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Informality and Tax Revenue in Ghana

Informalidade e Arrecadação de Impostos em Gana

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INFORMALITY AND TAX REVENUE IN GHANA

***INFORMALIDADE E ARRECAÇÃO DE IMPOSTOS EM
GHANA***

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Dissertação de Mestrado apresentada ao Programa de Pós-Graduação em Desenvolvimento Econômico, área de concentração: Economia Social e do Trabalho do Instituto de Economia da Universidade Estadual de Campinas para obtenção do título de Mestre em Desenvolvimento Econômico, área de concentração: Economia Social e do Trabalho.

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DEDICATION

This thesis work is dedicated to the Almighty God for his protection and guidance and also to my lovely wife, Mrs. Prudence Thompson for her prayers, support and sacrifices throughout my study in Brazil.

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RESUMO

O setor informal em Gana é muito grande e emprega a maior parte da força de trabalho do país tanto nas atividades agrícolas quanto nas demais, mas ainda assim contribui muito pouco em termos de receita tributária. O objetivo de todo país em desenvolvimento é o crescimento de sua economia através do uso de suas receitas internas e a minimização do uso de empréstimos e subvenções que trazem dificuldades para o país. A maneira mais importante de tornar isso possível é através do uso da receita fiscal, ferramenta fundamental para a construção e sustentação das economias nacionais. Uma das áreas que exigem atenção nesse sentido é o setor informal. De uma população estimada de 1.5 milhão de ganenses que pagam impostos diretos, o setor informal representa menos de 5% desse número.

O ponto central dessa tese é o potencial de contribuição do setor informal para os cofres públicos, uma vez que esse apresenta grande potencial de crescimento e geração de receita, especialmente se for levada em consideração a parcela de população que obtém altos rendimentos e tem condições de pagar impostos, mais ainda não o faz. Para que o governo possa aumentar sua receita fiscal sem recorrer ao aumento das taxas é necessário ampliar a rede fiscal para nela incluir todos aqueles que deveriam pagar impostos. Gana utiliza o sistema progressivo de impostos, o que assegura que os impostos sejam proporcionais à renda. Isso significa, portanto, que a carga tributária é uma responsabilidade compartilhada por todos os cidadãos, e o setor informal não é exceção.

Palavras chave: Gana – setor informal – tributação – formalização

ABSTRACT

The informal Sector in Ghana by its size is very hug and employs the largest number of the country's labour force in both Agriculture and Non-agriculture activities yet, contribute very little in terms of tax revenue. It is the aim of every developing country to grow its economy by using more of its own internally generated revenues and to minimize or do away with securing loans and grants from donors which brings a lot of hardship on the country. The most important way of carrying out this is through the use of "Taxation Revenue" which is the fundamental tool for building and sustaining national economies. One area that needs concentration in this regard is the informal sector. Out of an estimated 1.5million Ghanaian tax population paying direct taxes, the informal sector consists less than 5 percent of the number. This thesis focuses on the informal sectors potential to contribute substantially into the tax revenue coffers, since the sector is highly potential in the growth and revenue generation, especially those in the high income spectrum of the sector who has the condition to pay taxes, yet are not paying. In order for the government to increase its tax revenue potential without increasing the tax rate is to widen the tax net to capture all those who are to pay tax. Ghana is using the progressive tax system in its direct tax administration, which ensures that the more your income the more tax you pay and the lower your income the lower tax you pay. It's therefore means that the tax burden is a shared responsibility of all citizens of the country for which the informal sector is not an exception.

Keywords: Ghana – informal sector – taxation – formalization

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Acronyms and Abbreviations

NBSSI-	National Board for Small Scale Industries
GDP -	Gross Domestic Products
GRA -	Ghana Revenue Authority
IDS -	Institute For Development Studies
ILO -	International Labour Organization
WIEGO -	Women in Informal Employment Global Organizing
GSS -	Ghana Statistical Service
ISSER -	Institute for Statistical, Social and Economic Research
PHC -	Population and Housing Census
ATS -	Africa Tax Spotlight
BOG -	Bank of Ghana
GoG -	Government of Ghana
SADA -	Savannah Accelerated Development Agenda
MoFA -	Ministry of Food and Agriculture
GPRS I -	Ghana Poverty Reduction Strategy I
GPRS II -	Growth and Poverty Reduction Strategy II
GSGDA -	Ghana Shared Growth Development Agenda
NDPC -	National Development Planning Commission
FDI -	Foreign Direct Investment
IRS -	Internal Revenue Service
IRA -	Internal Revenue Act
VAT -	Value Added Tax
SSSS -	Single Spine Salary Structure
GLSS -	Ghana Living Standard Survey
FAO -	Food and Agriculture Organization
HDI -	Human Development Index
OASL -	Office of the Administrator of Stool Lands
SAP -	Structural Adjustment Programme
SSNIT -	Social Security and National Insurance Trust

IMF -	International Monetary Fund
GTUC -	Ghana Trades Union Congress
CEPS -	Custom Excise and Preventive Service
RAGB -	Revenue Agencies Governing Board
NRS -	National Revenue Secretariat
TIN -	Taxpayer Identification Number
LEAP-	Livelihood Empowerment Against Poverty
LI -	Legislative Instrument
LTU -	Large Taxpayer Unit
DTRD -	Domestic Tax Revenue Division
PAYE -	Pay As You Earn
VIT -	Vehicle Income Tax
MSMEs	Micro, Small and Medium Scale Enterprise

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INTRODUCTION

One major challenge facing many developing countries including Ghana is raising adequate revenues internally to finance its social and developmental programmes. It is the aim of every developing country to be able to grow its economy by using more of its own generated revenues in order to become self-sufficient, for which Ghana is not an exception.

In 2011, Ghana was declared a Lower Middle Income country, which then imposes more challenge of self-reliance on internally generated funds than the over reliance on donor funding of its major developmental programmes.

For some decades, Ghana's budgeted revenues always fall short of its budgeted expenditures, thereby resulting in huge deficits. For instance, Ghana's budget deficit was estimated at 3.2 percent of GDP in 2007, currently (2012) Ghana registered a budget deficit of 12 percent of GDP, which gives an increase of about 8.8 percent in five years. Budget deficits impose a barrier to achieve the projected goal of becoming a Middle Income economy by the end of year 2015 (Budget statements 2007 & 2013). One of the reasons why deficits arise as obstacles for growth is public debt – both domestic and external - as its payment divert resources from governmental productive investments in education, health care and infrastructure building among other needed investments.

One and most important way of achieving this goal is through the use of Taxation revenue¹. Taxation is a fundamental tool, which is used to provide the essential revenue to build a state that is accountable and responsive to its citizens. Thus it becomes an important instrument for building and sustaining national economies. At the same time, accountability and transparency make easier for governments to tax its constituency, and to get support for a wider tax base (Prichard, 2009).

Ghana has a tax system that includes taxes on income and property, taxes on domestic goods and services, international trade taxes and value-added tax (Osei and Quartey, 2005). Up to 1999, when VAT became operational, the largest component of Ghana's revenue was taxes on international trade. Nowadays, the most important category is the income and property taxes. The Pay As You Earn (PAYE) component of these taxes, represent almost a third of this category. The second most important source of revenue is the value-added tax (VAT) was introduced initially in 1995, withdrawn and re-introduced

¹ The author acknowledges this is not the only measure that can be used to address the huge budget deficit.

in 1998. The conflicts surrounding VAT's implementation show the need to be extremely careful when trying to implement new taxes.

In order for the government to increase its tax revenue potential without increasing the tax base/tax rate is to widen the tax net to include all those who must pay taxes. There are two types of problems included here, one is pure tax evasion, and another is simple under reporting of income. In a very small set of cases taxes are not paid for simple ignorance of this duty.

Due to their organization, mid-sized and large firms honor their tax duties, but small units and self-employed workers barely contribute to the total tax revenue of the country.

There is a major conceptual issue involved here: On the one hand, there is the problem of the economic-legal- activities that are not registered by the Government Statistical Offices, and thus go unaccounted in the GDP statistics. On the other hand, there is a certain proportion of the working population that is not under the protection of the labor laws or the social protection net: self-employed people and workers in very small economic units (micro units). The first group is included under the label of "underground economy", "unregistered activities" or "informal economic activities". The workers who are part of the second group are usually labeled as members of "informal sector".

There is a non-void intersection between those categories, clearly, as members of the underground economy don't pay taxes, but a certain proportion of the so called "informal sector" certainly do. VAT and income and property taxes are collected from both the formal and the informal sectors of the economy, while international trade taxes are only collected from units in the formal economy as they are generally of medium to large size, and thus registered. While the formal sector is well structured in honoring its tax obligations, the same cannot be said of the informal sector.

The informal sector of Ghana employs more than 80percent of the total labour force, which is largely self- employed, yet it contributes very little to the total tax revenue collection of the country. It is estimated that out of about 1.5million Ghanaian tax population paying direct taxes, the informal sector contribution consists only 5 percent of the number (Terpker, 2013).

Seth Terpker, the Minister of Finance, in his address to the Top managements of the Ghana Revenue Authority (GRA) the body in charge of tax administration in the country,

has said among other things that the informal sector continue to be the worst offenders when it comes to tax evasion.

Ghana is using the progressive tax system in its direct tax administration, which ensures that the more your income the more tax you pay and the lower your income the lower tax you pay. It's therefore clear that the tax burden is a shared responsibility of all citizens of the country for which the informal sector is not an exception. The informal sector's contribution to GDP in 2009 is estimated to be 38.4percent. Thus, one can expect that the sector with such a size could contribute substantially to the tax revenue of Ghana. Many changes can be done in terms of taxing, not only the richest part of the Ghanaian population, but also foreign capital, big firms and financial capital. Those changes could bring forth higher tax revenue and greater levels of tax justice, In spite of those possibilities, the main focus of this work is to identify ways in which the informal sector operatives can increase its tax revenue contribution to the state.

A persistent feature of the Ghanaian economy is the large share of self-employment, as well as very small scale economic units, that conform to the so called "informal sector". Some members of the sector have the capacity to pay taxes, so they can be transformed into a source of revenue that could add resources for economic development. It can be noted that how to tax the sector remains a very difficult task (Anuradha&Ayee, 2001), because it means also that there is a need to discuss policies aimed to formalize economic activities and labor relations, to support micro and small scale activities and at the same time to strengthen the government's punitive and fiscalization capacities, viz a vis tax evaders with a real capacity to pay.

As governments of developing countries are finding ways of increasing internally generated funds to meet the growing pressure on them to improve infrastructure and other socio-economic developmental issues facing their countries, a big informal sector is an important target for tax revenue, this is particularly important since the bigger share of that sector is in the total economy, economic viability, market share and relatively large incomes accrue to informal sector participants (Santos, 2013). Public policies to improve income, productivity, revenue and economic performance of micro and small units can help the formalization of informal enterprises and its labour relations, and to reduce tax evasion in the formal sector.

Thus, proposals to formalize and tax at least the more successful groups of the informal sector enterprises and workers, especially the urban informal sector, that can lead to increase in tax revenue come to fore as an important problem to be confronted.

The objectives of this study are to describe the main characteristics of urban informal sector in Ghana and to define which sector, activities or people should effectively pay tax, separating them from the poor people working in the informal sector; analyze ways of formalizing the informal sector in order to increase their tax contribution, considering some important international experiences, mainly the public policies focusing on Brazil; analyze the inhibiting factors that make it difficult for the informal sector to contribute substantially to the tax revenue of Ghana; to offer some suggestions that when addressed can help the Ghana Revenue Authority to effectively tax the sector.

The importance of this study stems from the fact that the informal sector has become a focus of developing countries in their quest to maximize revenue from within and not to always depend on foreign donors as well as borrowing to carry out economic developments. This study can be justified also on the grounds of the need to think about a more fair tax revenue structure that also contributes to reducing inequality.

The study will also add to the numerous research and existing body and knowledge on international experiences on how to formalize the informal sector for the expansion of the economy, improve the labour conditions and remuneration and also to increase tax revenue. In these sense, the study will further help policy makers, especially, GRA-DTRD in fashioning out ways to address the critical issue of taxing the informal sector.

This work adopts the use of secondary information such as journals, academic studies and official information from ILO, Ghanaian Government and other countries and international institutions which are of relevance to the study. The study seeks to analyze the potential contribution of the informal sector (urban-informal sector) to the tax revenue in Ghana taking into consideration its huge size in the labour market. The study will also consider the issues of formalization and how it can lead to increase in tax contribution from the sector.

Unfortunately, the researcher is constrained with obtaining adequate information on the urban-informal sector in Ghana. It seems much attention has not been put on the importance of the sector under consideration. The government needs to resource the Ghana

Statistical Service adequately for them to conduct in depth research to cover all aspect of the informal sector and its contribution to the country.

The broad outline of the study are that, chapter one will analyze the Ghana economy in area of Labour market and the general features of the informal sector. The second chapter will also look at the SMEs in Ghana and government support to them, the chapter will also consider the discussion on formalization with some international experiences. The third and the last chapter will consider the tax structure of Ghana and the contribution of income tax from the various sectors of the economy. The final part of the chapter will assess the main aspect of the informal sector taxation and offer recommendations on how the sector can be formalized in order to increase the tax revenue.

CHAPTER 1: ECONOMY, LABOUR MARKET AND GENERAL FEATURES OF INFORMAL SECTOR IN GHANA

The informal sector's contribution to GDP in the Ghanaian economy is very difficult to estimate in this work because there is lack of information on it by the Ghana Statistical Service, the institution in charge of providing economic data in the country. A figure of 22% was recorded by (ILO/JASPA, 1989) and 38.4% is estimated as the sector's contribution to GDP in 2009 (ISODEC, 2009). This contribution tells how the informal sector is of great importance to the state and would wish to see its reflection in their tax revenue contribution.²

The persistence of a large agricultural sector, with low levels of productivity and a large share of small farms, is a telltale signal of economic underdevelopment. This is so because average income generated in those activities is extremely low. Thus the country might lack enough capacity for sustained growth, as investment and savings rates certainly will be very small. This is particularly true in former colonies, as the colonial powers were only interested in extracting agricultural or mining surplus and guaranteeing a stable market for the imported goods they produced at the Metropolis.

As another consequence, the power of the State after independence was relatively weak, with lack of revenue that limits the capacity of the country in the area of industrial investments. The lack of an industrial sector and the resources needed to build up one sets developing economies like Ghana into a vicious circle of low investment, low income and poverty. As the vast majority of the population needs some sort of labour income, the possibilities of self-employment stand up as a survival strategy for many workers. In the case of Ghana, the resource based economy meant that industrialization is not a current national priority. Revenue derived from raw materials or food products cannot use for capital accumulation.

² Informal sector operatives in Ghana, lack technology in their activities, most of them uses labour intensive capital in their work, unlike the formal sector that operate with a lot of technological equipment. Operatives in the sector work from simple tools to power operator equipment. These equipment's are rarely imported, they are either self-constructed or second-hand that need some improvement. Raw materials used by the informal sector for their work are largely from local resources or obtain from the formal sector. Some materials are also locally produced, discarded materials (Scraps) and very low imported goods that cannot be locally obtained.

Under these conditions, the lack of stimulus for generalized economic growth results in a stable (if not growing) small economic units expansion.

Ghana had its fair share of liberal policies in the mid-80s which adversely affected its labour market showing a constant decline in formal sector jobs, falling standards of jobs, low economic activities and poor living standards of Ghanaians. During the 2000s, high rates of GDP growth were accompanied by a very low level of employment creation and a growing informal sector. This shows that, from a structural point of view, because of the neoliberal policies implanted during this period, the positive impacts derived from GDP growth were minimized.

