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# Ghana's Trade Policies: Exemptions from Import Duty

## 1. Introduction

About 40 percent of imports officially cleared through Customs in Ghana are exempted from import duties. This does not include imports which enter at zero statutory rates, and under some kind of concessionary rates.<sup>1</sup>

The wide use of exemptions raises procedural, incentive and revenue issues.

The *procedural issues* relate to the transparency of policy processes and to the monitoring of their implementation. Exemptions can be granted in Ghana under a number of different authorities, under terms and conditions that are often poorly specified. The processes of granting exemption privileges invite rent-seeking and abuse. Inadequate monitoring and control systems aggravate these problems. In these circumstances, exemptions have many unintended effects, and often fail to meet their main objectives. More transparent, less costly and more effective alternatives to exemptions are often available. The most effective and transparent means would be for the government to identify the specific activities that they deem worthy of support and to provide direct budgetary subsidies. But the most effective method can be determined only after a careful examination on a case by case basis.

There are two types of *incentive issues*.

- C The users of imported goods brought in under exemption have a market advantage over users of the same goods imported under the statutory tariff rate. This creates an arbitrary differential in protection across firms. It also subsidizes rent-seeking and corruption, as importers and users of imported goods lobby for exemptions rather than engaging in socially productive economic activity.
- C The wide use of exemptions creates anomalies in Ghana's tariff structure, reducing effective protection to producers of exempted goods, and increasing effective protection to the users of exempted raw material inputs.

The *revenue issue* is straight forward. The wide use of exemptions creates a hole in the government's tax base — both directly, through legitimate imports of exempted goods, and indirectly, through abuses of the exemptions that are offered. This problem might well be aggravated as the government proceeds to move many or all of the goods currently imported at a

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<sup>1</sup> These and other import and tax collection numbers are based on a preliminary analysis of ASYCUDA data for 1998 provided by the Ministry of Trade and Industry.

zero rate into the new 5 percent category. In the presence of an *ad hoc* exemptions regime, importers of goods which previously had been zero-rated (or had been classified as such) will attempt to avoid the new import duties by seeking exemptions. The effectiveness and perceived fairness of this revenue measure will be seriously compromised if it is subverted by arbitrary exemptions.

## 2. Outline of Ghana's Exemption Regimes

### Description of the Regimes

Exemptions are granted under a number of different government programs.

The statutory basis for many of these exemptions is provided in *Parts A and B of the Third Schedule of the Customs, Excise and Preventive Service (Management) (Duties, Rates and Other Taxes) Act, 1994 (Act 476)*.

Part A (Tariff items F.1 to F.9) provides exemptions according to certain end-users ("Government, Privileged Persons, Organizations and Institutions). The specified end users are

- C F.1: the Head of State of Ghana,
- C F.2: diplomatic missions,
- C F.3: technical assistance schemes
- C F.4: the British Council,
- C F.5: the blind, deaf and dumb,
- C F.6: churches and religious bodies,
- C F.7: trade fairs and exhibitions,
- C F.8: the Volta Aluminum Company Limited, and
- C F.9: the Volta River Authority.

Part B (Tariff items F.51 to F.61) provides general exemptions for certain goods, and in some cases for certain types of uses. The exempted items are:

- C F.51: advertising matter,
- C F.52: aircraft parts and accessories for use by approved airline operators,
- C F.53: passengers' personal baggage and effects,
- C F.54: educational, cultural and scientific materials of a broad range of types, and those imported by the United Nations or its agencies,
- C F.55: West African raw foodstuffs and fish caught by Ghanaian owned vessels,
- C F.56: fishing floats and gear as approved by the Commissioner,
- C F.57: infants' foods,
- C F.58: machinery, apparatus and spare parts for agricultural purposes,

- C F.59: chemicals for agricultural purposes, as certified by the Minister of Agriculture,
- C F.60: jute bags imported by COCOBOD or any of its approved agents, and
- C F.61: gifts of a charitable nature from donors and recognized overseas bodies, as recommended by the Overseas Gifts Committee and approved by the Minister of Finance.

A second set of exemptions is set out under the *Bonded Warehousing* provisions of the Customs, Excise and Preventive Service Law, 1993 (Part VII, Sections 123-152) and the *Free Zone Act, 1995 (Act 504)*. Both of these laws provide for temporary exemption from import duties as long as goods remain in these zones, which are deemed to be outside of Ghana's customs territory. It is only if and when goods are removed from the zones for delivery into the domestic customs territory that they are considered to be imported and hence liable for import duties. If the goods are re-exported directly or indirectly, as inputs in production of exported goods, they never become liable for duties.

A third form of exemption is provision of special tariff treatment for certain approved importers or producers. Some such imports appear as entries in chapter 98 of the Tariff Book. The first group of items in this chapter are imports by manufacturers approved by the Commissioner, and the second group is imports by enterprises under the GIPC Act, 1994 (Act 478). Other exemptions from normal tariff rates are provided to manufacturers upon application to the Commissioner of Customs.

### **Imports Under Different Exemption Schemes**

No systematic data are collected on goods entering under different exemption schemes. This makes it impossible even to tabulate the total value of imports under the programs described above, let alone to analyze their revenue effects or implications for resource allocation.

