The World Bank

PREMnotes

DECEMBER 2001

NUMBER 61

PUBLIC SECTOR

Introducing a value added tax: lessons from Ghana

Because the introduction of a value added tax (VAT) can be highly sensitive, steps must be taken to ensure that public concerns are fully addressed.

In 1998 Ghana's government successfully introduced a VAT. But this success followed a failed attempt in 1995, when the country's first VAT was repealed after just three and a half months. Ghana's experience provides several lessons for the successful introduction of a VAT—particularly the importance of recognizing public sensitivity to changes in the tax system and of securing public acceptance when introducing a VAT.

A VAT's introductory rate has a big influence on public opinion, but so do public education and management of public expectations. In addition, political commitment—in terms of both an enabling macroeconomic environment and the enactment of legislation—is crucial for securing popular support and ensuring the timely introduction of a VAT.

Why a value added tax?

With assistance from the World Bank and the U.K. Department for International Development, Ghana introduced a VAT in March 1995 to remedy the deficiencies of existing consumption-based taxes. Those deficiencies included:

- An excessively narrow tax base, which resulted in low buoyancy and unstable revenue because it excluded fast-growing sectors of the economy.
- Weaknesses in the tax collection system, with inadequate checks and controls leading to revenue leakages.
- A need to move away from collection based on physical surveillance toward modern methods based on documentation, reducing the potential for corruption.

The VAT also provided an opportunity to introduce modern tax administration techniques—though limited to administration of the VAT—especially self-assessment.

Introducing the value added tax

In preparing for the introduction of the VAT, Ghana created a new revenue collection agency, the VAT Service, recruited and trained staff, and developed computer systems to administer the tax. Legislation was prepared and enacted, and a public education campaign was implemented. The VAT was introduced at a rate of 17.5 percent—higher than the standard 15.0 percent rate of the previous sales tax.

The introduction of the VAT provoked civil unrest, with demonstrations and riots resulting in several deaths. In response, the government announced a review of the tax. Although the government was expected to lower the VAT rate and raise the registration threshold, in June 1995 Parliament passed two bills that ended the short life of the VAT. The sales tax was reintroduced with the same rate, scope, and coverage as before, and the base of the service tax was expanded from 5 to 15 activities, covering mainly professional services. Still, the service tax base was narrower than what was envisaged in the repealed VAT law.

Ghana offers lessons on what should be done—and avoided—when introducing a value added tax

The second reform effort placed special emphasis on facilitating public acceptance of the new tax

Reintroducing the value added tax

As part of the Public Financial Management Reform Program, and with technical assistance from the U.K. Department for International Development, the government reintroduced the VAT at the end of 1998. Although a single rate of 15 percent was recommended—and included in the VAT bill—the rate was lowered to 10 percent after extensive consultations between Parliament and the executive branch.

The lower rate increased public acceptance of the tax, but it made revenue lower than it could have been—especially given the tax's comparatively narrow base. Still, revenue from the VAT exceeded the targets set for the initial phase of its operation.

Lessons

The second attempt to introduce the VAT drew on lessons from the negative experience with the first, with special emphasis placed on facilitating public acceptance of the new tax. Comparing the two reform efforts offers several important lessons.

Strong, clear political management is crucial

The introduction of a VAT may face strong resistance by groups lobbying for preferential tax treatment. Thus clear, top-level political commitment is needed to introduce a VAT, combined with efficient management of the legislative process to ensure that lobbying and political opposition do not undermine the implementation strategy. When Ghana first tried to introduce a VAT, political support was weak and political opponents influenced public opinion against the reform.

The situation was completely different when the VAT was introduced the second time. At an early stage of the reform process, strong messages supporting the VAT were delivered by the president and members of government. In addition, technical workshops organized for members of Parliament's Finance Committee improved understanding of the tax and facilitated passage of the law.

Sufficient time is needed between enacting legislation and implementing the tax

In 1995 the preparation and implementation of the VAT were hindered by delays in passing relevant legislation. The passage of primary legislation was delayed from May to December 1994, yet the VAT's introduction was postponed just three months. Thus there was not enough time for key activities, including appointing senior managers and staff to the VAT Service, implementing procedures and programs to facilitate training and publicity, and starting taxpayer registration. And because of further delays, secondary legislation—on exemptions, tax rates, and registration threshold levels—was not passed until two days after the VAT went into effect.

In contrast, when the VAT was reintroduced in December 1998, its legislation was enacted 10 months before—providing enough time for the key activities noted above. As a result the VAT Service was better prepared, with trained staff and offices open in all regions. Education campaigns addressed people's questions on compliance, resulting in a better-informed public. And taxpayer registration began in August 1998.

The tax administration must be prepared

The decision to establish a separate VAT Service to administer the new tax was made in August 1994, just seven months before the tax became effective. Until then the Customs, Excise, and Preventive Service (CEPS) was supposed to be responsible for collecting the VAT. The new arrangement led to substantial rivalry between CEPS and the VAT Service; staff transfers from CEPS to the VAT Service were delayed and senior CEPS managers were no longer fully committed to supporting the new tax. One result was the delayed appointment of the VAT Service's governing board, which was not in place when the tax became effective. Thus the VAT Service began operating with no oversight and substantial gaps in staffing, especially among middle-level management.