In a relatively poor country, whose modern productive sectors and manufacturing activities are underdeveloped, poverty and the harshness of daily life in rural areas; force a rural urban migration process, with people seeking better jobs, access to social services and better living conditions. This urban expansion process promotes informal sector growth, growth that was intensified by decades of liberal policies. Therefore, in the last decades, Ghana's labour market has seen a dominance of informal employment, self-subsistence activities, low productivity and small income agricultural activities.

1.1 Labour Market and Informality in Ghana

In terms of occupation in the country, a significant number of 3,875,957 representing 40.1% of the population are in agricultural employment. Another category of employees who deserves much of attention is 'Service and Sales Workers' due to their recent contributions to Ghana's economy. 21.5% of the population representing 2,076,970 of the labour force is service and sales workers (see table below). However, despite the fairly recent rates, the growth performance of the economy has not been sufficient to meet the employment needs of the rapidly expanding labour force. A high number of employees in this sector are not in permanent employment despite the various professions they find themselves in. Regardless of the fact that temporary employees can be found in professions such as banking, sales and marketing, teaching, information technology etc., contract or temporary employees are generally employed in hazardous jobs or jobs of low complexities with earnings below that of their permanent counterparts and in most cases they are less likely to have health and pension benefits. 15.6% of the population engages in craft and related trade works. Professionals and Managers also account for 5.5% and 2.5%

respectively. Of the active population, only 1.5% are clerical support workers and 1.9% are technicians and associate professionals.

Table 1: Occupation of Employed Persons 15years and Above, 2010

Occupation Employed	Figures	%
Total	9,657,179	100.0
Managers	239,343	2.5
Professionals	533,793	5.5
Technicians and associate professionals	181,219	1.9
Clerical support workers	143,225	1.5
Service and sales workers	2,076,970	21.5
Skilled agricultural forestry and fishery workers	3,875,957	40.1
Craft and related trades workers	1,506,206	15.6
Plant and machine operators and assemblers	494,335	5.1
Elementary occupations	588,377	6.1
Other occupation	17,754	0.2

Source: GSS 2010 Population and Housing Census

The 2010 Population and Housing Census conducted by the Ghana Statistical Service on 170 Metropolitan, Municipal and Districts Assemblies revealed that, out of 14,040,893 of the population who are potentially to be in some economic activity, 73.1% (10,268,699) are involved in some kind of economic activity³. The labour market currently has a total of 9,657,179 employed with 4,713,480 males and 4,943,699 females. There is more percentage of females than males currently in some economic activity. The total participation rate is 73.1% and an occupation rate 68.8%. The unemployment rate was around 6%; in absolute terms, the unemployment figure shows a total of 611,520 persons currently without any employment and again with a female dominance as they number 337,187, compared with 274,333 unemployed males.⁴ This shows that occupation and participation rates are high, and at the same time unemployment levels are not high, in a

³ A total of 3,772,199 people are not economically active which may be as a result of being at school, incapacitation, ill health or women playing housewife roles.

⁴ The survey considered economically active population to be 'all persons who did some economic activity for pay, profit or family gain seven days prior to the enumeration'. Leave applicants, temporary ill and temporarily laid off persons who also did some work before the survey were considered employed. People who did not work seven days prior to the survey and were looking for job but stop are not considered unemployed except those who did not have work but were actively seeking work, or were, at least, available to take up work if they were offered some during the reference period.

country where economic reforms in the last decades meant less employment in the more organized formal sector.⁵ So the major impact of those reforms was an expressive growth of informal activities and self-employment, for men and women equally.

Table 2: Economic Activity Status of Persons 15years and Above by Sex, 2010

Economic Activity Status	Both Sexes	Male	Female
Total	14,040,893	6,727,948	7,312,945
Economically Active	10,268,699	4,987,813	5,280,886
Employed	9,657,179	4,713,480	4,943,699
Unemployed	611,520	274,333	337,187
Economically Not Active	3,772,194	1,740,135	2,032,059
Unemployment Rate	6.0	5.5	6.4
Participation Rate	73.1	74.1	72.2
Occupation Rate	68.8	70.1	67.6

Source: GSS 2010 Population and Housing Census.

Public sector employment was greatly reduced because of the neoliberal policies implemented and so it was one of the most important factors that explain the observed growth of urban informal sector activities. Data from the GSS quarterly digest (1960-1991), showed that major expansion of public sector employment in Ghana took place before 1965 recording 10.2 percentage points' increment over the 1960 public sector employment when there exist numerous of government establishments in Ghana.⁶ The sector saw a drastic decline in its employment generation between 1975 and 1989, due to the crisis times of coup d'états in the seventies and the Structural Adjustment Programmes in the early eighties. According to the 2010 Population and Housing Census report, the public sector of Ghana's economy employed 475,416 (6.4%) of the total labour force in the year 2000. Although the number of employees increased in the 2010 census, the percentage share in the labour force

⁵ Ghana's unemployment figure currently stands at 6% for both sexes and high among females (6.4%) than males (5.5%). This figures don't include long term unemployment as people who are not working but stop looking for job 7 days prior to the enumeration will not be considered unemployed. The criterion used by the GSS which is a benchmark of IMF in the survey does not give a true reflection of the unemployment situation in the country.

⁶ The public sector increased its work force by 40 percent. Public sector employees are the number of people on government payroll as are referred to as workers in the Civil Service, Ghana Education Service, Judiciary, the law enforcement agencies, the Article 71 employees, the Foreign Missions, and Subverted Agencies.

declined to 6.2% as captured in table 5 below (GSS, 2012). The private sector (both formal and informal) has become the sole provider of all essential services and also the main source of employment. This reduction in the state's role of employment creation in recent years can be attributed to the introduction of the economic reforms by the government in 2008, as a way of reducing the public wage bill. Thus, the private sector has become the sector of attraction for the teeming jobseekers, but the supply of formal Jobs in this segment was not enough to counter the expansion of informal activities. The formal sector employment in Ghana is referred to as those having a legally enforceable employment contract with employee and contributing to the Social Security and National Insurance Trust (SSNIT) or both in the private sector. The private sector encompasses a wide range of economic activities. Among these activities are; banking & non-banking financial services, mining, construction, agriculture, forestry & logging, manufacturing, transport, trade, social & personal services. Because of the negative impacts of neoliberal reforms on formal employment, in recent years, the sector has received considerable attention from both government and development partners, aiming at developing and positioning the sector to support the public sector as a major source of formal employment.

The Social Security and National Insurance Trust (SSNIT), in its 2011 annual report shows that the formal sector establishments covered by the scheme increased from 27,980 establishments in 2007 to 36,534 in 2011. Of this figures the private sector has the highest share of 27,857 as against the public sector's share of 123 in 2007. In 2011, out of the total, the private sector still has the highest 36,534 establishments with the public sector managing a share of only 101 establishments.

Again the SSNIT report indicates that in 2011 out of an estimated 963,619 employees contributing to the scheme in Ghana. More than half of this number (560,955) representing about 58.21% are private sector employees, all public institution contribute the remaining of 402,664 (SSNIT, 2012 p.15). However, despite the above impressive figures, employment from the private formal sector in total employment fell from 8.5 to 6.8%, and remains relatively small, according to the 2010 census results (see table 5 below).

In addressing the labour market issues in Ghana, one cannot skip the issue of minimum wage which is at the heart of a successful income policy. At the beginning of every year Government, Employers and the Organized Labour (Tripartite) meet to fix the minimum wage for workers. This wage is the amount below which no employer must pay a

worker. As part of the communiqué which is issued at the end of the meeting, the minimum wage does not attract tax. This is done by considering the economic indicators at the time. This has over the period increased steadily, especially in the last decade. The minimum wage for 2013 is GH¢5.24 (US\$ 2.6) daily. Earnings or incomes from the sector are generally low. Many of the informal sector employees earn less than the monthly minimum wage as compared to their counterparts in the formal sector, about 58% earn below the minimum wage in the country (Baah, 2006). The statistical data from the GLSS5 indicate that 46% of food crop farmers earn less than the national minimum wage. The report further shows that 10% of private formal and 8% of public sector workers also earn less than the monthly minimum wage (GLSS 5). Unfortunately, there is no study on the average income of informal sector workers in the country. The table below shows the national minimum wage from 2000 to 2013 as contained in the above report and also by the Ghana Trades Union Congress⁷. From the table below, one can see how low wage levels in Ghana are which force even people with formal jobs to still have enterprises in the informal sector to support their monthly incomes, which has contributed to the high informal sector operations in the country.

Again, profit also varies between different activities. Records on the profit and earnings of the sector is not available, however, Sowa et al., 1992 and Barwa, 1995, provides that about 21% of the enterprises at the large end of the small-scale spectrum experience over 50% growth in output as compared to only 9% of the micro enterprises, which means when incomes or profit are relatively low, it impedes growth. In as much as we recognize incomes or profit of the informal sector entrepreneurs as low, some segment of them also earn relatively high returns yet, they still find themselves in the sector.

Thus, income levels for informal sector activities and for self-employed workers is low, but employers of the more organized small scale activities have higher income levels, potentially compatible with paying taxes

⁷The Exchange rates are from the BoG and the Minimum wage data from the GTUC. Ghana redenominated its currency in July 2007, the new Ghana Cedis exchanged for the old cedi at **¢ 10,000.00 to GH¢1.00**, Data from 2000 to 2007 are in the old Cedis and that of 2008 to 2013 in the new Ghana Cedis. Monthly minimum wage is calculated as daily MW multiplied by 27.

Table 3: Minimum Wage and Exchange Rate in Ghana (2000-2013)

YEAR	Nominal Daily wage (Cedis)	Nominal Exchange rate	Monthly National Minimum Wages (Cedis)	Monthly National Minimum Wages (US\$)
2000	4200	6820	113400	17
2001	5500	7000	148500	21
2002	7150	8000	193050	25
2003	9200	8500	248400	29
2004	11200	8971	302400	34
2005	13500	9074,06	364500	40
2006	16000	9175,86	432000	47
2007	19000	9357	513000	54
2008	2,25	1,06	60,75	57
2009	2,65	1,4	71,67	51
2010	3,11	1,5	83,97	56
2011	3,75	1,7	101,25	60
2012	4.48	1,9	120,96	64
2013	5.24	2,4	141,48	59

Source: Ghana Trades Union Congress, 2013.

1.2 Classification, dynamics and structure of urban informal sector in Ghana

This section is restricted to the enterprises that form the non protected segment of labour in urban Ghana, that is self-employed workers either with employees or not (Micro and small scale enterprises). This group is constituted by self-employed or own-account workers, owner of small businesses, employee of small, medium or big businesses without register or access to labor rights who deal in production, sales and distribution of goods and service in the urban areas of the country.

More than half of the employed population in Ghana are self-employed or own-account workers and a significant proportion of the labour force that are in wage employment also does not have formal employer-employee relationship making it extremely difficult to provide them with any form of protection, leaving them in the contest of job insecurity and low income. Public policy relating to the labour market has undergone significant changes over recent years, these changes respond to demands for greater flexibility in the labour market but they also respond to the pressures of growing levels of unemployment and its consequences for worsening conditions in the labour market. The

negative impact of the Structural Adjustment Programme (SAP) which was implemented in most developing countries including Ghana in the 1980s and the early 1990s had long term consequences (Barwa, 1995).

The above mentioned groups of workers are usually included under a single name: informal urban sector. There is a long standing discussion regarding how to define the informal sector, which activities constitute the sector and what name to give to it. The first organization to officially adopt the term Informal Sector was the ILO, in a report on employment in Kenya and continued to act as a driving force behind the study and the debate of the concept. Keith Hart, an anthropologist whom the origin of informal sector is attributed to, in his paper, *Informal income opportunities and urban employment in Ghana* (Hart, 1973), presented at an Institute of Development Studies (IDS) conference on Urban Unemployment in Africa in 1971, described the “economic activities of the low-income section of the labour force in Accra, the urban sub-proletariat into which the unskilled and illiterate majority are drawn” (Hart, 1973 p.61). Hart further focused on individual income opportunities and placed wage-earners in the formal sector and self-employed in the informal, which include both legitimate and illegitimate income sources (ibid, p.68-69). The use of the term informal sector became widely accepted among academia and the international development community in the 1980s. Thomas (1992), acknowledged the fact that there was some understanding of what kind of activities or groups of workers that could be associated with the sector, but focus and definition still remain.

The ILO adopted the term informal sector because what it used to be the traditional sector had become “profitable and efficient enterprises as well as marginal activities”. Thus, the change in the activities of the sector had a total change in the idea that this sector would eventually be absorbed into the modern capitalist or the formal economy and disappears (Chen, 2005, p.2&3).

Researchers have defined the informal sector in many ways. Many of these definitions are descriptive because of the difficulties involved in capturing all the dimensions of the informal sector in one definition. The most common features of the sectors activities are that the sector is unregistered, unregulated or the institutions escape regulations. Peattie 1987, p.851, describes the informal sector concept as “exceedingly fuzzy”. Thus, bringing a lot of confusion in coming out with a single definition of the sector.

The following are some of the definitions that have been used in the literature and are of relevance to this study. We should keep in mind that the first two definitions used the term “informal sector” as synonymous with undeclared or underground economy.

- a) Feige (1989) defined the informal sector as “all currently unregistered economic activities that contribute to the officially calculated Gross National Product”. His definition point to the fact that the sector is recognized but yet not registered, either for regulation or tax purposes.
- b) Schneider (2005) re-echoes the fact that the sector’s economic activities and the income derived from that circumvent or otherwise escape government regulation, taxation or observation. In other words, the informal sector here does not include illegitimate activities such as smuggling, armed robbery, just to mention a few. These illegal activities even though may provide income to the individuals involved, but add very little value to the society and the national economy (Fambon, 2006).
- c) Farrell et al (2000) and Thomas (1992) have defined the sector in two approaches: “the definitional and behavioral”.

According to Farrell, the definitional approach, “is an economic activity unrecorded in the official statistics such as the gross domestic product and/or the national income account” while the behavioral approach, sees the informal sector on the basis of “whether or not activity complies with the established judicial, regulatory and institutional framework”. For Thomas, the definitional approach is used to estimate the size and the economic value of the informal sector, and the behavioral approach is used to explain the causes of the informal sector. In broad terms, he refers to the sector as all productive activities, which are not included in the national income accounts of the country (Thomas, 1992).

Amin (2002, p.9), also stress that defining the sector depends largely on country by country and went ahead to come out with two approaches in which the informal sector can be defined, his approaches are 1) the Enterprise or 2) the status of labour.

Informal activities in the urban and rural sectors are very different, so there is a clear need to examine them separately (Adu-Amankwah, 1999, FES, 2012).

The rural informal sector is basically agriculture activities, ranging from small farm units, peasant or subsistence in nature, fishing and fish processes to rural agro-based processing. Agriculture (Both rural and Urban) employs about 54% of the total labour force and 63% of all self-employment non-agriculture work in Ghana. The actors in the informal agriculture sector are mostly illiterates or semi-illiterate, thus, they have not gone through any formal education or training. They generally depend on apprenticeship for their skills as well as family labour (Baah, 2006). The rural informal sector have less income, less organized and low productivity, and the urban informal sector have more potential to formalization and to increase their tax revenue.

On the other hand, the urban informal sector, the main subject of our work, is characterized by its heterogeneity. The sector's activities are grouped into small, medium and micro scale businesses in the areas of trading, transportation, construction, food preparation, dress making, footwear making, distilleries, Services, Manufacturing etc. According to Barwa (1995), male dominance in the areas of manufacturing, such as metal fabrication, footwear making is more than their female counterpart who dominates in the areas of Service sector such as food processing, trading and dress making.

According to the GSS, 2008, 80% of the informal sector work is dominated by three sectors, agriculture/fishery workers (55.1%), manufacturing/craft workers (13.4%) and the service/sales workers (13%). As it has been established earlier, agriculture is predominantly rural occupation, however many urban informal activities are dominated by service/sales work, such as, wholesale and retail, vehicle repairs.