CEPS has a coding system (Custom Procedure Codes, or CPCs) for all customs transactions — imports and exports, as well as movements of goods into and out of bonded warehouses and free zones. These codes are meant to indicate the precise customs procedure under which import transactions occur. Unfortunately these codes are constructed in a manner that makes them of limited value in analyzing the different exemption schemes. In particular, CPC's are designed without reference to the tariff items in the Third Schedule of the Customs and Excise Act. From examination of the data and discussions with customs officials familiar with these codes, it is clear as well that classification of actual transactions into the CPC categories is carried out in an imperfect manner, making all inferences from the data even more questionable. This arises from both the poor structure of the coding scheme and the lack of training and understanding of those who are required to implement it. Furthermore, a significant set of customs transactions (in particular, goods cleared from Free Zones and Bonded Warehouses in Accra) are not yet recorded in the computerized data base utilizing these codes. Immediate improvements in the design and implementation of these

codes is required in order to understand and deal systematically with import duty exemptions in Ghana.

Subject to these qualifications, Table 1 describes what is known about imports under different exemptions in 1998. Exempt imports are divided two groups — those granted “standard” exemptions, mainly under the Third Schedule of the Customs and Excise Act, and those granted temporary exemption when entered into bonded warehouses, free zones or under other forms of temporary admission. Partial exemptions, in the form of concessionary tariff rates, are not included as exemptions in this table.<sup>2</sup>

Total exempt imports amounted to 2.85 trillion Cedis, or 40.1 percent of imports in 1998. About 59 percent of exempt imports (1.69 trillion Cedis) came under the Third Schedule of the Customs and Excise Act, and 41 percent (1.16 trillion Cedis) were given temporary exemptions.<sup>3</sup>

Among the Third Schedule exemptions, the two most important are Minerals Commission, accounting for 28.6 percent of exempt imports in this category, or 17.0 percent of total exempt imports, and Ministry of Finance, accounting for another 21.8 percent of Third Schedule imports, or 13.0 percent of total exempt imports. The other significant items (in terms of import value) under the Third Schedule are Personal Effects for Home Use, Volta River Authority, Ghana Investment Centre and VALCO, accounting for 8.7, 6.7, 5.7 and 4.7 percent of Third Schedule imports respectively. No other category accounted for as much as 3 percent of Third Schedule Imports.

Eighty-five percent of goods entering under temporary exemption in 1998 (34.6 percent of total exempt imports) went into bonded warehouses. This was the single largest category of exempt imports in Ghana in 1998. Another 12.5 percent (or 5.1 percent of total exempt imports) went to free zones, and the remainder (2.2 percent) were other forms of temporary imports.

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<sup>2</sup> Whether partial exemptions in the form of tariff reductions (as opposed to full exemptions) should be considered as exemptions or some other form of special tariff privilege is a definitional question on which we have no strong opinion. We include them in our general discussion of exemptions because of the fact that, like full exemptions, they represent a departure from “normal” tariff treatment.

<sup>3</sup> The estimate of exemptions under the Third Schedule does not include goods subsequently entered under these provisions following release from bonded warehouses and other forms of temporary entry.

<b>TABLE 1 EXEMPT IMPORTS, 1998</b>			
	<b>Imports (Cedis)</b>	<b>% of Total Imports</b>	<b>% of Exempt Imports</b>
<b>Third Schedule Exemptions (CPC Codes)</b>			
Grants and Aid (c110)	46,754,726	0.0	0.0
Head of State (c111)	6,631,954,439	0.1	0.2
ECOWAS Designated Imports (c125)	22,835,270,760	0.3	0.8
Personal Effects for Home Use (c127)	248,473,731,890	3.5	8.7
Ghana Investment Centre (c130)	161,706,168,915	2.3	5.7
Ministry of Finance (c131)	369,570,194,645	5.2	13.0
VALCO (c132)	132,862,000,638	1.9	4.7
National Revenue Secretariat (c133)	8,912,664,103	0.1	0.3
Volta River Authority (c135)	191,158,671,843	2.7	6.7
Minerals Commission (c137)	484,651,609,325	6.8	17.0
Diplomatic Privileges (c140, c240)	66,954,056,988	0.9	2.3
<b>Subtotal</b>	<b>1,693,803,078,272</b>	<b>23.8</b>	<b>59.4</b>
<b>Temporary Exemptions (CPC Codes)</b>			
Warehouses (s300, s320, s322, s400, s700)	985,628,516,368	13.9	34.6
Free Zones (s900)	144,382,554,100	2.0	5.1
Other (s500, s600)	25,964,543,033	0.4	0.9
<b>Subtotal</b>	<b>1,155,975,613,501</b>	<b>16.3</b>	<b>40.6</b>
<b>Total Exempt Imports</b>	<b>2,849,778,691,773</b>	<b>40.1</b>	<b>100.0</b>

### 3. Some Principles for the Granting and Monitoring of Exemptions

In rationalizing the exemptions regime, it is necessary to agree on and act in accordance with some basic principles. In addition, it is at least as important to establish administrative procedures which ensure proper monitoring and control of the exemption process, without unnecessarily interfering with the facilitation of trade.

#### Principles for the Granting of Exemptions

There are several generally agreed circumstances under which, according to “best international practices”, imports are exempted from the obligation to pay import duties:

- C raw materials and intermediate products used in the production of exports,
- C goods imported under aid-funded projects governed by international treaties and agreements banning the payment of import duties, and
- C goods imported under diplomatic privileges governed by international agreements.

In addition, many countries exempt imports by

- C government departments and certain government agencies, and
- C firms granted special import privileges as part of an investment promotion program.

To issue exemptions in the absence of clear underlying principles is to invite rent-seeking, revenue loss and distortion of economic incentives, making sustainable development more difficult to attain.

