debt on a downward and sustainable path. To this end, the government agreed to extend the IMF-ECF Program for another year to end in December 2018.

Fiscal performance during the first half of this year, however, was worrisome. Domestic revenue mobilized was short of what the budget targeted, forcing the government to cut expenditure in order to achieve the set fiscal deficit, with the promise that expenditure in the second half of the year will be cut should revenue continue to fall behind the target. Weak domestic revenue mobilization has become the key fiscal challenge and risk, the root cause of fiscal imbalances in the country, and the biggest single threat to the achievement of the government's development objectives. This paper seeks to show how domestic revenue mobilization can be significantly enhanced to pave way for the formulation of a credible 2018 Budgets to support Ghana's development.

2. Fiscal Performance, First-Half of 2017

The first half of 2017 witnessed a worrisome fiscal performance. As Table 1 shows, domestic revenue fell short of the target for the period by GH 2,714.4 million (13.8%), driven mainly by a sharp drop in tax revenue. Tax revenue fell short of the target by GH 2,058.6 million, accounting for 75.8% of the drop in total revenue, caused mainly by shortfalls in income taxes and import duties. Non-tax revenue also fell short of the target by GH 527.6 million, representing 19.4% of the total drop in domestic revenue. Grants from donor partners dropped by GH 352.4 million (39.2%) during the period. To achieve the set fiscal target, the government cut total expenditure by GH 2,423.5 million (9.3%), with domestic-financed capital expenditure, which has direct implications for economic growth, carrying the heaviest brunt. Domestic-financed capital expenditure was cut by GH 592.5 million (74%) below the target, followed by expenditure on goods and services with a cut of GH 538.3 million (38.6%) below the target. Clearance of arrears was equally worrisome as only GH 107.3 million, representing 6.3% of the targeted GH 1,716.3 million, was paid during the period. As a result, the fiscal deficit, on cash basis stood at 3.0% of GDP, compared to the target of 3.5% of GDP. Including divestiture proceeds and discrepancy, the overall fiscal deficit stood at 2.7% of GDP, lower than the target of 3.5% of GDP, enabling the government to revise the overall fiscal deficit target for the year from 6.5% of GDP to 6.3%. If the budgeted expenditure of GH 25.9 billion for January-June had been spent as planned, the overall deficit (on cash basis) for the period would have been 4.2% of GDP, much higher than the 3.0% of GDP reported.

Table 1. Ghana: Fiscal Performance, January-June 2017

Item	Budget	Actual	Changes		Budget	Actual
	GH₵' million		GH₵ mill\.	%	% of GDP	
Total Revenue and Grants	20,537.2	17,470.4	-3,066.8	-14.9	10.1	8.6
Domestic Revenue	19,639.0	16,924.6	-2,714.4	-13.8	9.7	8.3
Tax Revenue	15,749.5	13,690.9	-2,058.6	-13.1	7.7	6.7
Nontax Revenue	2,723.3	2,195.7	-527.6	-19.4	1.3	1.1
Grants	898.2	545.8	-352.4	-10.0	0.4	0.4
Total Expenditure	25,932.6	23,509.1	-2,423.5	-9.3	12.7	11.6
Compensation of Employees	7,945.4	7,915.0	-30.0	-0.4	3.9	3.9
Goods and Services	1,392.9	854.6	-538.3	-38.6	0.7	0.4
Interest Payments	7,089.8	6,699.6	-390.2	-5.5	3.5	3.3
Grants to Government Units	4,695.2	4,294.8	-400.4	-8.5	2.3	2.1
Capital Expenditure	2,944.6	2,408.1	-536.5	-18.2	1.4	1.2
Domestic-Financed	800.3	207.8	-592.5	-74.0	0.4	0.1
Foreign-Financed	2,144.3	2,200.3	56.0	2.6	1.0	1.1
Overall Balance (Commitment)	-5,395.4	-6,038.7	-643.3	11.9	-2.7	-3.0
Arrears Clearance	-1,716.3	-107.3	1609.0	-93.7	-0.8	-0.1
Overall Balance (Cash)	-7,111.7	-6,146.0	965.7	-13.6	-3.5	-3.0
Discrepancy	-	582.4	582.4	>100.0	-	0.3
Overall Balance (incl. div. and disc.)	-7,111.7	-5,563.6	1,548.1	-21.8	-3.5	-2.7