In this text, the focused is on the urban informality, we consider the urban informal sector to include enterprises that are not legally registered, regulated, protected and majority of whom are self-employed without employees (own account businesses) and self-employment with employees, they have ease of entry and exit as well as a very high competitive environment and they generally engage in transactions on cash bases which makes it difficult for authorities to monitor their real income. Many of the operatives in the sector do not have permanent premises for their businesses; they operate in areas they can be seen in the general public. Many of them also operate from their residences, with some under sheds and structures. They are also puts under the threat of the local authorities to eject them from the public spaces (Baah, 2006 and Osei-Boateng, 2011).

In 2010, out of the total informal labour force of 8,364,649 (86.2%), 51% were from the urban area and 48.8% in the rural area. From the table 4 below, informal sector activity is high in the rural area (92.7% of the labour force) as compared to the urban area (66.2%). Non-agriculture employment is higher in the urban areas (47.4%) of the country than the rural areas (17.7%). According to Baah (2006, p.12), Self-employment in the non-agricultural activities account for 28% of total labour force and 37% of all informal sector workforce in the country, with women accounting for 57% of all informal sector activities.

According to Amin (2002, p.11), estimating the size of the sector remains problematic, thus most countries are not able to conduct comprehensive survey on the sector leaving out a lot of areas that are important to the sector. In Ghana, the size of the informal sector is estimated to be 86.2% of the total labour force, according to the Population and Housing Census (PHC) conducted by the GSS in 2010 (GSS, 2013). The sector is made up of self-employed with employee, self-employed without employees, contributing family workers, apprenticeships, as well as domestic workers (GSS, 2013, p.266). Although there are no data to prove the size of the urban informal sector in the past, it has been in existence before the SAP, by considering the survey conducted by Keith Hart in 1973 on the urban informal entrepreneurs in Ghana however, the current data show that the introduction of the SAP worsened the situation with it numerous changes in the labour market. The largest is the self-employed without employees, which are small/medium scale enterprises in nature.

The informal sector of Ghana lack proper linkage with the formal sector. Most of the products of the sector are sold directly to the final consumers. This does not encourage growth and formalization of the sector. There should be a mechanism that will require the formal sector to patronize the products of the informal sector. The public sector can design laws that will ensure that the informal sector becomes the first point of call for any goods or service required. A proper linkage of the two sectors is very important, as this can be a vehicle for the transmission of skills, resources and market for the benefit of both sectors. The situation where, policies and regulation in the labour market are designed to the advantage of the formally registered firms is not encouraging proper and coherent linkage of the two sectors. Most of the informal sector enterprises provide raw materials or supply finished goods to the formal firms either directly or through other informal intermediate firms. Like the structuralist school of thought that believe that the formal and the informal

sector economies are intrinsically linked, and that to ensure increase competitiveness, capitalist firms in the formal economy are seen to reduce their input costs, which include the labour costs, by promoting informal production and employment relations with subordinated economic units and workers. Chen, 2005, acknowledge that to understand the linkage between the formal and the informal economies it is important to consider the nature of the production system through which they are linked. I believe there is also the need for government to step in to invest in the economy in areas that will require the use of the goods and services of the informal sector, because the reliance on the private formal has failed to offer the needed linkage to promote the growth agenda of the informal sector.

The average size of employment is four, however, the number vary on the type of activities, for instance those in restaurants will require more hands than those in transport business (Baah, 2006). The tendency of informal activities to grow is so great that even workers with good educational levels get their jobs from this sector. Currently an estimated number of 250,000 fresh graduates enter the labour market annually; yet, the formal sector absorbs only 2% of this number leaving the rest either in unemployment or in the informal sector (Ulandssekretariatet, 2013).

Table 4: Employment Data of Informal Sector, Rural and Urban

CATEGORY	ABSOLUTE NUMBERS	PERCENTAGE SHARE
Formal Sector	1,413,596	13.8
Informal sector	8,829,851	86.2
Total	10,243,447	100.0
Urban Labour Force	5,125,635	50.04
Rural Labour Force	5,117,841	49.96
Total	10,243,447	100.0
Rural informal Workers	4,744,239	92.7

Urban Informal Workers	3,393,170	66.2
Total	8,137,409	
Rural Non-Agriculture workers (IS)	870,483	17.7
Urban Non- Agriculture Workers (IS)	2,395,617	47.4
TOTAL	3,266,100	

Source: GLSS V and the National Analytical Report, 2013 by GSS. The 2010 PHC report did not give the breakdown of rural and urban informal labour force, so the percentage figures were picked from the GLSS report which was based on 2005/2006 survey, page 36, table 4.4.

Table 5: Percentage Distribution of Employed Persons Aged 15 years and Older by Employment Sector, 200 and 2010.

SECTOR	2000	2010
Public	6.4	6.2
Private Formal	8.5	6.8
Private Informal	83.9	86.2
Semi-Public or		
Parasternal	0.8	0.3
NGOs	0	0.5
Others	0.4	0
	100	100
Total Number	7,428,374	10,243,447

Source: Ghana Statistical Service, 2013

Majority of informal sector entrepreneurs are self-employed without employees, they accounted for 68.2% in 2000 and 60.1% in 2010 of the labour force. Self-employed with employees are mostly found in the restaurants, woodworking (furniture), metal fabrication, construction and commerce (wholesale and retail). The sector's employment ranges from retail and restaurants 50%, manufacturing 37%, services 10% to transport 3% (Yankson 1992, Barwa, 1995). This category account for 5.2% in 2000 and 4.9% in 2010 (See the table 6 below).

The table below shows that a high percentage of the active population is in ‘Self Employment without Employees’. Self-Employed with employees account for only about 5%, meanwhile, they are mostly private informal jobs with challenges of job insecurity and low incomes influenced by local customs and traditions of employment devoid of employment and employment relationships as in the case of formal employment where employment contracts tend to be subjected to some measure of legislative control making it extremely difficult to provide them with any form of social and legal protection. High numbers of the self-employed category are subsistence farmers in husbandry, forestry and fishing. Majority of them can also be seen at the major cities in Ghana mainly Accra (the capital) engaging in one economic activity or the other just for survival. It can be concluded that employees in this category are just occupied by this form of employment in spite of the fact that most of them earn below the national minimum wage. Ayee, 2007 in his paper “*Building Tax Compliance through Reciprocity with Government*” has provided a lot of informal organizations and associations⁸, (Pages 3 & 4). These groupings represent the majority of the informal sector activities in Ghana.

Table 6: Percentage Distribution of Employed Persons Aged 15 years and Older by Employment Status, 2000 and 2010

EMPLOYMENT STATUS	2000	2010
Employees	16.0	18.0
Self-Employed without employees	68.2	60.1
Self-Employed with employees	5.2	4.9
Casual workers	0.0	2.0
Contributing family work	6.7	11.7
Apprentice	2.8	2.7
Domestic Employees	0.7	0.6
Others	0.5	0.2
Total	100	100
Total Number	7,428,374	10,243,476

Source: Ghana Statistical Service, 2013

⁸ Some of the informal groups are: Ghana Private Road Transport Union, Ghana Cooperative Transport Society, Progressive Transport Owners Association, Ghana National Chemical Sellers Association, Ghana National Tailors and Dressmakers Association, Musician Union of Ghana, Phonogram Producers Association, Ghana Tape Recorders Association, National Drinking Bar Operators Association, National Garage Owners Association

According to a recent data, about 80% of all manufacturing employments and 90% of employment in trade and commerce is provided by the informal sector, with about 56% in the service activities (FES, Ghana, 2011). Majority of the men in the informal sector are into the services and the manufacturing activities, whiles, the women are mostly into trading and commerce activities (Ibid, 2011). The labour Act in Ghana has it that employment relations are formalized by signing of a written contract between employers and employees. This provision is not complied by many private businesses both formal and informal with the latter been the worst affected. Section 12 of the Labour Act states that “the employment of a worker by employer for a period of six months or more or for a number of working days equivalent to six months or more within a year shall be secured by a written contract of employment”.

The compliance of this provision is not enforced by the authorities responsible. In Ghana, enforcement of the labour law is generally weak and the fact that the informal sector is not regulated makes it very difficult for any action to be taken against those employers (Osei-Boateng, 2011). The fear of a worker losing his/her job also prevents them from reporting to the authorities, making them more vulnerable to their employers. The informal worker has but very little chance of demanding his/her rights in an employment relation. The trade union has a greater responsibility to ensure that the informal sector workers are organized in order for them to enjoy their rights as workers. The enforcement of the labour Act to cover all workers irrespective of the sector need to be taken seriously, if there can ever be an end to this numerous inhuman treatments informal workers go through as well as ensuring that the minimum wage policy is implemented to cover these vulnerable workers. These are aspects that also contribute to the expansion of informal employment in Ghana.

Ghana’s informal sector as it has been identified earlier is made up of many activities mostly concentrated in the urban cities in the country, mainly the domestic workers and the street vendors sectors.⁹ One domestic worker is said to be in every household with larger households having more (LAWA-Ghana, 2003, Osei-Boateng,

⁹ The hidden nature of the domestic work in Ghana makes it difficult to obtain any statistical data on its activities. They are generally carried out in private homes, with very few in offices. The labour Act (Act 651, 2003) section 175, has defined domestic worker as “a person who is not a member of the family of a person who employs him/her as house-help”.

2011). In Ghana, the practice of using poor family relations as unpaid domestic workers is also common which normally end up seeing the use of under-age as domestic workers (Tsikata, 2009). These workers are usually from poor or deprived background and have to survive no matter the circumstances they find themselves. Activities of domestic workers range from house-helpers, gardeners, private security workers, cleaners, laundry men/women, drivers, cooks to nannies (Osei-Boateng, 2011).

When it comes to employment of domestic workers, they are normally done through friends and relatives, so, there is no legal contract of employment between the employer and the worker, agreement is mostly verbal. Although in Ghana, formal contract are supposed to be sign between employer and employee after six month of regular engagement in a year, same cannot be said for the informal sector in general and domestic workers in particular. In some urban centers there are recruitment companies and agents who recruit domestic workers as intermediaries, these companies usually sign the contract with the employer on behalf of the worker. The companies then ensure that all disputes are resolved. The agents on the other hand, only ensures that the worker get the work, takes his commission, any contract is between the worker and the employer, he does not perform any mediation function again (Osei-Boateng, 2011).The lack of written contracts in the informal sector and especially the domestic workers is the result of “unfair termination of employment relations by employers in the sector and some domestic workers also leave their employment at will without notice” (Ibid, p.9).

In terms of wages, the domestic workers like most informal sector workers, earn below the national monthly minimum wage in most households in Ghana, there is no separate law that fight for the right of domestic workers as in the case of Brazil. According to Osei-Boateng, in 2010, domestic workers in the capital city of Ghana (ACCRA), received monthly wages between GH80 (US\$57.00) and GH 100.00 (US\$71.00). Although these payments were above the minimum wage at the time, they were still low, especially dependent individuals.

In Ghana, street vendors mostly are found in the urban cities especially the major capital cities. Like the domestic workers, there is no statistical data or information from the Ghana statistical service on the activities of the street vendors as well. A study on the activities of these street vendors conducted by Mittulah and cited by Osei-Boateng however, reveals that majority of these people are women, including widows, who have to

put food on the table of her family. Their male counterpart also join street trading at a very young ages with the hope to leave when they get good jobs (Mittulah, 2003 and Osei-Boateng, 2011).

Education attainment is also very low among street vendors. 52% of street food vendors in Accra had basic education as the maximum education level and 36percent had no education (Obeng-Asiedu, 2000, Osei-Boateng, 2011). The major driven force of street vending like most informal activity is poverty. “As many as 92.5percent, of street vendors in the capital city (Accra) were found to be migrants from other regions in the country to seek better standard of living” (Osei-Boateng, 2011, p.7). Most of these people come with the hope of leaving with their relatives to better their lives, but they end up in the street to fend for themselves.

Unlike domestic workers and other workers within the informal sector, street vendors are mostly self-employed, they control their own profit from the sales they make, although these incomes can be irregular, they are able to manage it.

1.3 Life Condition of Workers in the Urban Informal Sector

Informal sector employees in Ghana do not have any social protection, many of them are not considered in the decision making process, not even the once that affect their work, such as, their wages, health and safety at the work place. Access to benefits such as, sick leave with pay, annual leave with pay, pension scheme are not guaranteed at all as well as lack of income and job security (Osei-Boateng, 2011). In Ghana, there is a pension scheme that mandates employers and employees to contribute into a fund that gives guarantee to workers on retirement. Many informal workers do not enjoy these facilities because of lack of written contract. However, the scheme allows individuals within the informal sector to make their own contributions with a defined benefit at the end of their working life (SSNIT, 2012). This arrangement is for both self-employed persons and workers. The special scheme allows interested informal sector individuals to make contribution at their own convenience, daily, weekly or seasonal basis. One can have some sort of relief in the fact that if employers are not contributing to their future; they have the opportunity to do so by themselves. The government has also established some social protection programs for the citizens which operatives in the informal sector can also take advantage of them to support their livelihood. Some of the schemes are: The National

Health Insurance Scheme, the Capitation Grant to basic school children which guarantees free basic education for all school going age, free school feeding program, the free school uniforms and the supply of exercise books to basic schools as well as the cash transfers for the very poor households known as the Livelihood Empowerment Against Poverty (LEAP) (FES, 2011, P.4-10).

Majority of the informal people are not highly educated, some researchers put it at about 36.1% (Ayee, 1977) to 50% (Yankson, 1992), these are those whose education is below the secondary school level. Currently, in Ghana, education attainment in the economic active population as reported by the GSS are that 33% have never been to school, 47.8% have obtained basic education whiles, only 19.2% have secondary education and higher. Apprenticeship also is important in the informal sector - GSS put the numbers at 2.8% and 2.7% for 2000 and 2010 respectively -, as skills and knowledge is transferred to others. This was higher in the 1990s, about 54% (Yankson, 1992). The levels of literacy also have direct relationship with the level of informality in a country. It is obvious that, with a low formal labor supply and a great labor surplus population in the urban areas, people with low education cannot be attracted by the formal sector. Employers are looking for persons with high skills to work with, by this those with very low education find themselves in the informal sector to make a living or survive. According to Baah, 2006, “countries where the share of formal economy is large, their literacy rates are also high”, which then means that the reverse is also true. There is a positive correlation between poverty, underemployment, informal sector and lack of public policies.

But it is important to emphasize that there is not necessarily a causal relationship between low education level and informal employment. A greater supply of jobs in medium and large companies and the public sector, due to possible higher levels of development and industrialization and higher rate of economic growth can increase the rate of formalization, by employing workers in the formal sector who currently are not hired because there is no demand and not because they have a low level of education and qualification. Even in more advanced and developed countries in this current pattern of capitalist development, sectors are compatible with workforce of low-skilled occupations because they are repetitive jobs such as assembly lines, construction, cleaning etc. On the other hand, the increase in development and the pace of industrialization and economic growth are aspects that contribute to the rise in per capita income and tax revenues,

allowing greater investment in education, training and professional qualification. Thus, the correlation reported by Baah (2006) expressed over the relationship between low level of development, low per capita income, low investment in education at the same time hinder higher education spending and limit the expansion of formal employment, since capitalist sectors that are typically more organized, with highest levels of productivity and able to offer formal jobs have low share of the total employed population.

On the other hand, workers in the informal sector face appalling living conditions related to the lack of urban and social infrastructure. Ghana is generally fighting to cube its sanitation problem, especially in the urban areas. Health of Ghanaians in general and the operatives in the informal sector in particular poses great danger. Poor public and environmental health, in both the residential and market areas where informal sector workers operate is a major urban problem in Ghana and are risk to the health of many informal workers (Apt and Amankrah, 2004; King and Oppong, 2003; Kwankye et al, 2007, Osei-Boateng). Heaps of garbage remains the common sight on the streets of the major cities even as vendors do brisk business. Many workers in the informal sector are either ignorant about hazardous practices or substances or simply cannot afford protective gadgets because they are expensive. Some work in environment with very high dust or noise levels, under the scorching sun or extremely high or cold temperatures. Some are exposed to dangerous chemicals, vibration and excessive lighting. They are thus exposed to all forms of diseases such as typhoid, malaria, and other forms of occupational diseases. This sicknesses if not handled as early as possible can cause death to this informal workers.