### **Monitoring and Controlling the Use of Exemptions**

In the absence of proper monitoring and control, exemption programs are open to rent seeking and to abuse. Exemption permissions must be designed to ensure that they are not used as a “back door” to avoid normal import duty obligations. Ghana is replete with stories and suspicions of such abuse.<sup>4</sup>

The necessary monitoring and control mechanisms for this purpose are similar to those commonly (but not yet in Ghana) used for bonded warehouses, duty exemptions for exporters and other similar programs. They must include

- C a clearly itemized list of approved goods, providing descriptions (including HS tariff codes), quantities and values of goods, to be imported under exemption,
- C a sunset clause in the form of a timetable for exempted imports, including most importantly a deadline after which exemptions will not be granted without submission and approval of a new application,
- C a system for checking all import entries against the approved list of exempt items and for verifying the cumulative imports against the approved list,
- C post-audit procedures for verifying that goods are used for the approved purpose, and
- C when applicable, procedures for exporting, disposing of and/or making tax payments on goods remaining after completion of the project or activity for which the imports were approved.

Regardless of the regulatory or statutory authority of any exemption program, it must include an effective monitoring system with the features described above.

In his 1998 Budget Statement, the Honorable Minister of Finance observed that “in the past year, the entire exemptions regime was reviewed in order to reduce the loss of revenue through the abuse of the system. The revenue issue aside, legitimate beneficiaries of exemptions will be periodically audited with the view to ensuring that exempted goods are used for the purposes for which the exemptions were granted” (Paragraph 265). Such concerns could be substantially alleviated

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<sup>4</sup>See the related paper, Vincent Castonguay *Review of CEPS Activities with Respect to Controls, Processing Procedures and Trade Facilitation Regimes* (Sigma One Corporation), September 1999 for a description and analysis of systemic problems in monitoring and controlling exemptions in Ghana. More specific examples of monitoring and control problems in relation to specific exemption categories are provided in later sections below.

through implementation of integrated monitoring and control systems.

An issue that will inevitably arise in moving to such a system will be how to deal with already-existing exemptions granted prior to the development of these monitoring systems. It will be unacceptable to issue a “grandfather” clause exempting existing programs without time limit. A strict and short time limit must be placed on all existing exemptions. Following the expiry of that limit, Customs must be required to refuse all exemptions which are not governed by these monitoring systems. Legitimate exemptions affected by this measure can be renewed, but under new and effective monitoring and control mechanisms.

#### 4. Specific Exemption Issues

##### **Ministry of Finance and National Revenue Secretariat Exemptions**

Thirteen percent of Ghana’s exempt imports enter under letters from the Ministry of Finance. None of these exemptions is initiated by the Ministry. They are initiated instead in other ministries, such as Agriculture, Social Welfare and Employment and Health. The same is true of exemption letters issued by the National Revenue Secretariat.

Despite the centralization that seems to be implied by the role of the Ministry of Finance, the Ministry contends that it does not grant any import duty exemptions. Nor does it appear to exercise any control over the monitoring of exemptions granted under its letters. As already observed, however, exemptions granted under Ministry of Finance letters are recorded by customs according to these letters, rather than the permissions granted by the initiating ministries or agencies.

This creates confusion, reduces transparency, and raises serious issues about the monitoring and control of a significant portion of the import duty exemptions granted in Ghana.

##### **Exemptions Granted for Social Purposes**

A number of the Third Schedule exemptions in the Customs and Excise Act are designed to achieve social purposes. These include the exemptions for the blind, deaf and dumb (F.5), churches and religious bodies (F.6), educational, cultural and scientific materials (F.54), infants’ foods (F.57), and gifts of a charitable nature (F.61).

Without questioning in any way the social goals of these exemptions, several observations are still in order.

*Exemptions are Usually an Ineffective Form of Subsidy*

An import duty exemption is equivalent to an open ended grant based on the value of an activity's imports. This a non-transparent and highly inefficient way to subsidize just about any kind of activity. Does the amount of social good accomplished by a church or a charity depend on how much it imports? Is the nutritional contribution of a child food program dependent on the amount of infants' foods imported? If not, an import duty exemption is an inefficient way to subsidize a church, a charity or an infant nutrition program. The same observation applies to all of the exemption programs for social purposes.

*Exemptions Have Unintended and Perverse Incentive Effects*

Using import duty incentives to subsidize the achievement of social goals imparts a bias in favor of foreign inputs. To take advantage of the subsidy to infants' foods, the foods must be imported. With an exemption on imported educational materials, a domestic producer of school textbooks, who must use tax-paid paper and ink, must compete against duty-free imports from countries with access to inputs at world market prices.

In addition, the granting of import duty exemptions to achieve social purposes invites abuse in several forms.

- C Organizations get themselves designated as eligible institutions in order to avoid taxes, and it is very difficult to design clear and transparent criteria to deal with this problem.
- C Goods can be imported under this guise for personal or commercial uses which are unrelated to the principal activities of the eligible organizations — a problem which is equally difficult to deal with in a transparent and consistent manner

Even in the absence of actual abuse, stories and rumors of its presence reduce the legitimacy of the organizations responsible for meeting social purposes.

There are other more direct, transparent and less distorting ways in which the government can subsidize activities such as these, starting with direct budgetary support. Such measures would not tie assistance to arbitrary indicators such an organization's imports, and thus would have far fewer unintended and counter-productive incentive effects.

