The impact of increasing VAT rate on state revenue, a South African case

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Abstract. The study seeks to evaluate the impact of the increase in VAT rate from 14% to 15% on the state revenue as well as on future VAT collections. VAT historical data spanning from April 2009 to March 2018 (108 observations) on a fixed rate of 14% was obtained. Assuming no change on the 14% VAT rate, ARIMA(0,1,1)(0,1,1)12 was fitted to the data to predict the collection of R311.2bn and R326.7bn for 2018/19 and 2019/20 respectively. The difference between prediction (at 14% rate) and actual realisation of R324.8bn and R346.7bn for the same period (at 15% rate) was computed to get the impact. Based on the model fitted values, a percentage increase in VAT rate increased payments by 4.2% in 2018/19 and 5.8% in 2019/20. This results in a slight increase in the total state revenue of 1.1% and 1.5% in 2018/19 and 2019/20 respectively. Furthermore, the model forecast R313.9bn to be collected in 2020/21 at 15% rate, the lower collection is due to the covid-19 impact on revenue collection. The usage of these types of models will assist the South African government in their budgetary plans and future decisions by taking into account more accurate projected VAT collection. However, monitoring of the model is crucial as the prediction power deteriorate in the long run.

Keywords. South African Revenue Service (SARS), Value Added tax (VAT) and Seasonal Autoregressive Integrated Moving Averages (SARIMA).

JEL. H24, C15, E37.

1. Introduction

Value added tax (VAT) is an indirect tax which is levied on consumption of goods or services. It is the second largest tax, having a fixed tax rate of 14% (Tax Statistics, 2019). Since 1993, the VAT rate had remained fixed at 14%, lower compared to other countries. The former minister of finance, Mr Malusi Gigaba, during parliamentary budget speech on the 21 February 2018 revised the VAT rate upwards by 1% to 15% and declared it to be effective from 01 April 2018 onwards as one of the tax proposals designed to generate more tax revenue for the SARS fiscal year 2018/19. However, basic foods such as brown bread, dried beans, maize meal, and rice will remain zero rated to limit the impact on the vulnerable and poorest household (Budget Speech, 2018).

It is widely known that the collection of the state revenue is related to the economic performance of Gross Domestic Product (GDP) or some...
components of GDP, which is normally referred to as the base. The VAT base would be total household consumption. The increase in VAT is good for the state to function at its maximum capacity and the consumers may have some relief from the zero rated goods and services. However, the burden of a percentage increase in VAT will heavily affect poor citizens.

VAT contributes 25% to total tax revenue and 6.6% to the South African nominal GDP. During fiscal year 2018/19 the registered VAT vendors were 802,957 from which 448,710 (55.9%) were active. The vendors were distributed into companies and close corporations (77.2%), Individuals (17.3%), Trust (2.8%), Partnerships (1.7%) and others (1%) (Tax Statistics, 2019).

The VAT payments by sector for the fiscal year 2018/19 shows that finance was the highest, contributing 158.9 billion (42.1%), followed by wholesale at R55.8 billion (14.8%), manufacturing at R53.8 billion (14.2%), communication, social & personal service at R24.0 billion (6.4%), construction at R22.4 billion (5.9%), transport, storage & communication at R22.4 billion (5.9%), mining & quarrying at R14.0 billion (3.7%) and other sectors share the remaining R224 billion (7.0%) (Tax Statistics, 2019).

The biggest debatable scenarios for the economists, statisticians and econometricians analysing the South African economic outlook just before the beginning of fiscal year 2018/19, was that if VAT is increased by 1% in 2018/19 fiscal year (first increase since 1993):

- What would be the impact of this increase to the economy and how would this affect the collection of VAT? Will this affect the economy positively or negatively?
- How can we measure the impact of this change? and
- How much can be expected from the economy beyond 2017/18 fiscal year?

This study aims to evaluate the impact of the 1% increase in the VAT rate starting from fiscal year 2018/19 by predicting VAT collections for 2018/19 and 2019/20 using the historical data at 14% rate and compare predictions with the actual realisation of VAT at 15% rate for the same period. The prediction utilises the commonly used time series model, SARIMA.

This paper is organised as follows; section 2 presents the literature review, section 3 is the theoretical models, section 4 shows the empirical results and analysis, and section 5 discusses model results and limitations. Conclusions and recommendations are provided in sections 6.

2. Literature review

Prediction or forecasting plays an integral part on planning and decision-making. Lack of planning might result in failure for the organisation. Different types of methods exist to predict or forecast the continuation of a historical trend. These methods could be classified either as qualitative or quantitative and the applications of these methods have their own advantages and disadvantages.
Under the quantitative methods, sufficient quantitative information should be available to build a model, which relates one variable, referred to as a response variable, to one or more explanatory variables. Such forecasting techniques are referred to as regression methods. The other quantitative technique is a time series model, which relates current or future occurrence to the historical patterns of the same variable. However, qualitative methods are used when there is little to no quantitative information, but sufficient qualitative information exists (Hyndman et al., 1998).