1.4 Conclusion

The much talked about economic growth has not created enough jobs for the people of Ghana. Unfortunately, these gains have not also reflected in the expansion of formal sector or in improving the lives of its people. The question is what is economic growth without improvements in the livelihood of the citizenry? Almost all the productive sectors of the economy witnessed growth in recent years led by the service sector, yet, there are still growing informality, which shows that the growth of the economy is not linked to job creation that has the potential of reducing poverty, reducing informality as well as reduction in the high growth of rural-urban migration.

The country over the years has been dependent on import oriented policies, this I believe need to be reversed. Ghana exports its products to the international market in it raw state, no value added, this call for government to embark on public investment policies that can establish industries to add value to our products before exporting them. By this more job opportunities can be created to bring down unemployment and informality. One important area is the Agricultural sector that has not receive attention in the area of technology and mechanization, the country still rely heavily on rainfall for cultivation, no irrigation programs for farmers to improve their methods of farming, no better road infrastructure from farming areas to market centers. This has brought a lot of hardship to the rural areas whose major occupation is agriculture, contributing to the issues of poverty and migration to the cities to search for decent jobs, but end up in the informal sector for survival. Lack of rural development, infrastructural deficit and low productivity in the rural areas has resulted in the high level of migration to the urban areas. The government and policy makers need to address these issues to encourage reduction in the high urban informality in the country.

Informal sector as we can see from the above information stands at 86.2%, of the labour force in the country which has the tendency of retiring the development that is expected. The lack of formal job opportunities in the country and especially in the urban areas has resulted in the country's huge informality. To address this situation, government and policy makers should put in more public investment initiatives aiming at creating jobs by moving the country to the era of industrialization and also encourage more of the informal enterprises that have the potential of formalizing to do so. However, the issue of formalization has been dealt with in the second chapter.

The government and policy makers need to look at how the informal sector can be included in the national account of the country through strategies for formalization and tax payment. In spite of the informal sector's contribution to the Ghanaian economy, most of the informal sector workers live in a very deplorable condition such as housing, health, education and sanitation. In order for the informal sector to contribute meaningfully to the nation in the area of taxation, government should implement public policies to improve the conditions within which this entrepreneurs and workers find themselves. Again, public investment in the area of building more schools, health facilities, roads etc. will help to

create job opportunities for the informal workers that can encourage them to pay more income taxes.

CHAPTER 2: SMALL AND MICRO ENTERPRISES, FORMALIZATION AND INTERNATIONAL EXPERIENCES

The focus of the chapter two is to identify the structure and the dynamics of the Small and Micro Scale Enterprises (SMEs) in Ghana and government policies to support them. The chapter will further discuss the formalization process of businesses in Ghana; some international experiences with focus on Brazil, the chapter will end with an Indian positive impact of a tax reform for small businesses.

2.1: Structure and Dynamics of the SMES in Ghana and Government Policies

SMEs in most developing countries accounts for a greater share of employments. It has also been accepted by many economies that SMEs are important pillars of economic growth and development because they encourage entrepreneurship, generate employments and reduce poverty.

But in capitalist economies, industrialization and development process depends heavily on the ability to accumulate capital, finance and technological development, centralization of financial capital, and the large-scale production, range of domestic and international markets, which are promoted mainly by large companies. Thus, rhythm, dynamic and diverse conditions that define the performance space of micro and small enterprises are determined by the dynamics of big businesses. The expansion of more modern and organized micro and small businesses, therefore, depends on their links with the large and medium enterprise - national and international - generally showing a relationship of subordination: as a subcontractor; producer of raw materials; supplier of parts, parts and components; service provider; distributors of the products produced by large companies; dependent on the dynamics of income and employment created by medium and large scale enterprises to expand their markets and sales of products and services to household (Santos, 2013).

Therefore, to support small businesses, it is necessary that the country has a dynamic of growth driven by medium and large company, with the government supporting the productive, technological, financial (credit) development, research, exports of large and medium-sized enterprise as a form of open space, expand markets for micro and small enterprises (Santos 2013). Changes in these directions can help to increase exports at global scale and so on, its means that it is so much important that the developmental

policies of the country should create conditions to promote national medium and big enterprises who can bring about industrialization. At the same time, public policies need to support micro and small businesses so that they reduce their organizational and competitive disadvantages: reducing bureaucracy; developed support for the qualification of entrepreneurs and managers programs; favored offering online credits, low interest and solving the problems associated with collateral requirements; offering a favored and easy to perform tax regime; stimulating exports and organizational and technological development; facilitating the access of SMEs to government procurement; among other important policies that are clearly seen in many countries, including developing and average per capita income countries, such as Brazil (Santos 2013).

In order to discuss the various policies that government has put in place to help the SMEs, there is the need to actually understand its characteristics and the structure in the Ghanaian context. The following is the detailed discussion of SMEs.

The SMEs in Ghana is defined by the National Board for Small Scale Industries as, enterprises that employs not more than 29 workers, with investment in plant and machinery (excluding land and Buildings) not exceeding the equivalent of US\$100,000.

The Venture Capital Trust Fund Act (Act 680, 2004) in section 28 has also defined the SMEs as an industry , project, undertaking or economic activity which employs not more than 100 persons and whose total asset base, excluding land and Buildings does not exceed the cedi equivalent of US\$1million in value. Another important sector in the Ghanaian economy is the Ghana Statistical Service, which has also defined the SMEs as firms which employs between 5 and 29 employees and with fixed assets not exceeding US\$100,000 as small scale and those employing between 30 and 99 employees as medium scale.

From the above definition of the sector, it shows that there are two ways in which the SMEs can be identified, either by the number of employees or the total value of the firms fixed assets. Since there can be challenges regarding the use of the fixed asset values in the area of uniform valuation, Ghana in practice uses the number of employees to define and identify its SMEs (Boon, 1989).

In Ghana, SMEs are heterogeneous in nature; they operate from small workshops making furniture, metal fabrications and dress making to medium sized manufacturing of machinery as well as service providers in restaurants, consultancy and computer or ICT

firms. Some enterprises within the SMEs are operated for survival of families and so does not poses growth potentials whiles some are also highly growth oriented in their operations.

The SMEs can also be considered as urban or rural enterprises, the urban enterprises can further be subdivided into organized and unorganized enterprises. The organized enterprises tends to have employees with a registered office and mostly solely owned by an individual (self-employed) with small employees, whiles the unorganized enterprises are mostly made up of artisans who work in open spaces, operate in temporal structures or at the residences of the owners and also employ very small or no salaried workers. They mostly use family members or apprentices in their work. The rural enterprises on the other hand, are mainly family groups, very small and operate mainly for survival, they are engaged in individual artisans, women in food processing, soap making and detergents, fabrics, clothing (Batik tie and dye), tailoring textile and leather works, blacksmiths, timber and small scale mining etc. (Kayanula and Quartey, 2000). Majority of SME entrepreneurs and workers have very low education background and other necessary training that are very important in their business. Because of the self-employment nature of the sector, the concept of separation in accounting does not hold, many uses their personal account as business account, which possess several problems for them.

The contribution of the SMEs to the Ghanaian economy cannot be overlooked; many governments' programmes have regarded the SMEs as the engine of growth of the economy, seeing the sector as possessing Ghana's transformation key (Ayimah-Ackah, 2006). It is for this reason that the government must assist the sector to grow by implementing policies that seeks to concentrate on growing the sector to take advantage of the potentials they are made off.

SMEs in Ghana are estimated to account for about 93%t of all registered businesses in the country, playing very important role by offering employment opportunities, opening of new businesses, enhancing entrepreneurship and fostering creativity among many other things. They are said to constitute about 85% of all manufacturing employments in the country and also contribute 70% of GDP.¹⁰ In terms of developments, the SME sector is recognized as the engine through which the growth objectives of many developing countries rest (Kayanula and Quartey, 2000). They provide the potential source of

¹⁰ This was contained in an article published on www.ghanaweb.com/GhanaHomePage/NewsArchive/artikel.php?ID=246015 (accessed on 26/05/14).

employment and income for many people. This sector apart from job creation, many of them also pay taxes, brings innovations as well as leading the global trade of many economies including Ghana.

According to the 2003 National Industrial Census, SMEs in Ghana constitute the greater percent of all businesses (96%), out of total firm units of 26,493. The Medium and Large firms share the rest by 2.9% and 1.1% respectively. In terms of employment generation, SMEs employs 47.6% of all employees, in the country (see table 7 below)

Table 7: Employment Distribution of MSMEs in Ghana, 2003.

Firm Size	Total Units		Total Employees		Average No. Workers/ Unit
	NO.	%	No.	%	
Micro	14,438	54.5	36,031	13.1	2
Small	10,990	41.5	94,928	34.5	9
Medium	762	2.9	36,551	13.3	48
Large	303	1.1	107,988	39.2	356
Total	26,493	100	275,498	100	--

Source: National Industrial Census report, and cited by the Korea Knowledge sharing program, 2003.

SMEs in Ghana face a lot of challenges in their businesses. Majority of SMEs entrepreneurs lack the requisite knowledge and training in managing their businesses (Baah, 2006). Although there are institutions providing training and advisory services for these SMEs, many have not taking advantage of the opportunities. In view of the fact that many SMEs are self-employed or owner managed businesses, they do not see the need to employ the services of qualified managers to help them due to the perceived high cost involve. Those who posses some level of skills also do not adopt the right attitude in their work, by not putting in their maximum effort towards the growth of their businesses.

Many SMEs are not able to compete with the foreign products in the Ghanaian market. The reliance of foreign products to the neglect of the local produced once has put a lot of pressure on the efficiency, prices, consumer satisfaction as well as quality of the local product. This situation has created low share of SMEs in the Ghanaian market. The trade liberalization adopted as part of the Structural Adjustment Programme has also contributed to this trend.

The growing technological advancement in the business environment has become a huge challenge for small businesses in Ghana (Duan et al, 2002). The inability of SMEs to learn and use technology in their line of business has eroded them from benefiting from it. With the changes in technology, many SMEs appear to be unfamiliar with new technologies even if they have the skill. However, those who have acquired the knowledge in ICT are reaping the benefit of their investments.

The issues of bureaucracies and high cost of starting businesses in Ghana is a major challenge for SMEs. They see the registration process as burdensome to undertake all in the name of regulations, these has impeded growth of many business and has also left some in the informal sector. The high cost and legalities in clearing goods especially raw materials from the port are also a big problem. There is the need for government to address these issues that have the possibility of retarding the growth of many SMEs. If government or policy makers will take steps to reduce the high cost associated with registration and obtaining regulation and legal assistance for small businesses in the country, it will go a long way to encourage formalization of many informal businesses.

One of the many challenges faced by SMEs in Ghana is the issue of access to credit and financing mechanisms. Access to credit in the area of working capital and raw materials is a huge problem creating a lot of bottlenecks in the growth of many small businesses. They have very limited access in obtaining credit from the capital market either locally or internationally, largely because of the perception of high risk in the SMEs business. Other areas have to do with management weakness, barriers to information and high cost of intermediation for small firms. One other important element in this issue of finance is the lack of adequate collateral to secure loans from the banks. Banks always demand for collateral in place of the risk that surrounds the small business operations so that they can recover their monies in case of default.

According to Cuevas et al (1993, p.24), the lack of clear title to much useable land in Ghana, has posse limited amount of real property that can be put up as collateral. Since many of the lands in Ghana are stool or family lands, usage of it as collateral for advance from financial institutions is restricted. Delays by authorities in finalizing mortgages, where titles are available with regards to regulations also impede access to loans. This situations only leave the entrepreneur to rely on family, friends or to the informal financial markets that offer very expensive advances in terms of interest rate.

The lack of expansion by many private sector firms in Ghana is mainly attributable to this challenge of finance and access to credit. It is for this reason that the government need to come to their aid to help small businesses to raise the necessary funding for anticipated expansion or growth.

In the quest for the support of SMEs in Ghana, the government in 1981 passed the law to establish a Board to look at the promotion of this sector in its expansion and growth potentials.¹¹ The need for greater contribution to employment creation and development of the economy was identified in the Ghanaian MSMEs at the time and it's still considered important. The Act 434 (Act 1981) became operationalized in 1985 with the establishment of National Board for Small Scale Industries as the apex body to coordinate the activities of the MSMEs in the country as has been said earlier. The coming into being of the NBSSI merged there then, Ghanaian Enterprises Development Commission (GEDC) and the Cottage Industries Division of the Department of Rural Housing and Cottage Industries, this merges was to have a single body responsible for the development of MSMEs in the country.

The NBSSI was mandated to look at two broad needs of the sector, the Financial and the Non-financial needs. The Financial services included extending credit through its loan schemes to entrepreneurs for both working capital and the acquisition of fixed assets. The interest rates of these loans were to be lower than that of the open market (Banks) with flexible repayment periods of monthly installments. Due to the fact that small-scale entrepreneurs do not have collateral as security for loans from the financial market, accessing the loans from the board only requires a personal guarantee.

¹¹ All information about the operations of the MSMEs can be access from the web page of the NBSSI <http://www.nbssi.org/AboutUs.aspx?PageId=16>

The board functions on the following areas to help the development of MSMEs in Ghana:

➤ “Facilitation of access to enabling environment through the provision of relevant market information, providing explanation on government policies and procedures and help the entrepreneur fulfill all regulatory requirements, information on incentives and investment opportunities available to the entrepreneurs. Last but not the least in this category is to assist entrepreneurs to exhibit the products at both local and international fairs by acquiring space for them”. This will help to strengthen the information that they need to know in order to make the right choices regarding their growth and expansion.

➤ “Facilitating access to credit through the provision of advice and direction to entrepreneurs, assisting entrepreneurs to locate sources of funding and working with them on their applications. Another way is helping the entrepreneurs to streamline their accounting and business records and ensuring credit delivery and recovery”. Access to credit is a very major need of the MSMEs; this will enable them to expand their business because they do not have a very high capital outlay to operate without credit.

➤ “Training and counseling, training of entrepreneurs in the sector is very important, the board provide training in the area of: management development skills, marketing practices, information on local and foreign markets, choice of equipment, business plan preparation, assist in feasibility studies, problem solving techniques and help entrepreneurs to identify their strength and weakness in their field of business”. Due to the low level of education by most of the entrepreneurs, these trainings are designed to equip them to function properly and also make them ready to compete with the outside world.

➤ “Support for business associations, in Ghana there are many business owners who come together to form associations to help assist each other. The board has programs to support these associations to achieve their aims in the areas of: promoting and strengthen their business, offer training to their executives and strengthen their operational capabilities as well as helping the associations to determine their goals and objectives”. In Ghana the phenomenon of groups and associations are very common, so reaching them will help the board to cover a large number of people at a time.

The board also has specific programs for the rural dwellers by name the Rural Enterprises Project. The NBSSI through its district offices in the rural areas offer assistance to enterprises in these areas by: given entrepreneurs literacy and numeracy training,

business orientation seminars, community based training to impart basic level skills in simple activities like soap making, mushroom growing, etc. Another area is assisting in small business management training and counseling. Finally in an attempt to link rural enterprise to their urban counterpart, the board offers them marketing support that will equip them to compete favorably in any market they find themselves.

The board has revived its credit scheme aiming at supporting SMEs who have registered with the Registrar General's Department (RGD), Credit Unions and the NBSSI itself with an amount of 10 million Ghana Cedis from the Export Trading, Agriculture and Industrial Development Fund (EDAIF). The support is also to encourage agro-processing enterprises that have export potentials.