Charitable activities which are funded by international donor agencies under international agreements which include tax-free treatment would have to be granted exemptions status accordingly in any case. However, implementation of effective monitoring and control mechanisms is still important as a means of avoiding abuse and distortions.

**Temporary Exemptions for Entry into Bonded Warehouses and Free Zones**

According to 1998 ASYCUDA data, goods worth 1.13 trillion Cedis were cleared into bonded

warehouses and free zones. This represents 15.9 percent of Ghana's total imports in 1998, or 39.7 percent of exempt imports. Eighty seven percent of these imports, or 987 billion Cedis, went into bonded warehouses, and the remainder into free zones.

According to the data available for this study, only 23.7 percent of these goods were subsequently cleared for entry into the domestic market or for export. Of the 263 billion Cedis worth of goods reported to have been cleared from bonded warehouses to the domestic market, 25.9 percent, or 68 billion Cedis, were exempted from import duties.<sup>5</sup> Some of the details are shown in Table 2.

However, these data are woefully incomplete and misleading. One of the most serious problems is that goods cleared out of bonded warehouses in Accra, where the vast majority of Ghana's bonded warehouses are located, are not entered into the ASYCUDA data system. This represents a glaring hole in the government's ability to monitor and control the activities of bonded warehouses and free zones. On the basis of available data, therefore, we are unable to determine what happens to the majority of imports entered under temporary exemption into bonded warehouses or free zones. Only 23.7 percent of goods entered into warehouses and free zones are accounted for in the 1998 data.

#### *Bonded Warehouses*

Like many other countries, Ghana permits goods to be imported temporarily into bonded warehouses without payment of import duty. For import duty purposes, these warehouses are considered to be outside of the Ghana's customs territory. Duty is paid only when the goods are subsequently released for domestic use, and are not exempted under some government program. If they are re-exported or sold or transferred to other duty exempt agents, organizations or uses, duty is not paid.

As with any other kind of exemption, it is necessary to have effective monitoring and control mechanisms to avoid abuse. Ghana's control system for bonded warehouses is based entirely on physical control. Customs officers accompany all deliveries of goods from the port of entry to a bonded warehouse facility. A Customs officer is permanently posted at each bonded warehouse, and physically monitors and controls all shipments into and out of the warehouse. In principal, at least, the warehouse gate cannot be opened without a Customs officer present.

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<sup>5</sup> Why would importers bother to enter exempt goods into bonded warehouses rather than importing them directly? One possible explanation is that these are not really exempt goods when imported into the country. But when the owner of the goods wishes to clear them into the local market, a deal is made with an NGO or charitable organization to have them entered under the organization's exemption letter. The goods are then sold in the local market, with the profits shared between the trader and the "charitable" organization.

<b>TABLE 2 ENTRIES INTO AND EXITS FROM WAREHOUSES AND FREE ZONES</b>		
	<b>Imports, Cedis</b>	<b>% Shares</b>
<b>Warehouse and free zone entries</b>		
Private warehouses (s.300, s.400)	972,833,755,784	
Industrial warehouses (s.320, s.322, s.700)	12,794,760,584	
Subtotal: warehouses	985,628,516,368	87.2
Free zones (c.900)	144,382,554,100	12.8
Total	1,130,011,070,468	100.0
<b>Warehouse and free zone exits</b>		
<b>Warehouses</b>		
Export (r200, r300, r380)	508,495,017	0.1
Local Market (c3, c4 & c933)	262,732,782,825	26.7
of which exempted (c311, c322, c330, c331, c333, c.337, c..340)	68,082,076,766	
Subtotal	263,241,277,842	26.7
<b>Free Zones</b>		
Export (e900, e930)	952,926,450	0.7
Local Market (c930)	3,250,991,256	2.3
Subtotal	4,203,917,706	2.9
<b>Total exits</b>		
Export	1,461,421,467	0.1
Local Market	265,983,774,081	23.5
Grand Total	267,445,195,548	23.7

Despite this extreme form of physical control, there are many stories of abuse of bonded warehouse facilities. Consumer electronics, for instance, which are imported into warehouses under temporary exemption and subsequently released for re-export to neighboring countries are reportedly sold in the domestic market without payment of duty (or VAT).

In response to such abuses, CEPS has recently tightened controls on the transfer of goods into bonded warehouses. Entries into warehouses must be applied for on a consignment-by-consignment basis. The result is long and arbitrary delays in granting permission for such entries, with the normal delay being 4 to 7 days. This causes high and unnecessary port and storage charges, and the process invites and encourages the payment of unofficial facilitation fees. These costs must be paid by honest and dishonest importers alike, without discrimination. And this part of the "control" process does nothing to improve the systems for monitoring and controlling goods which enter warehouses under bond.

A detailed analysis of monitoring and control procedures for bonded warehouses is provided in a

related report.<sup>6</sup>

In addition to reviewing its systems for bonded warehouses, the government might well wish to review the purposes of its bonded warehousing programs. In particular, it might wish to ask whether it really wishes to grant deferrals of import duty and VAT payments on common consumer goods. The costs in terms of both compliance and control of the systems are high. The potential for abuse appears to be equally high, putting honest importers and producers at a disadvantage in the local market relative to those who are willing and able to use the system to avoid payment of taxes. Requiring that all consumer goods make immediate payment of taxes and duties on clearance from the port of entry would contribute to the government's revenue needs at the same time as leveling the playing field in the domestic market and eliminating a major source of system abuse.