Source: Ministry of Finance (July 2017)

Total public debt increased from GH 122.6 billion (73.3% of GDP) at the end of 2016 to GH 138.6 billion (68.6% of GDP, using a projected higher GDP). The government plans to issue instruments to the tune of GH 14.8 billion during the last quarter of 2017, of which GH 12.8 billion will be used to roll over maturities and the remaining GH 2.0 billion as fresh issuances to meet its financing requirements. If this happens, the public debt will increase to GH 140.6 billion at end-December this year.

3. The Revenue Mobilization Gap

The government's program targets a fiscal deficit of 6.3% of GDP, consistent with the 2.5% primary adjustment targeted in 2017. The frontloaded fiscal consolidation is expected to result in a decline in the debt/GDP ratio from 73.3% in 2016 to 70.5% this year. The government has promised to commit itself by law to ensure that the overall fiscal deficit remains within a reasonable band of between 3-5%, beginning in 2018. In part, this is to ensure that persistent and excessive fiscal deficits do not get in the way of BoG's zero-financing of the government. Mobilizing additional revenue as part of the fiscal consolidation thus becomes a key priority for the government as it is the only option available to create fiscal space, increase priority spending, and reduce dependence on donor support which is not without limits.

Table 2. Ghana: Domestic Revenue Performance

Indicator	2012	2013	2014	2015	2016	2017 *
Original Target/GDP (%)	20.7	24.0	23.6	22.9	23.0	23.0
Revised Target/GDP (%)	22.0	n/a	21.7	21.3	21.7	
Revised Target versus Original Target (% point of GDP)	1.3	n/a	-1.9	-1.6	-1.3	
Actual Domestic Revenue/GDP (%)	20.7	20.0	21.1	21.0	19.3	19.6
Of which Tax Revenue/GDP (%)	16.7	15.3	16.9	17.2	15.3	15.3
Revenue Gap from Original Target (% point of GDP)	0.0	-4.0	-2.5	-1.9	-3.7	-3.4
Revenue Gap from Revised Target (% point of GDP)	-1.3	n/a	-0.6	-0.3	-2.4	
Addendum Item.						
Sub-Saharan Africa (SSA) Tax Revenue/GDP (%)	27.0	26.9	27.4	27.4		
Ghana's Revenue Gap from SSA Performance (% point of GDP)	-6.3	-6.9	-6.2	-6.4		

*Figure for Jan-Jun

Domestic revenue has always fallen short of the budget targets in the last couple of years, with the revenue gap increasing significantly since 2011. Ghana's domestic revenue/GDP ratio has also remained far below the levels of its regional comparators. The country's domestic revenue/GDP ratio averaged 20.4% between 2012 and 2015, compared to the Sub Saharan African countries average of 27.1% of GDP for the same period. This gives a revenue performance gap of 6.7 percentage points of GDP (see Table 2). Over the same period, government expenditure averaged 27.6% of GDP, compared to the average of 32.3% for its African peers. This development made the IMF to once describe Ghana as "taxing like a low-income country but spending like a middle-income country.” The low revenue/GDP ratio suggests that Ghana’s actual domestic revenue is far short of what its economic potential and institutional development should generate.

Indeed, if Ghana had performed like its regional comparators, with an average domestic revenue/GDP ratio of 27.1%, the country could have generated a total of GH 26.6 billion extra domestic revenue between 2012 and 2015, which could have paid off the total fiscal deficit (expenditure overruns) of GH 22.3 billion for the period, with an extra GH 4.3 billion to pay off some of its debt. Ghana would not have recorded any fiscal deficit. Quite clearly, the low domestic revenue mobilization is the cause of the Ghana’s fiscal imbalances and the rising public debt.