Various literature around the globe support the use of time series models to predict tax revenue. Edzie-Dadzie (2013) used time series analysis to forecast Ghana’s VAT revenue. The aim of the paper was to study the behaviour pattern and trend in Ghana’s VAT revenue and to choose the best model based on high predictability level among various ARIMA models. Yearly import and domestic VAT observations covering the period 1999 to 2009 (132 observations) were examined. The data was secondary data collected from the Research, Monitoring and Planning Department of the VAT Service and Monitoring and Evaluation Unit of CEPS, Headquarters Accra. Time series analysis was used to model the VAT historical patterns. An ARIMA (2, 1, 2) was found to be the best model to forecast domestic VAT revenue and an ARIMA (2, 1, 1) was found to be the best model to forecast import VAT revenue. A forecast of future VAT revenue for the next thirty-six months was done.

In their study on VAT revenue modelling, Gumbo & Dhliwayo (2018) used three different methodologies to forecast VAT revenues. The authors tested Exponential Smoothing, Elasticity Approach and the Effective tax rate approach to forecast VAT revenues. Secondary annual data used for this study covered the period 2010 to 2013 and was collected from the government of Zimbabwe publications, the International Monetary Fund (IMF), the World Bank, RBZ, Zimbabwe Revenue Authority (ZIMRA) and ZIMSTAT. VAT revenue data for the year 2009 was not available from ZIMRA. Exponential Smoothing had the lowest relative absolute forecast errors for the years 2012 and 2013 compared to the other forecasting techniques. The study recommends the adoption of a systematic VAT revenue forecasting approach and the insulation of the revenue forecasting process from political interference.

Similarly, Okseniuk (2015) conducted a study to show the use of moving averages, correlation and regression analysis in order to forecast VAT revenue. In addition, the author analysed the efficiency of the methods, computed a forecast for the years 2014–2016 and identified key reasons of the problems of VAT forecasting. The sample covering the period 2007 to 2013 was collected from the official websites of the Ministry of Finance and Treasury. The method of correlation and regression analysis was found to provide more precise forecasts compared to the moving average method. However, both methods do not take into account the change in tax rates and the introduction of differentiated rates. This is necessary in order to
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improve the moving average method and the method of correlation and regression.

In another related study, “Forecasting tax revenues using time series techniques – a case of Pakistan”, Streimikiene et al., (2018) collected 31 years of data from July 1985 to December 2016 to forecast tax revenue of Pakistan for 2017. The authors used three different time series techniques, namely AR model with seasonal dummies, ARIMA model and the Vector Autoregression (VAR) model and evaluated the efficiency of the model by using Root Mean Squared Error (RMSE) test. The data was collected from the different issues of the Pakistan Bureau of Statistics (PBS) monthly bulletin. The study indicated that the ARIMA model forecasted the best values of total tax revenue because the value of the RMSE was minimum compared to the AR model with seasonal dummies and the VAR model.

In the case of Ukraine, Legeida & Sologoub (2003) developed an ARIMA model to forecast VAT revenue in the short run. The aim of the paper was to test different methodologies for forecasting VAT revenues. The primary source of data was budget execution reports released by the State Treasury of Ukraine (VAT revenue plan and execution) and reports of State Tax Administration (VAT exemptions). Furthermore, the data from the State Statistics Committee (on GDP) and the data of the National Bank of Ukraine (on exports and imports) for VAT base calculation was collected. The data from the input-output tables was used to estimate the effective VAT rate. To build an econometric model, the readily available data for 1998-2002 (on a monthly basis) was used. The ARMA (2, 6) model provided a reasonable forecast of VAT revenues for 2003 that was fully consistent with government projections for the 2003 budget. The results revealed that actual VAT revenues are less than a half of potential VAT revenues.

Furthermore, Ofori (2018), in his paper titled “VAT revenue forecasting in Ghana”, estimated VAT revenue by using a sample of monthly observations spanning from 2002 to 2017. The ARIMA with intervention analysis method of forecasting outperformed the Holt trend model in forecast accuracy and precision. The ARIMA model was then used to forecast monthly VAT revenues for the next 24 months. The paper recommends that the ARIMA with intervention analysis model should be compared with the in-house model used at Ghana Revenue Authority for forecast accuracy and prediction and if it out performs the in-house model, it should be adopted by the Ghana Revenue Authority in forecasting monthly VAT revenues for the purpose of government budgets.

In another related study, Nandi et al., (2014) conducted a study to identify an appropriate model to forecast tax revenue. The models under study were ARIMA SARIMA multiplicative approach, Holt-Winters seasonal multiplicative approach and the Holt-Winters seasonal additive approach. The sample of monthly tax revenue spanning from July 2004 to November 2012 (101 observations) was collected from the Bangladesh Ministry of Finance. Out of the 101 observations, 84 data points were used to specify a model and the remainder was used to check for the fit of the
specifies model. The results revealed that the Holt-Winter seasonal multiplicative approach was the most appropriate method with minimum forecast error.