### *Free Zones*

The recent proliferation of free zones raises some even more serious issues of monitoring and incentive design. The *Free Zones Act, 1995 (Act 504)* is designed, in principle, to facilitate manufacturing for export. Under the provisions of the act, at least 70 percent of production in a free zone is meant to be exported.

This is a very important function for a country like Ghana. Ghana has a "high cost" economy, due, among other things, to a wide variety of factors in the tax and the regulatory environment. Principal among these are inefficiencies in importing from and exporting to the outside world. This high cost environment makes it difficult to attract outward-oriented investments. Free zones, if designed and managed efficiently, can be an important vehicle for overcoming tax and regulatory barriers to exports.

Despite these intentions, it is reported that the vast majority of free zone enterprises currently licensed or in operation are mere trading companies, with little or no actual production or manufacturing. Why would trading companies wish to establish themselves as free zones rather than bonded warehouses? There are two obvious types of answers.

First the monitoring and control systems for free zones are even weaker than for bonded warehouses.<sup>7</sup>

Second, the act also provides extremely generous income tax incentives for zone operators and

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<sup>6</sup> Vincent Castonguay *Review of CEPS Activities with Respect to Controls, Processing Procedures and Trade Facilitation Regimes* (Sigma One Corporation), September 1999.

<sup>7</sup> See Vincent Castonguay *ibid.* for more details.

enterprises. According to Paragraph 28 of the Act, free zone developers and enterprises are exempted from all income tax on profits for 10 years, and are guaranteed a maximum rate on income tax of 8 percent in perpetuity afterwards. In addition, all shareholders of such companies are exempted, without time limit, from the payment of withholding taxes on dividends arising from these investments.

Under such incentive schemes, and in the absence of adequate monitoring and control systems for free zones, it is surprising, not that close to a hundred zones and/or enterprises have been established already, but rather that there still exist *any* taxable companies in Ghana that have not yet set up such enterprises.

### **Other Temporary Imports**

Goods are also granted temporary entry under exemption if they are intended to be transshipped or re-exported to other countries. This is a legitimate form of business and can be quite useful and profitable for a country whose port, customs and transport systems are superior to those in neighboring countries, or if the neighboring countries in question are landlocked.

While there is undoubtedly a considerable amount of legitimate business of this sort, it is also apparent that this kind of temporary entry is often used to avoid Ghanaian customs regulations. Stories abound of traders who bring in ten containers of goods on this basis and subsequently obtain customs documentation of transshipment and re-export, when, in reality, almost all of the goods never leave Ghana and are sold in the local market in competition against local goods or imports that have come in tax and duty paid.

### **Raw Materials Used by Exporters**

Exporters should be exempted from the direct, cost-raising effects of import taxes. This can be done through bonded warehousing and manufacturing facilities, exemptions, or duty drawbacks. There is always a danger of leakage under such systems. The most serious problem of this sort is usually with respect to imports which are granted exemption from duties, or drawbacks, in respect of exports that never occur.

There are reported to be leakages of consumer goods imported into Ghana under bond and which are claimed to be, but not actually, re-exported over land to neighboring countries. While it is necessary to police such fraudulent exports, it is important to do so through systems which do not interfere with and raise the costs of legitimate exporters. As revenue concerns have heightened in recent months, there are reports that the "police function" has begun to dominate the trade facilitation function of customs. A review and improvement of procedures for dealing with the legitimate and increasingly important role of export facilitation might be timely.

### *Indirect Exports*

A perennial difficulty of import facilitation programs for exporters is in providing for the needs of “indirect exporters” — for example box makers who import cardboard for cartons used to package exported goods. If the box maker is not the direct exporter of the packaged goods (e.g. fresh pineapple), it might be very difficult to secure the documentation necessary to claim a duty exemption or drawback on cardboard imported for this purpose. International practice has shown that the most effective way to deal with this problem is to have the box-making and final packaging of the export good done under bond, with provision for shipments of intermediate goods (e.g. boxes) to bonded export firms to be treated themselves as shipments outside of the local customs area of the country — i.e as exports.

Ghana has a number of facilitation programs for exporters, including statutory exemptions for certain major export producers, bonded and free zone facilities, and a duty drawback program. Bonded warehouses and free zones are dealt with separately.

### *Duty Drawbacks*

The duty drawback system is not operating well. Producers report that drawback payments are extremely slow to be processed and in many cases almost impossible to obtain. The minimum time required to process a claim is 3 to 4 months; but the norm is much longer, and many claims are never realized.

Not only are procedures slow and cumbersome; they also require that claimants relinquish their sole copies of official import documents, creating serious difficulties for subsequent company record-keeping. The documents they are required to provide in this manner are already kept on file in Customs, and so it is unclear why exporters must relinquish their copies.

The procedural problems with duty drawbacks have made it necessary for companies to employ special drawback consultants, adding further to the costs of exporting from Ghana.

### *Free Zones*

As discussed earlier, free zones can play a critical role in facilitating Ghanaian non-traditional export growth. In redesigning the monitoring and control systems in these zones, it will be important to bear in mind and to be sure not to interfere with their principal goal of easing regulatory burdens on exporters.

### *Other Special Export Programs*

Since cocoa, most minerals, and almost all the production of the Volta Aluminum Company

(VALCO) are exported, the import duty exemptions granted to COCOBOD, the Minerals Commission and to VALCO could be thought of as special, sector-specific duty exemption programs for exports. In this light, any discussion of the possibility of eliminating these exemptions would have to bear in mind that such a move would have very few net revenue implications (unless the government wished to penalize these particular exporters). The key question in this regard, therefore, is whether an alternative form of exemption would be administratively or economically more effective than the present schemes.