2.2 Formalizing the Informal Sector and SMEs

The issue of formalization is always at the heart of discussions of the informal sector, which has been very difficult to achieve by many developing countries. Chen, M.A. (2007), has put it that it is not clear what is meant by "formalization", thus in order to address the issue, there is the need for clearer understanding of what is formalization.

Nelson and De Bruijn (2005, p.579), has defined formalization to mean "graduating from the informal sector to the formal sector, either directly or via semi-formal status", indeed, not all informal enterprises can be graduated into the formal but, those with the potential and the capacity for growth.

Some policymakers in the world over views the subject of formalization as a means of informal sector enterprises or entrepreneurs, getting or obtaining license, registering their businesses and paying taxes. But the question is asked about the benefit the businesses will obtain when formalized. There is a comprehensive approach to the issue of formalizing the informal sector which affects both the informal enterprises and the informal jobs (WIEGO, 2012).¹²

¹² It must be noted that the focus of this thesis is on the informal enterprises which operate as a modern capitalist, because this section of operatives makes profits which needs to be assessed for taxes to be paid.

Box 1: Formalization of the Informal Economy: A comprehensive Approach

1. Formalization of Informal Enterprises

a. Registration and taxation:

- simplified registration procedures
- progressive registration fees

b. Appropriate legal and regulatory frameworks, including:

- enforceable commercial contracts
- private property right
- use of public space
- occupational health and safety regulations

c. Benefits of operating formally:

- access to finance and market information
- access to public infrastructure and services
- enforceable commercial contracts
- limited liability
- clear bankruptcy and default rules
- access to government subsidies and incentives, like procurement bids and export promotion packages
- membership in formal business associations
- access to a formal system of social security.

2) Formalization of Informal Jobs

I. Legal recognition and protection as workers

II. Rights and benefits of being formally employed:

- Freedom from discrimination, -minimum wage
- occupational health and safety measures
- employer contributions to health and pensions
- right to organize and bargain collectively
- membership in formal trade unions

Source: WIEGO working Paper No. 1, 2012

Every firm or business would like to operate formally and not be classified as informal which connote something of less value. The issues as I posed earlier is that what benefit is derived when moving from informal business or firm to formal? I however, agree to the fact that formalization has different dimensions beyond just registering and paying taxes (WIEGO, 2012). Box (1) above has outlined the benefits informal sector enterprises seek in the area of receiving legal and social protection enjoyed by the formal firms and formal workers. The various tax holidays and tax incentive packages¹³ being enjoyed by the formal firms or businesses can be a very important encouragement for enterprises operating informally to think of moves towards formal operations. The other issue is allowing them to organize and to have representative voice in rule-setting and policy making processes and more.

In fact, these dissertation agree to those who have come out to state that formalization is not a one-step process, but rather an on-going process of extending benefits of formalization incrementally to the informal sector, this should be greatly be recognized by policy-makers on various dimensions.

According to, Wedderburn et. al, (p.11), in a paper captioned “*The informal economy in Jamaica: Is it feasible to tax this sector?*” “The following outlined points are ways of ensuring that the informal sector in Jamaica operates formally in order to contribute significantly to the official recorded economic growth. The paper underscores the fact that:

- 1) “Business registrations be simplified
- 2) Improvement of social programs
- 3) Equity in the tax system
- 4) Confidence in the tax administration”

Would encourage moves towards formalization. In this sense, is also important to add that simplifying the tax system by making it easy for businesses and individuals to access can be more important to encourage formalization than reduction in the tax. The example of the Brazilian experience below can be considered.

¹³ Sections 10 and 11 of the internal revenue act, Act 592 as amended has provided a number of these exemptions and industrial concessions for business but can only be enjoyed if you operate formally.

To further appreciate the need for a greater reduction in informal activities in most developing countries, Uganda in a research has alluded to the fact that when informal sector is formalized, the country's chances of expanding employment opportunities, increase government tax revenue as well as raising income of participant in the economy is very high (Muwonge et.al,2007 p.28). Formalization of informal enterprises tend to be cost to the entrepreneurs, they see the fact that they have to be licensed, register their accounts and also to pay taxes (or social contribution) as not a benefit but a cost (Chen, 2005).

The informal entrepreneur is interested in the benefit that is accrued to him or her for moving from informal to operating formally, they look forward to receiving such benefit as: enforceable commercial contracts; legal ownership of their place of businesses and means of production; tax breaks and incentive packages to increase their competitiveness; membership in trade associations; and statutory social protections, access to government contracts. The informal wage workers also seek converting their current employment status into formal jobs; obtain new formal jobs; have a secured employment contracts, worker benefits and social protection as the benefit of formalization (Chen, 2005). In order to ensure that formalization is achieved, the benefits should be made clear to the operatives in the informal sector by so doing the will be willing to voluntarily formalized their businesses. The bottom line is for both informal self-employed persons and informal wage workers to see a reduction in the cost or the challenge of working informal to increasing the benefit associated with operating formally.

Finally, Chen, 2005, p.90-91, makes three important conclusions to the formalization debate apart from the issues of cost reduction and increased benefit to the informal enterprises and workers. To her in as much as there are campaigns for formalization of all enterprises and workers in the sector there are also constraints that will impede the process, these constraints are; 1) 'bureaucracies would not be able to handle the volume of license applications and tax forms to be processed by the authorities,' thus, informal entrepreneurs would not be prepared to spend a lot of time waiting before they commence their businesses. 2) 'Most bureaucracies would claim they cannot afford to offer informal businesses the incentives and benefits that formal businesses receive', thus, authorities are looking at the increasing cost of benefits to formal businesses. And 3) 'there are not enough jobs to absorb the growth in employment', meaning formal job seekers are much more than available job vacancies.

In Ghana businesses are expected to first of all register with the local authorities¹⁴ to enable them obtain a license or permits to operate. The licenses are issued for specific trade or services and so the cost is lower and it's a little simpler in processing. The revenues generated from this registration is used for rural and community development. The second stage of the process is to register a unique business name with the Registrar General's Department (RGD)¹⁵ which will issue the certificate to commence business as well as the certificate of incorporation (in the case of Limited liability Company). As part of efforts to encourage formalization in the country, government has established institutions to offer technical and financial support to the informal entrepreneurs (Self-employed). Some of the institutions are:

- National Board for Small Scale Industries (NBSSI)
- National Vocational Training Institute (NVTI)
- Micro Finance and Small Loans Center (MASLOC)
- Venture Capital Fund (VCF)
- Ghana Chamber of Commerce and Industries (GCCI)

In order for these informal enterprises to access the various support and assistance available to them, they are first of all required to register with the Registrar General's Department to obtain all the necessary certificates or to obtain business operating permit from the local authorities. And also they are required to register with the Ghana Revenue Authority with the issuance of their taxpayer identification numbers, file their tax returns and ensure that they meet their tax obligation (if any). Aside the above, self-employed businesses who have registered with the revenue authority are entitled to various tax reliefs at the end of the year after filing their tax returns. The Section 39 (1) of the Internal Revenue Act, 2000, Act 592 as amended states that, "the assessable income of an individual for a year of assessment shall be reduced by the following tax reliefs". The current tax reliefs available to individuals can be observed in the table 8.

¹⁴ In Ghana these local authorities are known as the Metropolitan, Municipal and District Assemblies.

¹⁵ The RGD is the organization in charge of registration of all nature in Ghana; businesses, properties etc...

Table 8: Personal Income Tax Reliefs, 2002 and 2013

Tax Relief	Annual Rate 2002	Annual Rate 2013
Marriage	GH¢30,00	GH¢100,00
Old Age	GH¢30,00	GH¢100,00
Children Education	GH¢24 up to 3 dependents	GH¢100 up to 3 dependents
Aged Dependent	GH¢20 up to 2 dependents	GH¢ 50,00 up to 2 dependents
Marginal	GH¢120,00	GH¢1,584,00
Disability	25% of assessable income	25% of assessable income

Source: GRA Regulations

The major constraints in this registration process are the cost and the procedure involved, this situation has been confirmed by the World Bank Doing Business report for 2013¹⁶, where Ghana is ranked 64 as an economy that has not created conducive regulatory environment for doing business. In the area of starting business, Ghana is ranked 128 in 2013 from 111 in the previous report, which means the country is making reforms that are difficult for people to register and do business, this create incentive for people to operate informally. Again, from the same report, Ghana is ranked 7 out of 10 score in its procedures involved in registering business in the country, which also indicate difficult bureaucratic procedure for businesses.

Even though, various support and assistance initiatives have been provided, the difficulties the informal sector operatives go through to formalize is discouraging them to do so, hence, their continuing stay in the informal sector.

¹⁶ <http://www.doingbusiness.org/data/exploreeconomies/ghana/#starting-a-business>

2.3 The International Experience

In order to learn some lessons from what other countries have done in the area of formalization of businesses that has reduced informality, the Brazilian experience is considered below as well as that of Liberia and India.

During the Lula government, the system for encouraging small and micro businesses to formalize was further extended to a larger set of segments, with its replacement by Simples Nacional, also known as Super Simple. According to Leone (2010),

In an attempt to increase the creation of formal employment and reduce business costs the Federal government implemented the Simple (Law of Micro and Small Enterprises), approved by Law No. 9,317 of 05.12.1996 , which provides a special regime for small companies with sales of up to 36 thousand dollars a year. The single was abolished on 1st July, 2007 and replaced by the National Singles and Super simples laying down general rules on the differential tax treatment to be accorded to microenterprises and small businesses within the Union, States, Federal District and Municipalities upon single system of collection, including ancillary obligations (<http://www.portaltributario.com.br> accessed 26/06/2010).

Despite the Simple System contributing to the formalization of small businesses and their employees, their rules mainly benefit small businesses with a better degree of organization. So, to reach small businesses with lower level of organization, usually individual entrepreneurs with help from family work - with a small number of employees - the Brazilian government created in 2008, the Law of Micro Entrepreneur Individual (MEI) (Santos 2012).

In Brazil, very small businesses are formalized through registration as either Individual Micro-Entrepreneur (MEI - Microempreendedor Individual).¹⁷ MEI allows the operatives to formalize their status, equally and also allows them to obtain a National Registration of Legal Entities [CNPJ – Cadastro Nacional de Pessoa Juridical] and pension coverage. However, to become an Individual Entrepreneur, it is necessary to raise a maximum turnover of R\$60,000 per annum. By law the individual cannot participate in

¹⁷ The information on the Brazil Experience was accessed from <http://www.portaldoempreendedor.gov.br/how-to-open-business-in-brazil/types-of-companies-in-brazil>

another company as a partner, director or holder, nor have more than a single employee¹⁸. Registration of these businesses is free and it is done on the internet, also some accounting firms undertake the registration for the entrepreneurs with no cost. Registration offers the individual entrepreneur access to open a bank account, access to bank loans and invoice issuance¹⁹. Entrepreneurs in more than 400 activities can join MEI, and they can also be employed in another firm (SEBRAE, 2011). The micro businesses shall be exempt from federal taxes (Income tax, and other charges and social contribution on the payroll). One only pay a fixed monthly amount of R\$34.10 (Trade or Industry), R\$38.90 (services-related) or R\$39.90 (trade and Services), which will be allocated to social security and to ICMS (a kind of VAT) or to ISS (tax on service sector). The amount is annually updated in accordance with the minimum wage. Paying this monthly amount, the entrepreneur enjoys social security benefits including maternity-leave, sick-leave, retirement, among others.

After registration, the following charges are paid: 5% of the minimum wage as social security; R\$1.00 to the state if business activity is Commercial or industrial and R\$5.00 for the municipality if business activity is service related²⁰. Since its launch in January 2009, about four million businesses have been formalized by these new policies. The impacts of the MEI were very positive on formalization, as highlighted by Santos (2012),

... At least informal units associated with lack of social security contributions, CNPJ, permits and other forms of legal recognition and licensing ... made substantial progress with the progressive advance of the registration of entrepreneurs and self-employed in MEI. ... Participation in MEI is only possible with the hiring of at most one employee. However, not only by the possibility of formalizing employers with a single employee, but also by the fact that these perspectives opened by formalizing stimulated by MEI will take many entrepreneurs to join in future the Super simples and thus placing

18 According to Santos (2012), when fit on the Super Simple, "your employee becomes entitled to pension benefits, eg, retirement, unemployment insurance, aid for accidents or sickness, maternity leave. All other labor rights of the employee are also held for the regime of MEI.

¹⁹ Along with a wide-ranging set of benefits for entrepreneurs formalized by MEI, according to Santos (2012) this program has also "facilitated access to the banking system and differential credit, issuing invoices, participate in government procurement and bidding consortia, have formalized an employee with a yield of 1 MW or wage ', besides having a procurement employee at a lower cost (only 3% of social security contributions on wages). The registration also entitles you to receive provisional operating license for 180 days, simplified accounting procedures, participation in consortia specific for carrying out joint procurement purposes. Besides, the EI has access to a streamlined electronic system for issuing guides ever with payment values calculated by the system (Santos, 2012).

²⁰ The entire amounts stated are paid monthly and the payment is via the internet by the 20th of each month.

themselves in a situation of full potential employer, the impacts of the broad process of registration in the MEI already contributes and, over time, will further contribute to the formalization of the informal group of employers, i.e., to reduce informality not only in the universe of own account workers, but also for employers.”

Formalization has reached many businesses with fixed premises, as well as those without fixed location or category, such as street vendors: Santos (2012) shows that "quite surprisingly, the total subscribers in MEI, most IEs develop their activities in fixed establishments, that proportion reaches 56.4% for the whole country. This indicates that the MEI is serving as a way to formalize proportionally more small businesses who are already established (and probably in better condition) in less developed regions, in areas where the size of establishments, sales and the level of organization and productivity seem to be in need of further support of public policies for their formalization (SANTOS, 2011). The formalization of IEs developing activities without fixed location or property (street, door to door etc...) appears as the second most important activity in this process of formalization by MEI, reaching 21% of total EIs formalized throughout the country."

From the above description on how businesses are formalized in Brazil, it shows that, there is no cost involve and the process is also less bureaucratic with the use of internet, providing an incentive for once informal businesses to become formal as well as providing a future through the benefit of social security after one's active working age.

In Liberia, greater number of the informal sector enterprises have the desire to be formalized in order to avoid the many payment of unofficial money's they pay to authorities illegally, yet there are a lot of bottleneck to be addressed. Unlike many developing countries, where formalization of informal sector is being enforced, in Liberia governments are reluctant in enforcing the need for formalization of the sector, because it sees the sector as an employment incentive in the countries post war era. And also believe that interfering with the informal sector will derail the peaceful environment the country finds itself now.²¹ Aside the fact that the government is not enforcing the issue of

²¹ This was contained in a policy briefing by Alfred K. Tarway-Twalla (Factors Influencing Contribution of Informal Business to Private Sector Development in Liberia.

formalization, in a related survey²² the informal operatives in Liberia expressed their willingness to voluntarily formalize their businesses if the following issues are addressed:

- I. Lack of Information on how to Formalize their businesses
- II. Burdensome procedures to formalization - the informal sector operatives who have made various attempt at formalizing by registering with the authority complain of burdensome procedures as well as it been expensive for them and however, does not encourage them to complete the process.
- III. The issue of high income tax payment, high compliance cost and social contributions associated with the formal sector, that they avoid also serves as motivation for them to remain informal.

The Liberian situation is a very unique one in the sense that, this is post war economy that lost a lot of its formal working life and is now building it. Hence, the government reason for not interfering with the peace by enforcing programs on the informal sector is legitimate. According to the world Bank 2013 doing business report, the country is ranked 38 out of 185 countries in the area of starting business, also it has the highest ranking among the ECOWAS countries.