The low domestic resource mobilization in the country is associated with structural factors, such as low income, demographic factors, share of agriculture in GDP, low rents received from natural resources, large informal sector and underdeveloped financial markets, that are difficult to influence in the short-to-medium term. Alongside the structural factors, macroeconomic stability and governance also influence revenue mobilization in the country. The task of mobilizing more fiscal revenue is also complicated by increased erosion of tax bases, resulting from non-payment of taxes on capital gains, tariffs and other trade taxes. Also, as the country tries to attract more foreign investment, it experiences great pressure to sustain revenue from corporate income taxes because of tax competition. Two other major causes, including weaknesses in tax policy underpinned by widespread exemptions and concessions, and weak revenue administration underpinned by tax evasion and corruption also work in concert to undermine the country’s efforts to enhance domestic revenue mobilization.

4. Closing the Revenue Mobilization Gap

To close Ghana’s revenue mobilization gap, a strategy that seeks to reduce the widespread tax exemptions and evasion, broaden the tax base, strengthen revenue administration, improve tax compliance, help combat abuses and corruption is urgently needed. This will require a critical look at the taxes paid by mining companies, operators from the free zones, state-owned enterprises, and the informal sector businesses, as well as managing the risks associated with oil revenues.

4.1. Increasing Revenue from the Mining Sector: The mining sector in Ghana has a dominant potential to contribute to national resource mobilization. However, the sector's contribution to government revenue has not grown at the same pace as the overall GDP growth, and the overall impact of the sector to national development, despite the mineral commodity boom, is not very visible. This is because the incentives accorded mining companies have greatly limited the share of government revenue from the sector and constrained the opportunities for government to mobilize adequate resources to fund social and development programs. The framework of the current mining legislation in the country, which generally seeks to encourage foreign investment, is not necessarily compatible with the maximization of revenue and attainment of social and economic development. The mining fiscal regime defines an array of taxes, rent, fees and tax incentives to foreign investors in the mining sector. The range of capital allowances, list of mining related equipment and items exempted from custom duties, the non-payment of capital gains taxes, value added taxes (VAT), dividend withholding taxes, corporate income taxes, the huge offshore sales revenue retentions and the payment of royalty at the lowest allowable rate constrains domestic revenue generation, resulting in less visible contribution of the sector to national economic development.

The Minerals and Mining Act, 2006, (Act 703) provides for fiscal stabilization, mining investment and development agreements. These agreements are supposed to be signed by mining companies with mining leases for specific mining prospects. The Act provides for companies to negotiate stability agreements to ensure that mining operators, for a period not exceeding 15 years, are not affected by new legislative enactments and amendments that would adversely affect their operations. In addition, companies with investment portfolios exceeding US$500 million may negotiate development agreements with the government. Such agreements enable the companies to negotiate specific rates and quotas for royalty payments, income taxes for their expatriate employees, etc. that tends to limit taxes and non-tax revenue paid by the companies. To ensure that the country benefits from the mining sector, in terms of growing its tax base, the government has to undertake a complete review of the mining fiscal regime and its investment and stabilization agreements. This will require a re-examination of the Minerals and Mining Act, 2006 (Act 703) and a review of mining contracts and agreements.

4.2. Reviewing Free Zones Tax Concessions: Tax exemptions and concessions granted to operators in the country's free zones also work to undermine effective revenue mobilization. According to the Free Zone Act, 1995 (Act 504), a free zone enterprise shall have the right to produce any type of goods and services for export, except goods that are environmentally hazardous. Free zone operators and enterprises granted licenses under the Act are exempted from the payment of income tax on profits for the first 10 years from the date of commencement of operation, and the income tax rate after 10 years shall not exceed a maximum of 8%, while companies operating outside the free zone pay between 25-30%. Also, free-trade zone shareholders are exempted from the payment of withholding taxes on dividends arising out of their investments. The issue here is that while the outputs of the companies operating in the free zones form part of the country's GDP, not much taxes are paid by them due to the displacement of the tax bases, seriously eroding the country's tax/GDP ratio. This calls for a major review of the concessions granted by the Free Zones Act to enable the operators in the zone contribute significantly to government revenue.