## Investment Incentives

Many countries have felt it necessary to employ tax incentives to attract foreign and domestic investment. A particular type of tax incentive is exemption from import duties on capital equipment and/or raw material inputs.

International experience on tax incentives around the world has shown that

- C tax incentives rank very low in the priorities of investors in making investment decisions,
- C stability and certainty in the tax regime is far more important for investors than availability of discretionary incentives,
- C tax incentives usually result in transfers of government revenues to foreign governments or to firms who would have invested even in the absence of the incentives, and
- C tax incentives usually have unintended and unanticipated effects which are biased in favor of large, well-established firms for whom the incentives are unnecessary, and against smaller firms for whom some assistance might be important.

In addition, WTO rules now seriously restrict the ability of governments to utilize tax incentives in the ways in which they were employed in the past.

Realizing the ineffectiveness of tax incentives, their potentially harmful and unproductive incentive effects, and their significant revenue costs, many countries are seriously restricting their use, and often abandoning them entirely. Narrowly defined investment promotion is now focusing much more on marketing and provision of information. In a broader perspective, governments are realizing the importance of stability, certainty and transparency of tax and regulatory regimes as the basis for promoting sustainable investment growth and economic development.

In Ghana, the GIPC is involved in provision of two types of tax incentives — those related to company income tax, and to customs duties. This report concentrates on the latter.

The GIPC does not itself grant import duty exemptions or concessionary rates. All incentives in this regard are provided under the Customs and Excise Act (1996, Act 512, as amended in 1998, Act 545). The GIPC, however, advertises two sets of import duty concessions available to investors.

- C Lists of items in chapters 82, 84 and 85 of the Tariff Book are zero rated for customs duty.

These rates are not specific to any particular end uses or end users; they apply to all imports of these goods.

- C A smaller, but rapidly growing list of imports, all itemized in chapter 98 of the Tariff Book, are granted concessionary rates for specified end-users. These concessionary rates are available only when the goods are imported “by manufacturers approved by the Commissioner” (Ch. 98A) or “by enterprises under the Ghana Investment Promotion Centre Act, 1994 (Act 478)” (ch. 98B). For many items, the Tariff Book specifies particular end uses for these products (e.g. “polyethylene for the manufacture of mosquito nets”, “materials for mosquito coils”, “raw materials for manufacturers of pipes and tubes of plastic”, “steel wire for hexagonal wire netting”, etc.). The concessionary rates are all either 0 or 10 percent.

Importers must apply for the concessionary rate privilege on a consignment-by-consignment basis. Application is submitted only after arrival of the goods in port, and must be processed in the CEPS Head Office. The application must be physically delivered to the Head Office, and the letter giving the resulting ruling must be released by Customs for delivery to the port of entry before goods can be cleared at the concessionary rate. This process routinely takes 3 to 4 days and can often take 7 days. If the importer wishes to clear the goods beforehand, he must do so at the non-concessionary rate, and it is highly unlikely that a refund would be granted after granting of the concessionary rate.

As currently administered, the concessionary rate system is a mixed blessing and is of limited effectiveness as an incentive to domestic manufacturers. At a minimum, it adds 3 to 7 days to the time required to clear goods through Customs. This results in additional port and storage charges; it ties up goods in inventory; and the process invites and encourages the payment of unofficial facilitation fees.

Many of the items under this program are used almost exclusively in further manufacturing processes, and are not really of a dual use nature. For some of them, the concessionary rate is the same as the regular rate. In all such cases, there is no need to limit imports to approved manufacturers and to require application and approval on a consignment-by-consignment basis.

### **Imports Governed by International Agreements: Diplomatic Missions and Technical Assistance Schemes**

Without the consent of donors and lenders, Ghana has no choice over the granting of exemptions on imports associated with aid-funded projects. While it might be interesting to enquire whether such organizations and governments would be willing to relax these conditions, this would be a long-term exercise at best.

The same is true of privileges accorded to diplomatic missions.

However, Ghana has an obligation to itself and to its international donors and lenders to ensure that such exemption regimes serve their intended purpose, and do not become a general conduit for duty free imports.

Although only a very small share of exempt imports seems to enter under these categories (especially so for grants and aid), there is a disproportionately large number of “popular” stories about abuses of these privileges. It might be that some exempt imports under technical assistance are classified in some other category, such as “Ministry of Finance” or “National Revenue Secretariat.”

### **Imports by Government Departments and Agencies**

Ghana operates a Treasury Credit Note (TCN) system which requires all Ministries, Agencies and Departments that operate on the Consolidated Fund to pay import duties, chargeable to their vote in the Annual Estimates. Despite this, Tariff item F.1 in Part A of the Third Schedule of the Customs and Excise Act grants exemption from import duties to “All goods imported or purchased in Ghana by or for the use of the Head of State of Ghana.” Imports under this item appear to be very small relative to total imports (see Table 1).

### **Other Special Purpose Exemptions**

The Third Schedule includes a number of other special purpose exemptions, in particular for

- C advertising matter,
- C fishing floats and gear, and
- C chemicals for agricultural purposes.

Without an appreciation of the history of the exemption on advertising materials, it is difficult to understand why Ghana has chosen to provide such special import privileges to this activity. Very few countries in the world offer such a privilege (or levy such a tax on domestic producers of advertising materials).