In India (Bihar), they undertook a tax reform aiming at improving tax compliance of the Micro and Small businesses through simplification of tax laws and procedures to reduce compliance issues as well as to encourage small businesses to register as taxpayers²³. According to an article on “Simplifying Tax Compliance for small firms, Improving Business Climate” the reforms has brought a lot of improvement in tax payment and has also widen the tax base with improved business climate. The following were some of the reforms undertaking:

- “Adopting of several progressive measures by the use of fixed tax rate for micro and small enterprises with no or less routine scrutiny.
- Improving online filing of tax returns for larger enterprises

²² Survey on the theme Small Business Taxation: Is this the Key to Formalization? By Richard Stern and Jan Leoprick.

²³ The reforms was initiated by the International Finance Corporation from 2009 to 2013 <http://www.ifc.org/wps/wcm/connect/1dc55500437d35118397bb869243d457/Small+and+medium+enterprises.pdf?MOD=AJPERES> (accessed on 26/05/2014).

- Simplified admission of appeals
- Faster resolutions and payment of refunds to taxpayers”

The reform project at the end of the period from 2009 to 2013 produced the following results:

- “It recorded 24% increase in the taxpayer base
- Increased the number of tax payers filing their returns online through the e-returns from 149 in 2009 to 22,000 which has brought improvement of about 93% of tax revenues collected electronically.
- Last but not the least; it has also recoded increase of registration of small tax payers to 6,800”

Finally, to the small enterprises the reforms has lessen the burden in tax compliance and the ease of doing business has also improved.

In concluding for this chapter, we can understand that although the dualism and the pluralism of markets or business are important in an economy, efforts needs to be made to reduce informality in economies with high percentage of the informal sector. Looking at the importance of Small and Micro businesses in the employment structure of the country, there is the need for government to come out with concrete polices that will help the transition of small businesses into medium and large ones that will have the potential of growth and also change the labour market structure from high informal to a more formal and job creation oriented one. Also of great importance is the need for expansion of market for small businesses that can lead to the promotion of national medium and big enterprises with the potential of bringing about the intended anticipation of industrialization. The major challenge of these SMEs is the access to credit and finance for expansion, which needs to be handled with all seriousness. This challenge has contributed to the high rate of informality in the country. Although, the NBSSI is to provide assistance to SMEs in the area of finance, the processes that this assistance is accessed are cumbersome and discouraging. Efforts needs to be made to re-organize these processes to ensure that the goals of the board is achieved to enhance the growth of SMEs in the country.

In order for Ghana to experience reduction of its high informality, policymakers must consider that formalization is a gradual process and not a one-time activity, the need

for reduction in the bureaucratic procedures and increase incentives for registering businesses (i.e. the cost and ease of registration). There is also greater need for the identification of those firms or businesses within the informal sector/economy that can be formalized, because not all businesses within the sector can be formalized, as formalization of some informal sector businesses is just not justifiable or desirable and could create greater hardships to operatives. Both informal enterprises and informal workers will look out for certain benefits especially in the areas of social protection and formal job openings before taking a decision to formalize.

The Brazilian experiences that have made a great impact with reduction in informality would have to be considered, by linking social benefits to the payment of taxes for small businesses that can result in reduced informality and increase tax revenue. Simplification of the tax structure in favour of small businesses as has been undertaken by India which has resulted in an increase in the taxpayer base and tax revenue can also be looked at seriously.

CHAPTER 3: STRUCTURE OF GHANA'S TAXATION, INFORMAL SECTOR TAXATION

In order for the state to fulfill its obligation of providing the needed funds for social programs and infrastructure development, taxation revenue is what is required. Taxation is a distributive mechanism for redistributing incomes of the rich population to the poor (Abdullah, 2008, p.12). We can agree that it's a dual responsibility of both the state and the citizens that tax is raised as enough as possible. When state's raise enough revenue from their own people, it gradually builds the capacity of achieving the fiscal social contract between them. Concentrating and collecting more taxes from the citizenry, will reduce the reliance on donor funding that comes with a lot of challenges to states, in a form of conditionality. Because governments would have to apply those donor funds to areas that the donors want, this may not be a priority of the state.

Edgar and Sandler (2005) suggest five purpose for which a nation will impose taxes on its citizens, these purposes are: a) to give government power to allocate resources, b) to enable governments to provide or support social development, c) to stabilize the economy, d) to constitute and define the market place, e) to encourage optimal economic growth. The above purposes are important but it is necessary to consider the important role of tax revenue in reducing inequality and eradication of poverty, which will mean looking at the importance of a progressive tax system.

In Ghana, the tax revenue to GDP has decline from an average of 20% between 2004 and 2007, to 17.1% in 2012, of this figure, the self-employed tax which is mainly from the informal sector is less than 5 percent (ISODEC, 2009 and BoG, 2013). It has been noted that not all informal enterprises can be formalized and pay tax, because there are operatives who are generally not capable to do so. This issue is addressed by first looking at the various segments of taxpayers and the tax payment of the informal sector.

This chapter is dedicated to look at the general tax structure and the various tax types in Ghana as well as a critical assessment of the systems available to tax the informal sector (self-employed) and their tax payment.

In 2009, the government established the GRA as part of the various reforms of the tax administration of the country. The Ghana Revenue Authority Act 2009, (Act 791) was passed in December, 2009 to give legal backing to the Authority. This reform was aimed at

bringing all the revenue agencies of Internal Revenue Service (IRS), the Valued Added Tax Service (VAT), the Custom Excise and Preventive Service (CEPS) as well as the Revenue Agencies Governing Board (RAGB) under one umbrella to offer a one stop- shop service for taxpayers.

This tax reform marks the possible end of decades of several attempt from 1986 when the Customs, Excise and Preventive Service (CEPS) and the Internal Revenue Service (IRS) was taken out of the civil service and made semi-autonomous self-accounting public sector institutions with separate boards, in the same year the National Revenue Secretariat (NRS) was also established to formulate policies, supervise and manage possible tax reforms. As a first step of reforms the Value Added Tax Service (VATS) was reintroduced in the country in 1998 after rejection of the tax and its eventual withdrawal in 1995, the VAT was to administer the various consumption taxes under legal backing of VAT Act, 1998 (Act, 546) and accompanying Regulations 1998 (LI 1646) with the aim of widening the tax net.

Again, the Revenue Agencies Governing Board (RAGB) was established in 1998, with the passage of RAGB Act, 1998 (Act 558) to abolish the individual boards of the CEPS, IRS and the VATS. In 2001 the RAGB started its work as the supervisor and the coordinator of the RAs. In order to enhance information interchange and risk profiling as part of the tax reforms of the country, the Taxpayer Identification Number (TIN) system was introduced in 2002 by the passage of Act 632. The RAGB in 2004, recommended for the establishment of the Large Taxpayers Unit (LTU) to operate on functional lines to pave way for the eventual integration of the Revenue Agencies (Ghana Revenue Authority). The RAGB saw the need to reform the tax administration further by proposing the establishment of the GRA to conform to best practice in the world.

The government of Ghana in order to follow the modern trend of tax administration which focus on functional revenue administration that leads to improved customer delivery as an alternative to the old aged tax type administration. Many countries in the world including South Africa, Tanzania, Kenya, and United Kingdom, just to mention a few have all adopted this new trend. The main reason for the establishment of the GRA includes: 1) to integrate the management of the Domestic tax and the Customs; 2) to modernize Domestic Tax and Customs operations through the review of processes and procedures; 3) to integrate IRS, VATS into Domestic Tax operations on functional lines.

The Ghana Revenue Authority has three divisions to enable it achieve its objectives.

➤ The Domestic Tax Revenue Division (DTRD) consisting of IRS and VATS which is responsible for the administration of both Direct and Indirect taxes such as, Individual income tax, Corporate tax, Capital gains tax, Gift tax, Value Added tax, Communication Service tax as well as the National Health Insurance Levy. This division is in charge of collecting taxes from the Self-Employed including the Informal Sector. There is an office responsible for small taxpayers and field operations, where policies and programs to improve the tax collection of small businesses and the informal sector enterprises emanate from. It is a very important division because of its responsibility to expand the tax net to capture many of the informal sector enterprises in the country.

➤ Custom Division which collect the taxes and perform the duties of the erstwhile Customs, Excise and Preventive Service (CEPS). Administer taxes and duties at the country's entry points.

➤ Support Services Division (SSD) which has brought together all the finance and the administration functions of the erstwhile Revenue Agencies together.

The Ghana Revenue Authority seeks to achieve the following: “reduce administration and tax compliance cost; better service delivery; improved departmental information flow; holistic approach to domestic tax and customs administration; enhance revenue mobilization”

Taxation plays a very key role in the economies of nations. It is the socio- economic bedrock of all nations. Without taxation nations cannot offer any meaningful social benefit to its citizens. Taxes are the “blood” that runs through the veins of nations. From an unpublished GRA training material, socio-economic benefit of taxation to a state and its citizens can be said to include the following.

Tax revenue is the most important source of income to any nation or government. It is taxation that helps governments to offer social services and infrastructure to its people. Without taxation as its being said earlier, the quality of health services, basic education, roads, transportation, water etc., will suffer, leading to reduction in the level of confidence the citizenry have in their nation.

Taxation also can be used as a tool for equitable distribution of the nation's income to its people. Through the institution of a progressive tax system, the rich are made to

contribute more to the “taxation fund” than the poor. By so doing the government can distribute it for the benefit of all citizens.

It is used as a tool to control inflation or deflation in a country. A spiraling inflationary situation may be curbed by increasing the incidence of taxation and thus absorbing the excess liquidity. A deflationary situation may be controlled by reducing the incidence of taxation and thereby increasing the volume of money in circulation.

Taxation may be used to foster growth of the key sectors of the economy. Under the current tax laws, for instance, in Ghana, manufacturing companies situated in the Regional capitals other than Accra and Tema enjoys a tax rebate of 25% while those located in non- regional capitals enjoy a tax rebate of 50%. The law has also made a lot of tax holidays available to those who are in the Agriculture sector ranging from 5 to 10 years, depending on the nature of farming being undertaken. Also, the Real estate Developers in Ghana enjoys a tax holiday of five years and Venture Capital firms are encouraged with a tax holiday of 5 years from paying Corporate Tax. The above measure is to expand development to other areas of the country. The growth in the key sectors may result in increased employment and improved standard of living.

Taxation is used as a tool to reduce the budget deficit and pay lesser amount of interest. An effective and efficient tax Administration may result in increase in tax revenue. This may have the effect of a reduced budgetary deficit which will lead to the reduction of government borrowing, amount of interest and increase the public spend in the social program, infrastructure, industrial and SMEs policies etc.

For efficient tax administration, the tax authority (GRA) has grouped taxpayers into:

- a) Individuals who pay taxes on their profit or gains, which are called the self-employed taxes, (entrepreneurs either registered or not);
- b) Employees pay taxes on their wages and salaries which are referred to as Pay As You Earn (PAYE);
- c) Corporate Tax is also paid by registered legal entities on their profits;
- d) Partnership is also a legal entity, but tax payment is not paid in the name of the partnership business but from the individual partner’s share of profit.

This also the way tax payments are recorded and reported statistically.

Ghana’s taxation is backed by laws enacted by parliament, although there is integration of all the revenue agencies, the individual laws are still in use for the administration and collection of tax revenue now. Internal Revenue Act, 2000 (Act 592) as amended is the law that is used to administer direct taxes in Ghana; the law has three

categories of income on which taxes are levied in Ghana. These categories are i) income from Business; ii) income from an employment; iii) income from an investment.

Section 7 of the Act defines income from business as: a) a person's income from a business,

as that person's gains or profits from any business carried on for whatever period of time by that person; b) there shall be included in ascertaining the gains or profits from a business carried on by a person amounts accruing to or derived by that person that are attributable to the business and that would be included in calculating that person's income from any investment

Thus, any individual engaged in any business venture must declare his/her income to be taxed, which includes entrepreneurs in the urban informal sector. The tax rate differs from the type of business, the category (company or self-employed) and either resident or non-resident.

Section 8 (1) of the Act defines what the law means by income from employment as "that person's gains or profits from that person's employment". Section 8, sub-section 2 from "A-F" state various gains that comes to the hands of a person in employment, yet not tax as gains or profit to that person. Sub-section 2 state that "the gains or profit from an employment of a person include any allowances or benefits paid in cash or given in kind to, or on behalf of, that person from that employment". The tax on employment is by the use of the monthly graduated rate after all additions in the form benefits in cash or kind have been made and deductions in the form of personal reliefs have also been considered. However, in the case of an employee whose monthly earning is up to the minimum wage, the rate is charge at 0% with those earning is in excess of 5% of the minimum wage, pays a flat tax of 2.5% on the excess.

Section 9, sub- sections 1&2 of the Act also define and give meaning to what the law regards as income from investment:

"i) a person's income from an investment is that person's gains or profits from any investment"; ii) "the gains or profits of a person from investment include any dividends from a non-Resident company, interest, charge, annuity, royalties, rent, natural resource payment, or other income accruing to or derived by that person from the investment other than an amount included in ascertaining that person's income from a business or employment".

Tax rate on investment incomes is different for all the categories mention in ii) above, for instance, rent tax is charge at a rate of 8% of the total rent income and dividends from non-resident companies are taxed at 10% of the total amount.

In Ghana, the following are the important taxes administered by the Ghana Revenue Authority (GRA), and these are group under two broad categories which are Domestic and Custom duties or taxes. The Domestic Taxes are directly under the Domestic Tax Revenue Division (DTRD) and the Custom Division is also in charge of the collection of the custom and excise taxes.

I) Income Taxes in Ghana

Taxes on income and property in Ghana are generally derived from personal and corporate income taxes. The personal income tax is a progressive system that covers employees, sole proprietors and partnerships. These taxes are charge on the income of individuals and companies. The incidence of the tax is on the individuals or the companies earning the income. Some of the major taxes are briefly discussed:

Corporate Tax

These are taxes paid by companies on their profit in a particular year. The tax is charged after all outgoings and expenses that are *wholly, exclusively and necessary* incurred in the production of the income are allowed to be deducted. The basis period of a company is the accounting year. However, the tax law allows companies to choose their own accounting year; the companies can only change with prior approval from the Commissioner General of the Ghana Revenue Authority. The current general rate for the company (corporate) tax is 25%. This rate is agreed on between the government and the tax authority after considering a lot of economic indicators and the performance of the economy. It does not have a single base on which the rate is determined.

Personal Income Tax

These are taxes levied on self-employed persons who are obliged to pay income tax on their profit or earnings at the end of the year after all outgoings and expenses which are *wholly, exclusively and necessary* are deducted. The basis period of the individual is the

accounting year (1st January to 31st December). Unlike the company tax, the self-employed businesses, excluding those in the informal sector are taxed using the graduated rate as in the table below.

Table 9: Annual Tax Rate for Self-Employed Persons, 2013.

	Chargeable income GH¢	Tax Rate %	Tax Charged GH¢
First	1,584.00	Free	Nil
Next	792.00	5	39.6
Next	1,104.00	10	110.40
Next	28,200.00	17.5	4,935.00
Exceeding	31,680	25	

Source: Ghana Revenue Authority

In this table, the chargeable income represents the annual income of a resident self-employed (monthly in the case of an employee) at which the tax rate is multiplied with in order to get the tax for the individual. If that person's chargeable income does not exceed GH¢1,584.00 (marginal threshold), the rate is free and therefore, no tax is paid. The more the chargeable income exceeds the marginal threshold, the higher the rate and the resultant tax to be paid. The table 10 below which is for the calculation of monthly employees' tax is the same.