4.3. Enhancing State-Owned Enterprises Financial Performance: State-owned enterprises (SOEs) contribution to government revenue is also very low as many of them do not declare dividends annually. SOEs are legal entities established by the government to undertake commercial activities on its behalf. As at 2012, the government owned 33 SOEs and their assets and liabilities were estimated at GH 32.9 billion and GH 16.6 billion, respectively. Although these enterprises do not directly depend on the national budget to finance their operations, those in the energy and utility sectors get affected by government subsidy policies. The profitable ones, such as COCOBOD, pay dividends annually to support the national budget. Dividends, interest and profits from SOEs contributed GH 561 million, about 12% of the total non-tax revenue of the government in 2013.

The root cause of the low dividend payments by SOEs is political interference in their operations, coupled sometimes with weak management and poor supervision. Additionally, there is no robust and transparent framework for assessing the management of SOEs, causing many of them to underperform. The budgets of many SOEs are not disclosed, making it difficult to assess their financial performances annually. Many SOEs do not share their budgets with the public nor the relevant government institutions. They usually prepare their budgets for the information of only their boards. Management of these SOEs are not publicly held accountable for their performance and budgets. Even though the State Enterprises Commission prepares and enters performance management contracts with SOEs and their sector ministries, these contracts are neither enforced nor respected by the parties. Some SOEs that publish their financial accounts have challenges with colossal legal claims (contingent liabilities) and debt-service charges. Some are involved in litigations with third parties, the majority of which usually crystallize as liabilities against them. The legal framework setting up many of these SOEs does not allow them to increase their equity share of capital, thus forcing most of them to rely heavily on bank loans.

The obscurity of SOE budgets and their outturn, which make it difficult to assess the performance of these enterprises, together with the huge interest charges and contingent liabilities account for the low or no dividend payment by the enterprises to support the national budget. The government therefore needs to review the country's financial laws governing SOEs to enable the Ministry of Finance capture data on all of them. The Ministry of Finance should be able to transparently and comprehensively capture, monitor and report on the financial situation of SOEs to Parliament during the budget presentation. This will enable the government to influence the investment decisions of these enterprises to make them more efficient and support the implementation of government policies. It will also enable the enterprises undertake special revenue generating activities that could bolster their financial positions and make them able to declare dividends to the government to support domestic revenue mobilization.

4.4. Taxing the Informal Sector: Government should also pay serious attention to taxes paid by the country's informal sector operators. Statistically, less than 8 million people of the projected 28 million Ghanaian population are potential taxpayers. Of the potential 8 million taxpayers, less than 4 million (below 50% of the taxable population) actually pay tax. This situation demonstrates the enormity of the revenue mobilization challenge facing the country, requiring practical steps to salvage it.

The local economy is largely informal, with 88% of the labor force engaged in the sector where over 75% of the local economic activities are housed (GSS, 2014). Meanwhile, the relative share of income tax revenue from the informal sector has been abysmally low over the years. A large proportion of government revenue from income tax comes from the formal sector while a very infinitesimal figure comes from the self-employed and the informal sector. Government's fiscal challenge is how to bring the informal sector operators into the tax net.

Currently, the government adopts the presumptive tax method for taxing small informal firms. This involves a flat rate turnover tax of 3% for small firms in place of the standard VAT, while micro businesses are covered by a tax stamp regime of a fixed tax per quarter. Given their small sizes, mobility, and potential political influence, effective taxation of informal sector firms is likely to depend on encouraging greater voluntary compliance. The success of voluntary compliance may be linked to the broader issue of benefits of formalization. This is because despite the willingness, informal operators may be unable to register formally due to problems of capacity, the transience of their businesses, the prevalence of cash transactions, or general uncertainty. The broader environment is also often not enabling and is characterized by a lack of trust in government and the lack of access to a range of services, including information, accounting services, security, justice, and insurance. Thus, even if informal operators are aware of the benefits of formalization, their businesses tend to remain in the informal economy. There is therefore the need to empower informal operators, especially the small firms, in terms of strengthening their access to justice, assuring property rights, increasing economic opportunities such as credit, markets, investment and insurance. This implies that for the purposes of taxation, government must adapt tax regimes to the characteristics of informal operators and supplement the business environment with policies to reduce costs of registration, securing property rights, improving security, establishing dispute resolution mechanisms, and providing affordable accounting services. This approach should be supported by institutional reforms to better reward informal sector tax collection, including segmentation of the tax administration, with a specialized unit for the informal sector (Joshi, Prichard and Heady, 2014).