In the cases of fishing gear and agricultural chemicals, there is nothing that is accomplished by an exemption (and accompanying registration and approval mechanisms) that could not be accomplished more simply and effectively by a zero tariff rating for such products. It is possible that the exemptions for these products arose from the need to grant special privileges to basic industries in an era of foreign exchange controls. If that is the case, the justification for duty exemptions is certainly no longer relevant.

## **5. Options and Recommendations for Ghana**

## **Review the Rationale for all Import Duty Exemption Programs in Ghana**

Ghana has a wide variety of import duty programs. The rationale for many of them is long forgotten. Some programs might have arisen from needs related to import licensing and foreign exchange control programs, or to the sales tax regime, which are no longer in place. Others might be due to previous tariff regimes which were more complex and had much higher rates than at present. Some exemption programs were designed to achieve social purposes which could now be achieved by more effective means.

### *Recommendation 1:*

Parliament should review all import duty exemption regimes to determine whether import duty exemptions remain the most appropriate means of attaining their desired goals.<sup>8</sup>

## **Systematic Collection and Reporting of Imports Under Every Exemption Program**

It is very difficult to track imports under the wide variety of exemption programs in operation in Ghana. To properly monitor, control and design policies in this regard, such basic information is essential. Import duty exemptions are inherently non-transparent in their costs and their benefits. Ghana must increase the transparency of any exemption programs that it decides to retain.

### *Recommendation 2:*

Revise and elaborate the Customs Processing Codes (CPCs) used by CEPS so as to properly reflect the authority and the programs under which all exempt imports enter the country. CEPS and/or the Ministry of Finance should be required to publish and present to Parliament regular reports on the amounts and types of all goods imported under each program.

## **Improved Monitoring and Control of All Goods Imported Under Exemption**

There are serious weaknesses in the monitoring and control of exempt imports into Ghana. For many of the Third Schedule exemptions, division of authority between line ministries and the Ministry of Finance leads to major implementation gaps. Systems governing bonded warehouses and free zones have serious weaknesses. Attempts to deal with these systemic problems through periodic *ad hoc* measures do little to deal with the underlying problems, while raising the costs of doing business for everyone.

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<sup>8</sup>Such a review also could be carried out by a specialized agency or department such as Finance or CEPS. The main point of the recommendation is to ensure a thorough and transparent review, whose results will carry sufficient weight to ensure appropriate legislative and administrative follow up.

*Recommendation 3:*

All Third Schedule exemptions should be placed under supervisory authority of the Ministry of Finance. As part of its responsibility under this authority, the Ministry should impose uniform requirements with respect to the detailed listing of all exempt imports, timing, deadlines and cumulative accounting requirements for exempt imports. All line ministries and departments involved in recommending exemptions should be required to follow these procedures, and CEPS should be required to ensure their proper implementation.

We were informed that similar measures were recently agreed with the IMF. However, soon after detailed implementing guidelines and procedures had been drawn up by Ministry of Finance officials, some higher authority removed the file from those who had been assigned responsibility for the measures. No further action has been taken.

*Additional Recommendations:*

Further options and recommendations for dealing with many of these systemic problems are provided in a related report.<sup>9</sup>

## **Exemptions for Social Purposes**

Import duty exemptions are a crude and ineffective way to subsidize most social purposes. They are also open to abuse.

*Recommendation 4:*

Import duty exemptions should no longer be used to subsidize “social purposes”. In particular, tariff items F.5, F.6, F.54, F.57 and F.61 should be removed from the Third Schedule of exemptions under the Customs and Excise Act. Sensitive or particularly important items imported under these categories should have their statutory tariff rates reviewed in light of the standard treatment afforded to similar goods in the tariff schedule. Tariff rates should not diverge significantly from those applying to similar goods, and should apply to all importers and end users. In cases where continued subsidization is deemed to be necessary, Parliament should find more direct and transparent means of doing so.

*Recommendation 5:*

In the interim, or in the event Parliament decides to retain some special import tariff

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<sup>9</sup> Vincent Castonguay *Review of CEPS Activities with Respect to Controls, Processing Procedures and Trade Facilitation Regimes* (Sigma One Corporation), September, 1999.

treatment for some NGOs, charitable activities, etc., all bodies subject to such special privileges should be reviewed with respect to international norms for the registration of these organizations and activities; their status should be reviewed on an annual basis, and they should be required to submit to annual financial audits.<sup>10</sup>

*Recommendation 6:*

Any new exemptions granted under the tariff items listed in Recommendation 4 should be issued under new monitoring and control procedures which include

- C a clearly itemized list of eligible goods, providing descriptions (including HS tariff codes), quantities and values of each of these goods to be imported under exemption,
- C a sunset clause in the form of a timetable for the imports, including a deadline after which further exemptions will not be granted without submission and approval of a new application,
- C a system for checking all import entries against the approved list of exempt items and for verifying the cumulative imports against the approved list,
- C post-audit procedures for verifying that goods are used for the approved purpose, and
- C when applicable, procedures for disposing of and/or making tax payments on goods remaining after completion of the activity for which the imports were approved.

All existing permission letters in respect of such exemptions should be revoked, and, where appropriate, be eligible for renewed application under these procedures.

### **Procedures for Exemptions on Technical Assistance Projects**

Uniform, consistent and effective procedures should be developed and implemented for the approval, monitoring and control of exemptions on all technical assistance projects.