Table 10: Monthly Income Tax Rate for Employees, 2013

	Chargeable income GH¢	Tax Rate %	Tax Charged GH¢
First	132.00	Free	Nil
Next	60.00	5	3.30
Next	92.00	10	9.20

Next	2,350.00	17.5	411.25
Exceeding	2,640.00	25	

Source: Ghana Revenue Authority

Pay As You Earn (PAYE)

PAYE is a method of withholding tax that employers withhold from the salaries and wages of their employees as contribution to the tax revenue of the country. These taxes are deducted using the graduated rate (Monthly). The law gives the employers on or before the 15th of the following month after the month of deduction to pay same to the GRA. The table above shows how the tax is deducted. Again as a way of lifting some of the social burdens from workers or individuals, Section 39 of the Internal Revenue Act, 2000 (Act, 592) as amended allows for the following personal upfront reliefs to be deducted from the salaries before tax is calculated. These reliefs are: Old age relief, Aged dependent relief, Child education, Marriage/Responsibility and Disability relief. The tripartite committee has also made it a point that, employees who earn the monthly minimum wage or below do not pay taxes on their wages. With this policy in place, since most of the informal sector workers earn below the minimum wage, their wages are not taxed

Other Domestic Taxes

Other taxes that are administered by the DTRD are The Value Added Tax (VAT), National Health Insurance Levy (NHIL), and Communication Service Tax (CST). The VAT is a form of consumption tax which is imposed on goods and services supplied or imported into the country. The incidence of the tax is on the consumers when they purchase goods or services rendered. Businesses are registered to collect the tax based on their turnover in the stages of value added, from the manufacturing to the retail stage. The current VAT rate is 12.5%. A special scheme of collecting the VAT known as the “VAT Flat Rate Scheme” has been designed for the traders operating in the retail sector. Retail operators are obliged to charge the VAT at a flat rate of 3% on all taxable goods (VAT, Act 564).

Levy tax is imposed on goods and services at the rate of 2.5%. This levy take the same attribute of the Value Added Tax, so in Ghana, both are collected together at a single transaction. It was introduced to cushion and help sustain the National Health Insurance scheme in the country. The tax is imposed on the use of communication services by consumers. It is collected by the communication service providers and paid to the GRA at the end of every month.

The CST was established by an act of parliament, Communication Service Tax, Act 2008 (Act, 754). Section 5 of the act mandates government to use at least 20% of the revenues generated to finance the National Youth Employment Programs (CST Act, 754). Others include: i) Vehicle income tax, ii) Tax stamp, iii) Stamp Duty, iv) Capital Gains Tax, v) Gift Tax, vi) Rent Tax and vii) Mineral Royalties.

II) Custom Duties

Excise duty is payable on all locally manufactured or produced goods, unless the goods are exempt from the duty. The duty is computed on the ex-factory prices of the goods produced. The ex-factory price of the product is the factory cost of production plus the manufacturer's profit margin. Currently excise duty is levied on alcoholic and non-alcoholic beverages as well as tobacco and petroleum products. The commissioner has the right to exempt some goods from taxed upon application from the manufactures. The duty is due and shall be paid by the manufacturer to the GRA before the goods are delivered from the factory or the warehouse. Unfortunately, there are no available figures to show the total excise duty contribution to GDP in Ghana, but according to Terpkker, 2001, excise duty increased from 12.8% in 1993 to 15% of GDP in 1995 after the restructure of the tax in the 1980s (p.3).

International trade tax includes import and export duties on both traditional and non-traditional goods. Import duties are payable on almost all import into the country except those with specific exemptions such as agricultural inputs, personal effects, industrial machinery, solar cells and panels, thermal energy and electrical generating set of 375 KVA and above, among other goods. Currently the general standard import duty is charged at the rate of 20%, but import of raw materials by manufacturing companies pay the duty at 10% of the total amount of the import (Abdullah, 2008). Export duty on the

other hand, is paid on goods exported from the country. The duty is currently levied on cocoa beans and Hydrocarbon oil, (e.g. Aviation turbo kerosene). Apart from this two goods, all other export are taxed at zero (0) percent (Ghana Revenue Authority web site).

3.1 Taxing the Informal Sector

There have been a lot of difficulties in taxing the informal sector by Tax Administrators in many developing countries. A report by Africa Tax Spotlight (ATS), it came out with three main benefits for taxing the informal sector, which are for government to raise enough revenues for the provision of more infrastructures. It will also help to advance the growth of the economy and if the informal sector operatives pay taxes, it will enhance political accountability as well as ensuring greater ways for engaging with the state. In many developing countries, taxation has been a burden on the shrinking formal sector while majority of the informal sector entrepreneurs continue to avoid the payment of income tax.

Wedderburn et al. (p.2), in a paper captioned “*The informal economy in Jamaica: Is It feasible to tax this sector*” also gave out further reasons or benefits in taxing the informal sector in Jamaica. The benefit to them are that taxing with the appropriate tax system will improve tax revenues which can pay off the nation’s debt, economic growth as well as providing domestic programs that will go a long way to improve the lives of the citizens. Taxing the informal sector will also help in revealing the size of the sector that can expose the “deeper, more pervasive issues of corruption and bribery”

The nonpayment of income tax by the informal sector undermines the linkage between citizens and the state (Green, 2013). It has been revealed that taxing the informal sector increases the moral and also increases tax compliance from other sectors of the economy (Terpker, 2003, Ayee, 2007, p.2). Torgler 2003 also gives account of the fact that “evidence from Latin America shows that tax compliance in the formal sector is high in countries with small informal sector” (Ayee, 2007, p.2). Therefore, one can strongly foresee that taxing the informal sector also have positive compliance effects on other sectors such as the formal sector, thereby improving tax collection in the country as a whole.

According to Ayee (2007), taxing the informal sector of Ghana as well as most developing countries comes with a number of reasons, enumerated as follows: “Revenue

needs, the phenomenal size and growth of informal sector, impact on tax compliance in the formal sector, State legitimacy, and demands from the informal sector as well as tax-accountability link”. However, not all informal sector businesses can be taxed.

Records available from the Bank of Ghana and the Ghana Statistical Service, reveal that the self-employed constitute the least taxpayers in the country in spite of its size. These self-employed businesses are mainly the urban informal sector operatives which constitute the largest business in Ghana. Although taxes from the informal sector (Self-employed) is very small, the size of the sector and the fact that there are some large operators within the sector makes it assuring that much tax revenue can be achieved. Ordonez (2010) was able to estimate that, if the Mexican informal sector is successfully taxed, it can lead to an increase of about 17% in total economic productivity.

The major obstacle to income tax collection from the informal sector are the size of the sector which makes it difficult to be identified for proper tax enforcement and since the sector is largely self-employed, with cash transactions, there are no proper accounting records that will help authorities to determine their actual incomes to be taxed, thus, making the informal sector worst offenders of tax evasion (Terpker, 2013). In the Minister of Finance’s address to the managements of GRA, he admitted that the informal sector continues to be the “worst offenders of tax evasion in the country” and that the tax administrators should put in place measures to curb this situation. This to me makes the issue of tax evasion by the informal sector important and needs to be addressed by authorities immediately. Otiaku (1988) outlines the following as constituting tax evasion: “a) illiteracy on the part of some informal sector entrepreneurs, b) lack of voluntary compliance in the payment of their obligated taxes, c) domination of cash transactions, d) low standard of record keeping and e) inaccessibility to tax offices to pay their taxes”. If adequate measures are put in place in addressing the issues above by policy makers, internal revenue generation can be increased.

I must acknowledge that it is not all informal sector operatives that have the right condition to pay tax, because some engage in informal activities as survival strategies and therefore taxing their meager incomes will bring a lot of hardships to them. There is also the need for the outlining of advantages or benefits in a form of social policies for the operators of small businesses and the informal sector as well as coming out with

appropriate punitive mechanisms to punish defaulters. These people to me need a lot of transfer programs from the state to help them survive and live better.

3.1.2 Tax Payment and the Contribution of Informal Sector

Taxpayers in Ghana are segmented according to their annual turnover (Large, Medium and Small) the following table provides the various turnover thresholds for each of the categories.

Table 11: Taxpayer Segmentation- GRA

TAXPAYERS	TURNOVER THRESHOLD
Large	GH¢5million and above
Medium	GH¢90,000 and not exceeding GH5million
Small	Turnover below GH¢90,000

Source: Ghana Revenue Authority.

The informal sector is captured as part of the small taxpayers in Ghana. It is not all small businesses that are classified as informal, because there are other small businesses that has registered officially or has been formalized and that proportion are taxed using the graduated rate. As has been said earlier, the part of informal sector who cannot go through registration as well as to pay income taxes are those who sell petty items on tables and the floor ranging from food stuffs to very small household items, domestic workers, street vendors etc. any attempt to tax these people can impose hardship on them and their families because they lack the condition to do so. In that sense Brazil's tax reforms MEI for small businesses can be considered. Their business activities are for their survival and not to accumulate profit. There are others who are in the informal sector whose earnings are very high and would have to pay more taxes. Some of this people are, for example, car dealers in our urban cities, food sellers, and textile sellers in our various market centers in the cities among others.

According to Yeboah 2012, the GRA has come out with the following statistics on the percentage size of businesses and their percentage tax contribution as contained in the table below.

Table 12: Business Size and their Tax Contribution in Ghana

BUSINESS	PERCENTAGE SIZE	PERCENTAGE TAX CONTRIBUTION
Large	Less than 1%	70% +
Medium	5%-25%	10%-25%
Small & Micro	70%-95%	Less than 10%

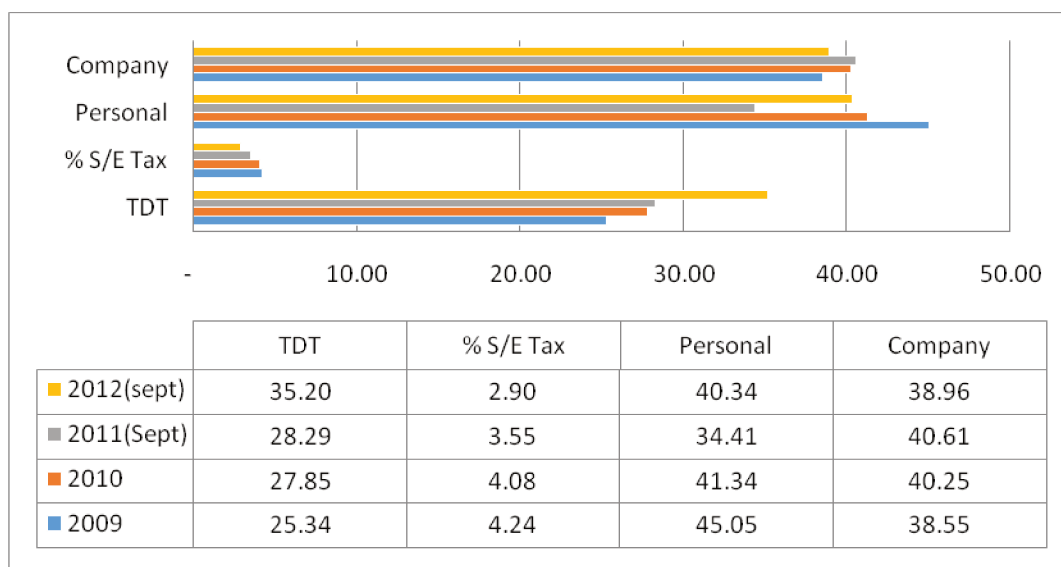
Source: Yeboah, 2012

The table above shows that the small and micro size businesses that form the informal sector are the majority (70-95%) of the firms in the country yet contributes less than 10% of tax revenue. Comparing this to the large firms that forms less than 1% yet, contribute more than 70% of tax revenue. There is the need for proper segmentation of the small businesses in order to identify the vulnerable groups to be exempted from tax and advocate for government to offer them subsidies to let them improve on their livelihood. There is also the upper segment of the informal sector or the small businesses that need to be taxed more, thereby increasing the tax revenue of the informal sector.

The Commissioner General of GRA, Mr. Blankson has said at the 2013 Management Retreat that the informal sector contributes 5% of tax revenue in the country. According to him, “an estimated 1.5million Ghanaians pay direct taxes only five percent of this taxpaying population is in the informal sector”. This trend has been in the system for quite some time, a former Assistant Commissioner of the erstwhile Internal Revenue Service, Mrs. Amamoo in 2008 also came out with some interesting figures to buttress the point that the informal sector contribute very little to the tax revenue of the country. She said, out of the 266,760 self-employed registered by the Ghana Registrar General’s Department, only 53,352 have been registered with the tax authority, this leaves the rest of

the people in the informal sector. It thus calls for reforms to link business registration taxpayer registration to capture all businesses.

Fig. 1 PERCENTAGE CONTRIBUTION BY TAX TYPE



Source: Data from GSS and BANK of GHANA. S/E= Self-Employed and TDT= Total Direct Tax

The above figure represents the percentage contribution of all tax types in Ghana for 2009 to 2012, September. As we can see while the other tax types increase their contribution to the direct tax revenue, same cannot be said for the Self-Employed (S/E). For instance, in 2009, the S/E contributed 4.24% of tax, this figure reduced in 2010 to 4.08%, the 2011 figures up to September recorded 3.55%, comparing the same period in 2012, the collection further declined to 2.90% with Personal Income Tax (PAYE) and Companies contributing 40.34% and 38.96% respectively, however, they contribute to VAT since that is a consumption tax. How can country develop meaningfully with a high informal sector that contributes very little to the tax wallet of the nation? This figure also shows that majority of the direct tax generated in the country comes from workers small salaries. Although there is no empirical evidence, some informal sector operatives earn incomes which are more than an average worker, yet are not paying tax.

3.1.3 Systems for Taxing the Informal Sector (Self-Employed)

The Ghana Revenue Authority (GRA) from 1970, adopted several methods of collecting taxes from the informal sector, before the coming into force of the Internal Revenue Act (IRA 592, Act 2000) and Internal Revenue Regulation (IRR, 2001, LI 1675). The erstwhile IRS used a general system of presumptive flat tax, as means of taxing the informal sector, which ensured that businesses operating within the sector are tax based on Standard Assessment, which did not take into consideration the incomes earned by the business, but was based on the size of the business and the industry. This system was first introduced in the 1960s with all operators paying a lump sum of money as tax. The estimated amounts to be paid by the informal sector as tax liability are based on financial and economic surveys of firms, industries or sectors. Also the system is based on standard indicators such as sales, purchases, estimated profit margins, floor space and number of employees if any. The system brought about a lot of difficulties to both the tax authorities and the tax-paying community, although it initially brought a lot of gains (Amamoo, 2008). According to Joshi and Ayee (2002), there was an agitation of the system not been fair, due to the fact that lower and higher income earners were paying the same tax. That the informal sector did not comply with the tax they were supposed to pay. This prompted a need for reforms that will help the state to find a better way of taxing the sector, the occupational group tax system adopted.

The revenue agency as part of addressing the poor implementation of the presumptive tax system brought about the idea of “agency role” of occupational groups or association. This measure was aim at widening the tax net to increase revenue generation from the informal sector. In 1987, occupational group or identifiable groups were given agency role by the IRS to collect taxes from their members on behalf of the commissioner after negotiations with their leadership, which was aimed at bringing into the tax net potential taxpayers within the various associations or groups. This was accepted because it was very easy to collect from their members that they already know. The system had gone through a lot of changes from daily collections initially through weekly collection to quarterly to reduce the high cost of printing of the receipts and monitoring by tax officials.

According to Mrs. Lydia Amamoo (Deputy Commissioner, DTRD), she revealed that “although the system chalked up some initial success, in the long run, it failed to make

the desired impact on self-employed collection”. Some of the problems associated with the failure of the system were:

- 1) “Failure to properly account for the taxes collected
- 2) Falsification of receipts and other records
- 3) Conflict in the associations
- 4) Spring up of sprinter-groups in the associations
- 5) Linking-up of membership fees and dues to payment of tax
- 6) Imposition of unauthorized penalties by the associations for non-payment of the taxes
- 7) Inadequate monitoring by the service”

This called for further reforms that will be appropriate to achieve the objective of adequately taxing the informal sector. The coming into force of the Internal Revenue Act and the Internal Revenue Regulations of 2000 and 2001 respectively, brought into effect regulations 25 of LI 1675 with the list of associations, occupational groups and classes of persons forming the informal sector in the country for the purposes of taxation and new ways of taxing them.