By contrast, in 1998 sufficient time was allocated to prepare the tax administration for registering VAT taxpayers and collecting the tax. In addition, experienced tax administrators were transferred from existing tax administration bodies to the VAT Service, easing staffing gaps.

Introductory rates and registration thresholds strongly influence public opinion

The initial VAT's introductory rate of 17.5 percent was one of the main reasons it failed. This high rate was partly driven by Ghana's worsening macroeconomic situation and large budget deficit in 1995. The public was especially angry because the initial education campaign had said that the VAT would be no higher than the sales tax.

In contrast, at a basic rate of 10 percent the VAT introduced in 1998 was much lower than the sales tax. Moreover, many basic goods—unprocessed food, agricultural inputs, drugs and health services, utilities, books, educational materials—were exempted from the VAT to further pacify public opinion.

Similarly, in 1995 small traders had a hard time complying with the VAT's registration requirements. The second time around, this problem was avoided by setting a higher threshold for the retail sector. In 1999 the threshold registration rate for the VAT was 200 million cedi ($80,000), up from 25 million cedi ($15,000) in 1995.

The tax's introduction should be timed to avoid inflationary pressures

The introduction of the VAT in 1995 coincided with several factors that raised prices in Ghana, including a higher excise duty on petroleum products, a significant jump in agricultural prices due to unfavorable rainfall, the normal seasonal low volume of food production, and fast depreciation of the currency, which made imported goods and services more expensive. The VAT received much of the blame for the higher prices, fueling public opposition.

In contrast, the date for the reintroduction of the VAT was carefully chosen to avoid inflationary phenomena. In addition, external bodies were encouraged to help monitor the tax's effect on prices before, during, and after its launch. For example, the Ghana Urban Traders Association—which had vociferously opposed the earlier attempt to introduce a VAT—was commissioned to survey market prices. The association provided independent verification of the modest price effects associated with the second VAT. And along with groups such as the Chamber of Commerce and Institute of Chartered Accountants, the association was represented on the VAT Oversight Committee.

A well-designed public education campaign is crucial

In 1995 a weak public education campaign was a key reason for the public outcry over the VAT. The campaign's coverage was limited to professional and trade body offices and high-end manufacturers, with limited outreach to low-volume traders and consumers. Moreover, the campaign's content was constrained by the delays in passing secondary legislation—which made it impossible to explain some of the tax's most important details—and by the absence of high-level support at the ministerial level.

In 1998 the VAT Service put a lot more emphasis on public education, launching a well-designed, comprehensive campaign. The campaign involved a wide range of stakeholders and distributed different types of informational materials throughout Ghana. In addition, the campaign extended to low-volume traders and consumers, and it gained a high profile by attracting ministerial support.

The campaign established national, regional, and district public education committees, drawing on the VAT Service, various ministries, the private sector, and civil society. Committee members included representatives of trade and commerce groups, the Market Women's Association, the Trades Union Council, and the 31 December Women's Movement.

As part of its efforts, the national public education committee gathered public feedback through a survey of 500 people across Ghana's 10 regions. Respondents included opinion leaders, manufacturers, business-

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Table 1 Features of value added taxes in Ghana and Elsewhere in Africa, 2000–01

Country or region	*Standard rate (percent)*	*Threshold (U.S. dollars)*	*VAT revenues as percentage of GDP*	*VAT revenues as percentage of total tax revenues*
Côte d'Ivoire	20.0	50,000	4.8	28.7
Ghana	12.5	80,000	3.8	23.5
Nigeria	5.0		1.6	19.7
Senegal	20.0	180,000	6.2	37.1
Sub-Saharan Africa	16.0		3.9	28.4

Source: IMF 2001.

Public feedback aided the evolving public education campaign

people, traders, market women, farmers, fishers, artisans, drivers, public servants, and the unemployed. The survey found that the initial stages of the public education campaign had raised awareness but that people's knowledge of the VAT remained limited. The survey also identified key public concerns—such as suspicions about abuse and corruption in the system and skepticism about whether the public would benefit from the extra revenue raised by the VAT. This type of feedback aided the evolving public education campaign.

Sustainability of the reform

A VAT was seen as a way of improving the revenue performance of Ghana's tax system. Although the 1998 tax was introduced at a low rate, it generated 20 percent more revenue than the sales tax it replaced. The government's macroeconomic framework—which aims to reduce trade taxes and gradually replace them with broadly based taxes such as the VAT and income taxes—now requires increasing the VAT's role in the revenue system. Less than two years after the tax was introduced, its rate was raised to 12.5 percent (table 1). The government is also giving thought to broadening the tax's base by cutting the registration threshold from 200 million to 100 million cedi.

Further reading

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