There is also the opportunity for greater use of technology to facilitate informal sector taxation. Of particular interest is the use of mobile banking to make tax payments. Such an approach has the immediate benefit of reducing interaction between tax officials and taxpayers, and the consequent risks of harassment, collusion, and corruption. This may also increase support among tax administrators by not only reducing the cost of collection but also perhaps making the work of collection less unattractive and painstaking. In the medium to long term, decentralizing the responsibility for informal sector taxation from national to sub-national governments should take place as part of the government's fiscal decentralization program. Presently, local governments collect fees, fines, property taxes, and others. Whereas the national government may see informal sector taxation as unrewarding, administratively difficult, and politically costly, local authorities may have stronger incentive to collect and bargain with the local associations.

Government should also consider using the Driver Licensing and Vehicle Authority (DVLA) to bring scores of vehicle owners and commercial drivers in the informal sector into the tax net. A policy should be developed to make vehicle owners and commercial drivers to present their income tax certificates as a requirement for registering their vehicles and renewing their driver's licenses. The idea here is to motivate and encourage vehicle owners and commercial drivers to pay income tax.

Property and rent taxes also have the capacity to enhance domestic (local) revenue mobilization. For this reason, the Lands Valuation Authority has to make sure that the market value of all lands, houses, and other landed properties are determined at all times to support efficient property and rent tax mobilization. As a matter of urgency, the National Identification Project should be completed. Credible tax regimes revolve around credible databases which in turn makes strategic revenue mobilization successful. Government should also complete the Street Naming and Property Addresses Project on time. These two national projects are very critical for efficient revenue mobilization, a vibrant banking industry, and development in general.

4.5 Managing Oil Revenue Risks: The country's oil sector presents both opportunities and risks to fiscal management, as it is expected to provide a strong but temporary boost to economic growth and government revenue. The oil sector is expected to generate an additional US$23 billion in public revenue between 2016 and 2036, with oil revenues projected to peak in 2023 and decline thereafter, with production ceasing entirely by 2036 (World Bank, 2017). These revenue projections, however, are highly sensitive to developments in the global commodity markets, and if oil prices fail to recover, Ghana's oil revenue could fall by more than half. Leveraging this short-term revenue surge to promote sustainable development poses a considerable challenge. Although Ghana has developed a sound oil revenue-management strategy, the oil revenue projections that underpin it have repeatedly been inaccurate. As the sector's fiscal importance increases over the medium term, the risk that an oil-revenue shortfall could destabilize the budget will rise with it. Effectively transforming oil revenues into productive investment and human capital development will require a well-designed investment strategy combined with improvements in expenditure efficiency.

5. Further Observations

First, some practices in Ghana's budget preparation undermine the credibility of the budget and make it difficult to estimate the true size of revenues and expenditures. The budget is usually not prepared based on a realistic macroeconomic framework. Although aggregate macro-fiscal framework and indications are usually presented within a multi-year time horizon, detailed macroeconomic analysis does not take place, leading, in most cases, to highly optimistic revenue and expenditure projections, thereby undermining the credibility and feasibility of budget targets. Also, during budget preparations, some government agencies do not report to the Ministry of Finance the revenues they generate internally (IGFs). Some ministries, departments and agencies have the perception that when IGFs are reported in full, the Ministry of Finance may not allocate enough funds for their budgets. This practice arises, in part, due to the lack of clear rules governing the use of IGFs which Parliament appropriates in the budget, leaving ministries, departments and agencies with the discretion to spend as they wish, the revenues they generate internally.