The following were the major reforms adopted to improve the tax revenue collection of the informal sector enterprises. The introduction of Vehicle Income Tax (VIT) is a way of capturing all commercial vehicle owners to pay their taxes on quarterly basis. This law was contained in the legislative instrument (LI. 1727), and schedule five of regulation 25A. The stickers are purchased from the offices of the IRS (now the STO offices of the GRA) which are to be conspicuously displayed on the windscreen of the vehicle; this will enable the police to effectively check defaulters. The stickers can be bought individually or by the transport unions.²⁴

The VIT that was introduced assisted in capturing all commercial vehicle owners on quarterly basis for tax purposes. The LI. 1727 came out with the following important issues as stated by Mrs. Amamoo (Deputy Commissioner, STO and Field operations):

²⁴ This was to encourage the unions and also 2.5% discount is given to them for bulk purchases of the sticker.

Box 2: IMPORTANT ISSUES OF LI. 1727

- 1) VIT stickers are mandatory for all commercial road vehicles
- 2) Stickers are to be displayed on the windscreens of all vehicles like the insurance and road worthiness Certificates.
- 3) Specified rates are provided for various classes of commercial vehicle
- 4) The VIT stickers system shall be enforced by the police and monitored by tax authority's monitoring teams in collaboration with the police
- 5) Taxpayers are required to file their tax returns at the end of each year since the payments for the VIT are not final but payment on account.
- 6) The LI also provided punitive sanctions against those who fail to comply, ranging from a fine of not less than 25 penalty units and not more than 50 penalty units to imprisonment of not less than two (2) months.

Source: Mrs. Amamoo (Deputy Commissioner, STO and Field operations)

The rate of tax payable by the commercial vehicle owners are reviewed as and when necessary through negotiation between the tax authorities and the transport unions. One can confidently say that the introduction of the LI.1727 has improved the tax collection from self-employed commercial vehicle operators. The current amendment of the regulation in 2011, LI 1997, has new figures as tax to be paid by the owners of these commercial vehicles as contained in the table below.

Table 13: Ghana Vehicle Income Tax Rate, 2013

Vehicle Class	Description	Annual Rate GH¢	Quarterly Rate GH¢
A1	Taxis and Private Taxis	48,00	12,00
A3	Trotro (which carries up to 15 persons)	64,00	16,00
B1	Hiring Cars (Salon and Caravan)	320,00	80,00

B1	Hiring Cars (4x4) four wheel Drive	480,00	120,00
B1	Trotro (Which carries up to 19 persons)	80,00	20,00
B2	Trotro (which carries between 20 and 23persons)	80,00	20,00
B3	Trotro (which carries between 24 and 34 persons)	120,00	30,00
C1	Commuter (which carries up to 15 persons)	80,00	20,00
C2	Commuter (which carries up to 16 and 19 persons)	100,00	25,00
C3	Commuter-Ford Buses (which carries up to 23 persons)	90,00	30,00
C4	Commuter (which carries up to 38 persons)	160,00	40,00
C4	Tour operators (which carries up to 15 persons)	320,00	80,00
C5	Tour operator vehicle (which carries between 16 and 23 persons)	400,00	100,00
C5	Commuter (which carries between 39 and 45 persons)	200,00	50,00
C6	Tour Operator vehicle (which carries between 24 and 38 persons)	280,00	70,00
C7	Tour operator Bus (which carries above 45 persons)	600,00	150,00
C7	Commuter (which carries between 46 and 60 persons)	240,00	60,00
D1	Pay loader with capacity to carry dry cargo below 2tons	140,00	35,00
D2	Motor vehicle which carries dry cargo of between 2 and 3 tons, tanker with a capacity of not more than 2000 gallons, sewage tankers, garbage trucks and		

	cranes.	256,00	64,00
D3	Tankers with capacity of more than 2000 gallons, graders and bulldozers	404,00	101,00
D4	Vehicle with the capacity to carry dry cargo of between 4 to 7 tons	480,00	120,00
D5	Tipper trucks (single axle)	320,00	80,00
D6	Tipper trucks (Double axel)	480,00	120,00
D7	Articulated truck and trailer with capacity of 18 cubic meters and timber trucks	800,00	200,00
D8	Tipper trucks (ranging from 12 to 14 wheelers)	600,00	150,00
D9	Ambulance and motor hearse	88,00	22,00

In 2005, the erstwhile IRS as a way of improving the contribution of tax by the informal sector (self-employed) other than the vehicle owners came out with LI. 1803 regulation 25B captioned “Tax installments payable by specified self-employed persons” which introduced a new quarterly tax payment known as the “Tax Stamp” system. The system also deals with the identifiable groupings, because of the lack of effective book-keeping that would have allowed for proper standard income taxation. By this system, informal sector operators are made to purchase a quarterly stamp that has to be displayed conspicuously in their premises, kiosk, and containers as well as to be carried around by hawkers. The tax stamp system has improved the tax revenue collection of the sector, yet much needs to be done.

In addition, schedule six was introduced to cover those who are not covered by the schedule two of LI. 1675 as amended. The schedule six classes of traders and their quarterly tax rate are stated in the table below. The important issues contained in the LI 1675 as amended are also stated in the box below.

Table 14: Taxes Paid by Informal Sector (Self-Employed Persons)

Type	Class of Traders	Quarterly Rate 2001 GH¢	New Rate 2013 GH¢
A	40 footer container/large kiosk operators	25,00	35,00 – 45,00
B	20 footer container/Medium kiosk operators	15,00	25,00 – 30,00
C	Small kiosk/container operators/ market stalls and itinerant traders	10,00	15,00 – 20,00
D	Table Top operators/hawkers	5,00	10,00

Source: GRA, Internal Revenue Regulations LI. 1675 and 1803

Box 3: IMPORTANT ISSUES OF LI. 1675

- 1) Identification of small scale self-employed persons in the informal sector
- 2) Grouping of business operations in the informal sector by business type and volume of business operation.
- 3) Taxpayers are obliged to buy the tax stamp in advance (i.e. 15th January, 15th April, 15th July and 15th October).
- 4) Taxpayers are required to conspicuously display the tax stamp on their business premises.
- 5) The tax stamp system is to be monitored and enforced by the erstwhile IRS at the various district
- 6) A person who fails or refuses to pay the tax commits an offence and is liable on summary conviction.
- 7) The LI also provided punitive sanctions against those who fail to comply, ranging from a fine of not less than 100 penalty units and not more than 250 penalty units.

Source: Mrs. Amamoo (Deputy Commissioner, STO and Field operations)

3.1.4 Difficulties in Taxing the Informal Sector

Taxing the informal sector is a very difficult task, operators within the sector generally transact business on cash bases making it problematic to assess their incomes and tax them appropriately. This form of transaction creates avenues for them to cover up their profit or incomes that are to be taxed. The following are three major difficulties that prevent proper taxation of the informal sector: i) capacity constraints; ii) the issue of equity; iii) political issue.

The informal sector lacks the capacity to keep proper books of account or financial records for tax purposes, making it difficult for tax authorities to effectively assess them to tax. According to Ayee (2007), he state that “...in tax administration a very important task is the correct determination of income of the taxpayer so that a meaningful assessment of the tax liability could be made”. This constraint can be attributed to the level of illiteracy among operators in the sector. Tax administrators on the other hand, also lack the capacity to enforce the laws available to them to collect taxes from the citizenry in general and the informal sector in particular. Terpker (2006, p.27), thinks that accounting is necessary for enhancing tax compliance, meanwhile small businesses finds it difficult and expensive to maintain proper or adequate accounting records. In order to solve this problem that will go a long way to put an end to the indiscriminate application of cash accounting and also to reduce the system of presumptive tax rules applied to all small business, it is important for “policy makers or those in the accounting practice to design a simple cash and accrual accounting format that comes with less cost that the operatives within the informal sector can afford”.

Income or profit from majority of the informal sector operatives is said to be low which are difficult to tax, some also receive a lot of income or profit that needs to be assessed for the right tax to be charged. In fact enough tax can be charged from this group to bring out the progressiveness of the direct tax system. However, the lack of effective financial records by operatives makes it difficult to target the high income earners to pay more tax in order to bring equity in the tax system to save the low income earners within the sector. The use of presumptive tax system to tax the informal sector, which are estimates imposed on operatives can be addressed if proper financial records are kept by business, that would help tax authorities to distinguish between who should pay more tax and who should not even pay the tax at all. If accounting record is been kept by all

operatives, the presumption tax should be paid by the vulnerable small businesses (Terpker, 2006).

Judith Tendler (2002, p.3), terms the political influence in the taxation of the informal sector as the “*Devils deal*”, which is an unspoken arrangement between politicians and the informal operatives. Low income taxpayers within the sector are many, yet contribute very little to the tax revenue, hence have a strong political voice, Politicians also have the strong incentive to exempt them or willing to turn blind eye on the informal sector in exchange of political support or vote to maintain them in power. As long as the politicians depend largely on the vote of the citizenry to keep them in power, they greatly do everything humanly possible to attract the vote of the informal sector.

The informal sector is a very important sector of the economy that needs a lot of attention from policy makers to ensure that the sector contribute more meaningfully and come out with programs to encourage formalization which will reduce the high informality the country is experiencing. I believe that for a sector that do not have the capacity to maintain accounting records which will enable tax administrators to give them proper assessment, the Tax Stamp and the Vehicle Income Tax (VIT) systems are the best way of taxing the sector. There is the need to separate the informal sector into those who have the conditions to pay more taxes and those who do not have the material and financial conditions to pay tax, they are just in the sector for survival and need government support, putting taxes on their incomes will create a lot of hardship for them.

4. FINAL CONSIDERATION

Ghana's tax system has a lot of difficulties which is affecting revenue mobilization in the country. The Ghana Revenue Authority has to improve the tax system in order for the citizen to have confidence and contribute significantly in to the tax revenue coffers.

The lack of resource in the form of human and logistics is one major constraint that has made tax administration very difficult. For effective and efficient tax administration, there is the need for more skilled human resources to be able to ensure proper enforcement of the tax laws and undertake inspection of taxpayers. Frequent monitoring of taxpayers requires a well trained staff. The other issue is the lack of logistics like operational vehicles, offices, computers and many more. The tax system in Ghana generally operates with more manual and paper work in this era of technological advancement.

After so many years of the existence as administrators of direct tax systems in Ghana, the GRA has still not been able to automate all of its operations and continues to do paper work. This has also contributed immensely to the poor tax revenue generation as a country. Government needs to change these systems by resourcing the revenue agency to speed up the automation of the tax system. The Brazilian case has shown that automation and cash-less business environment is a sure way of increasing tax revenue.

One other area that requires a lot of attention is taxpayer education by the revenue agency. Educating or training of taxpayers on some of the beneficiary provisions in the tax laws will encourage them to trust the system for voluntary tax compliance. Some of the benefits are: tax incentives, tax concessions and tax reliefs and also interpretation of certain unclear portions of the tax laws to them will also go a long way to help. This will give the GRA the confidence to carry out any action against those who do not comply with tax laws and their obligation to pay tax. The business environment in Ghana is dominated by cash transactions which make it difficult to analyze incomes of many tax payers for fair and proper assessment; this situation has made the informal sector very hard to tax. This is an area that needs to be looked at seriously by the tax authorities; a simple training on income and expenditure can be given to the small business owners who cannot afford the high cost of engaging a professional accountant to help them to prepare simple financial records and account for tax purposes.

The reforms that are being implemented for informal sector enterprises and SMEs, can be considered the best within the circumstances we find ourselves in, especially the Vehicle income Tax and the Tax stamps, since majority of the operatives in the sector are illiterate or semi-illiterate and cannot keep accounting records on their business for tax collectors to properly assess them base on their incomes. What is therefore, required is a further segmentation of the turnover threshold for small businesses in order to identify those within the informal sector who earn more incomes and need to be taxed properly to pay more, those who can continue to pay the tax stamps and those whose businesses are on survival bases and do not have the condition to pay income taxes, but rather to receive government support in a form of cash transfers.

The Act 592 of 2000 as amended was intended to bring about reforms to all aspects of the tax system in the country, but it seems the act is in favour of medium and large firms with very little mention of small, micro and informal sector businesses. Much needs to be done in the area of making tax reforms that will go a long way to encourage small businesses and the informal sector to think of moves to formalize which has the tendency of improving tax payment from the sector. The Brazilian experience, where tax payment for small businesses goes with some social benefits can be considered.

The informal sector in Ghana continues to grow but statistical data and information on the sector is limited, especially in the area of assessing the actual size of the sector. The sector's contribution to GDP and the actual contribution to tax revenue have not being adequately researched on to mention a few. Government should resource the Ghana Statistical Service and the Ghana Revenue Authority adequately to conduct in-depth research into the informal sector and its contribution to the GDP of this country. This will help tax administrators to come out with tax structure that will have greater consideration of small businesses and the informal sector. No meaningful reform can be done for small businesses and the informal sector, without a proper research of the sectors involved.

Simplification of the tax system is very important, there seems to be a lot of burdensome procedures in the system that authorities need to work on. Section 72 of the IRA, 2000 (Act 592 as amended) enjoins "a person to furnish a return of income for the year of assessment of that person, not later than four months after the end of a basis period of that persons ending within the year". Due to the voluminous nature of the forms, taxpayers always find it difficult in completing the forms which cannot also be accessed,

complete and submitted electronically. Taxpayers find it problematic to travel to the tax offices to complete this forms. Taxpayers are expected to always walk to the tax offices before they can even make payments. Policy makers must take steps to address this issue by, simplifying the processes and procedures for easy compliance, such as the return forms and also to provide the platform for electronic filing of the income tax returns and payments of taxes by the taxpaying population which will go a long way to help both the tax authorities and the taxpayers.

Registration of business in Ghana is a very important tool in the issue of formalization that has the potential of tax revenue generation. There are cumbersome and bureaucratic procedures business owners have to go through to register; the cost associated with this business registration is also a problem. This also makes it difficult for small and informal businesses to convert to formal businesses. According to the World Bank data on “Doing Business”, Ghana is ranked 111 out of 189 countries in the area of starting a business in 2013. In 2014, on the same category, Ghana was ranked 128 out of 189 countries. This record is very much discouraging and urgent steps are needed to address the issue which has the potential of reducing informality in the country.

In 2002, the parliament of Ghana through the TIN Act, 632 brought into force “An act to establish a Taxpayer Identification Numbering (TIN) system under which taxpayers are given identification numbers for official transactions with the public institutions by or under the Act and to connected matters”.

If this act is well followed, it would give the GRA an opportunity to capture all taxpayers including the informal sector operatives who escape from paying tax, because this numbers are unique to all persons. Section 5(1) of the act state that: “every person, liable to pay tax or required to withhold tax at source” by law is supposed to obtain Tax Identification Number (TIN). I therefore, believe that a nationwide issuance of the TIN and also properly linking it to some sectors of the economy especially the Driver and Vehicle Licensing Authority, would help us to identify and bring into the tax net all taxable persons including our high informal entrepreneurs.

Last but not the least, Ghana after fifty-seven (57) years of our independence cannot boast of a well street-naming system that would make it easier to locate persons, especially taxpayers within the informal sector. This failure is blamed on the Metropolitan, Municipal

and District Assemblies (MMDAs) on their inability to effectively provide layout and permit for buildings and house numbering (GoG, 2010). If the guidelines which was compiled by the Ministry of local Government and Rural Development, on street naming and property numbering system (street addressing system) could be followed, this would lead to roping into the tax net many persons who are doing business of which taxes need to be paid on their incomes, but yet cannot easily be traced or located. Many of our informal sector enterprises fall into this category of persons. This system in my opinion will have positive impact and also improve the “Rent Tax” collection, because of ease in locating properties.

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