*Recommendation 7:*

The government should approach international donors and lenders to explore the possibility of exempting Ghana from requirements to provide tax and duty free privileges on internationally funded technical assistance projects.<sup>11</sup>

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<sup>10</sup> In some countries, these audited financial statements are required to be made available as public information.

<sup>11</sup> The government of Ghana could not and should not take unilateral action in this regard, since loan and grant agreements typically provide that “the proceeds of the loan/grant cannot be utilized to pay local taxes.” Donors who are serious about assisting Ghana to achieve a uniform tax and tariff system, without exemptions or special rates, might be willing to waive this condition in future agreements. Some would argue that this is impractical, and that this is an initiative that must be pursued, if at all, by donors rather than the government of Ghana.

*Recommendation 8:*

The government should review its procedures for monitoring and controlling exemptions under internationally funded technical assistance projects (Third Schedule tariff item F.3). Included in the requirements for approval of exemptions for this purpose should be a board within the Ministry of Finance to set common standards for monitoring and controlling tax exemptions under all donor-funded projects and activities subject to internationally-required exemptions. No exemptions would be granted on any new project before meeting the board's requirements, which would include:

- C a clearly itemized list of eligible goods, providing descriptions (including HS tariff codes), quantities and values of each of these goods to be imported under exemption,
- C a sunset clause in the form of a timetable for the imports, including a deadline after which further exemptions will not be granted without submission and approval of a new application,
- C a system for checking all import entries against the approved list of exempt items and for verifying the cumulative imports against the approved list,
- C post-audit procedures for verifying that goods are used for the approved purpose, and
- C when applicable, procedures for disposing of and/or making tax payments on goods remaining after completion of the project for which the imports were approved.

*Recommendation 9:*

All existing exemption letters issued by the Ministry of Finance in respect of donor-funded projects would be terminated within three months and, where necessary, renewed under the new procedures.

### **Investment Incentives Under the GIPC Act**

Following the lessons learned from international experience, and the models now being set for “best international practices” in investment promotion, Ghana should cease using tax incentives for this purpose.

*Recommendation 10:*

In its next budget, or more immediately, the government should announce the cessation of the practice of granting new VAT, excise, import or income tax incentives to private investors.

*Recommendation 11:*

The scope of work of the GIPC should be redirected to marketing and information provision, investment facilitation, and identifying areas in which regulatory reform is required to improve the investment climate in Ghana. Annual reports and periodic reviews of the regulatory environment should be prepared and submitted to Parliament, where line ministries would be given the opportunity to respond to issues raised in these reports.

**Exemptions on Imports by the VRA**

There is no economic justification for subsidizing the VRA through a duty exemption on its imports. This is especially true now that the VRA is in competition in the local market with independent power producers.<sup>12</sup>

*Recommendation 12:*

Tariff item F.9 should be removed from the Third Schedule of exempt imports under the Customs and Excise Act.

**Exemptions Under the Minerals and Mining Law, Under the VAC Contract and for COCOBOD**

The principal economic justification for the exemptions on imports under the Mining and Minerals Law, under the VAC contract, and for COCOBOD is that the products of these activities are almost entirely exported. Their profitability (or not) is relevant to the design of royalties and other taxes, but not import duties. In fact, attempting to tax economic rents from mining or aluminum production (which would arise only from rents in electricity prices) through import duties is highly inappropriate since imported materials are costs, not revenues.

The existing exemption schemes might be the most effective way to shield these activities from the costs of import duties, especially in light of deficiencies in Ghana's duty drawback program. However, as suggested in earlier recommendations, above, on the monitoring and control of exemptions, these particular programs should be reviewed and improved in the same manner.

*Recommendation 13:*

The import duty exemption programs for mines, VAC (tariff item F.8) and COCOBOD (tariff item F.60) should be reviewed and evaluated against the alternatives of applying

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<sup>12</sup> An alternative to removing the VRA exemption would be to grant similar exemptions to all IPPs. However, this would aggravate rather than help solve the problem of the use of incentives.

standard duty drawback or free zones which are available to all exporters.

*Recommendation 14:*

As long as the current exemption programs remain in place, monitoring and control systems should be improved according to the suggestions in Recommendation 8 above.

### **Exemptions for the Head of State of Ghana**

Tariff item F.1 in the Third Schedule of the Customs and Excise Act, while a standard provision in many tax codes (“the Crown shall not tax the Crown”, etc.), is out of place in Ghana, which has an advanced and apparently well-functioning Treasury Credit Note system under which government ministries, departments, agencies pay applicable import duties.

*Recommendation 15:*

Remove tariff item F.1 from the Third Schedule of the Customs and Excise Act.

### **Other Special Purpose Exemptions (Advertising Matter (F.51), Fishing Floats and Other Fishing Gear (F.56), Chemicals for Agricultural Purposes (F.59))**

There is nothing achieved by such exemptions that could not be achieved more directly, transparently and effectively through the regular import tariff system.

*Recommendation 16:*

Eliminate tariff items F.51, F.56 and F.59 from the Third Schedule of the Customs and Excise Act. Review and, where necessary, adjust the statutory rates afforded these items in light of the rates facing similar goods in the tariff book.

### **Concessionary Rates for Manufacturers**

Concessionary duty rates for manufacturers generate large administrative burdens on CEPS and leave open significant possibilities for discrimination and for rent-seeking. A further review of this program and associated recommendations are contained in a related report.<sup>13</sup>

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<sup>13</sup> Roshan Bajracharya and Frank Flatters, *Ghana's Trade Policies: Tariff Rate Structure and Revenues*, October, 1999.