The IFS pointed out in March this year that the projected revenue target of GH 45.0 billion for 2017, representing 33.5% increase over the 2016 receipts, was overly optimistic and could not be achieved unless measures were introduced to grow the non-oil economy and enhance revenue administration. Again, in August, the Institute pointed out that, given the disappointing fiscal performance in the first half of 2017, the revised annual revenue projection for the whole year, although lower than the original projection, still looks optimistic. The government needs to establish clear guidelines for budgeting, including better revenue forecasting mechanism.

Second, over the years, governments in Ghana have outlined various measures that seek to increase revenue in the budget statements but the outcomes have been mixed. To achieve efficiency in revenue mobilization, it is the view of the current government that tax policies should be designed in such a way that they impose minimal cost on the productive sectors of the economy since those sectors serve as the engines of growth. Accordingly, the direction of the new government's revenue policy in 2017 is to strike the right balance between domestic revenue mobilization for development and designing an attractive tax regime that promotes domestic and foreign investment. To achieve this objective, the government plans to shift the focus of revenue policy away from mere revenue mobilization to include support for production.

The thrust is to release money to industry, thereby giving industry the ability to increase productivity and then taxing the gains made on outputs.

To translate the government policy into practice, a number of specific measures have been introduced, including the following: (i) removal of VAT and NHIL on financial services, domestic airline tickets, selected imported medicines, sale of real estates, and the introduction of 3% VAT flat rate scheme; (ii) removal of special levy on imported raw materials and machinery, and setting import duty on vehicle spare parts at zero; (iii) removal of excise duty on petroleum products and reducing the special petroleum tax from 17.5% to 15%; (iv) review of the exemptions regime; and (v) exemption of gains from realization of securities listed on the GSE from taxation. Other revenue enhancing measures introduced by government include the monitoring of VAT collections on real time basis by the use of electronic point of sales devices, implementation of the excise tax stamp Act, 2013 (Act 873), enhancing audits of multinational and free zone companies; the use of taxpayer identification numbering system for all transactions with government, and the encouragement of taxpayers to timeously file their tax returns. The government also plans to put in measures to ensure accountability and efficiency in the management of non-tax revenue.

Although the revenue measures outlined by the government are commendable, the problem is enforcement and evaluation. The IFS has long suggested a number of measures that can help significantly to improve tax revenue mobilization (see IFS, August 2017). The measures include the following.

- Improving the tax revenue performance of the key segments, i.e., large business taxpayers, high net-worth individuals, and the informal sector;
- Further reducing tax exemptions;
- Plugging leakages through under-invoicing of imported goods, revamping the bonded warehousing system; dealing with fraud involving collusion between tax payers and tax collecting officials, and
- Empowering the Ghana Revenue Authority with the needed logistics and resources to enable it strengthen tax revenue management and compliance risks; address the accumulation of tax debts; enhance collection enforcement; and increase the effectiveness of tax audits.

5. Conclusion

Ghana's fiscal performance has been very poor in recent years. Weak domestic revenue mobilization has become the root cause of fiscal imbalances in the country and the biggest single threat to the achievement of the government's development objectives. Ghana's domestic revenue/GDP ratio remains far below the levels of its sub-Saharan African comparators, and revenue gap has increased significantly in the past years. The country's domestic revenue/GDP ratio averaged 20.4% in recent years, much less than the sub Saharan African countries average of 27.1% of GDP, indicating a revenue performance gap of 6.7 percentage points of GDP. This suggests that Ghana's actual domestic revenue is far short of what the country's economic potential and institutional development could generate. Indeed, if Ghana's domestic revenue had performed like its regional comparators, the country could have generated significantly more revenue, which could have been used to pay off its fiscal deficits (expenditure overruns), with extra money to pay off some of its debts. In view of this, the IFS submits that paying serious attention to revenue mobilization should be the number one priority of the government in the 2018 Budget and beyond. A revenue mobilization strategy that seeks to strengthen revenue administration, improve tax compliance, help combat abuses and corruption, and increase the fiscal space for public investment and social spending is urgently needed. This requires reforms to the revenue-generating policies of the mining sector, free zones, informal sector, and SOEs.

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