In the case of South African literature, Erero (2015) used the dynamic computable general equilibrium (CGE) model to analyse the effect of increases in VAT (by 1% to 5%) to other sectors and the national income (GDP), using annual data for the period 2012 to 2018. The findings showed that an increase of 1% in VAT rate will not affect lower income household but will impact the investments through the price of capital. Hence the GDP will increase slightly by around 0.022% in 2013 to 0.114% in 2008 and also show positive impact for the period 2013 to 2018. However, this study uses shorter time series and does not show how the VAT will increase for the period 2018/19 and beyond in monetary terms or percentage change (or growth) from 2017/18 financial year.

The availability of historical quantitative data for the South African VAT payments allows this study to focus on the time series quantitative methods, SARIMA model, to predict and answer the question; what is the impact of the increased VAT rate for 2018/19 and beyond?

3. Theoretical models

3.1. ARIMA/SARIMA model

The autoregressive integrated moving averages (ARIMA) model or the Box-Jenkins methodology relates the current observation to its historical occurrence and builds the relationship and stochastic error term, referred to as model fitting (Gujarati, 2003). This means that the series to be forecast is generated by a random process with a structure that can be described. The description is given in terms of the randomness of the process rather than the cause and effect used in regression models (Pindyck & Rubinfeld, 1998). This type of model requires the data to be stationary around the mean and the variance.

As stated by Gujarati & Porter (2009), in practice most time series are non-stationary. Normal ARIMA models are not applicable to such data. This implies that the series should be differenced to obtain stationarity as follows: \( \nabla y_t = y_t - y_{t-1} = (1 - B)^d Y_t \). The series may become stationary when \( d = 1 \) or \( d = 2 \) in practice. When this is done, the resultant series is ARIMA (p, d, q).

The ARIMA (p, d, q) is expressed as a back-shift operator in equation 1, alternatively, as the more general model in equation 2.

\[
(1 - \phi_1 B - \phi_2 B^2 - \cdots - \phi_p B^p)(1 - B)^d Y_t = \theta_0 + (1 - \theta_1 B - \theta_2 B^2 - \cdots - \theta_q B^q)\epsilon_t
\]

(1)

\[
\phi_1 (B)(1 - B)^d Y_t = \theta(B)\epsilon_t
\]

(2)

where \( \phi(B) = 1 - \phi_1 B - \phi_2 B^2 - \cdots - \phi_p B^p \), \( \theta(B) = 1 - \theta_1 B - \theta_2 B^2 - \cdots - \theta_q B^q \), \( (1 - B)^d Y_t = \epsilon_t \), \( d \) is the degree of differencing and \( \epsilon_t \) is a series.
of random errors each with zero mean and constant variance $\sigma^2$. The model in equation 1 for the series $Y_t$ is referred to as the autoregressive integrated moving average model of order $(p,d,q)$, and is denoted by ARIMA($p,d,q$). Note that the AR($p$), MA($q$) and ARMA($p,q$) models are special ARIMA ($p,d,q$) models. For example, the ARMA($p,q$) model is the ARIMA($p,0,q$) model, the AR($p$) model is the ARIMA($p,0,0$) model and the MA($q$) model is the ARIMA($0,0,q$) model.

Time series data can be non-stationary, and/or, exhibit the rise and fall on the fixed points for an observed period. Such series are called seasonal time series data and can be seasonally differenced to obtain stationarity. The general seasonal autoregressive integrated moving average (SARIMA) model is represented by ARIMA($p,d,q$) ($P,D,Q$), using a back-shift operator. It is then expressed as:

$$\phi(B)\Phi(B^s)w_t = \delta + \theta(B)\Theta(B^s)\eta_t$$

where $w_t = (1 - B^d)(1 - B^s)^D y_t = (1 - B^d - B^{sd} + B^{sd+d})y_t$ is the product of seasonal differencing $D$ and non-seasonal differencing $d$, $s$ is the series seasonality which takes the value 4 for quarterly time series data and 12 for monthly time series data, $\delta$ is the constant term and $\eta_t$ is the disturbance or error term at time $t$.

Furthermore Yurekli, Kurunc & Ozturk (2005), and Maindonald & Braun (2003) express $\phi(B), \Phi(B^s), \theta(B)$ and $\Theta(B^s)$ as follows:

$$\phi(B) = 1 - \phi_1(B) - \phi_2B^2 - \cdots - \phi_p B^p$$

is non-seasonal AR components of order $p$.

$$\Phi(B^s) = 1 - \Phi_1B^s - \Phi_2B^{2s} - \cdots - \Phi_p B^{ps}$$

is seasonal AR components of order $P$.

$$\theta(B) = 1 - \theta_1B - \theta_2B^2 - \cdots - \theta_q B^q$$

is the non-seasonal MA components of order $q$.

$$\Theta(B^s) = 1 - \Theta_1B^s - \Theta_2B^{2s} - \cdots - \Theta_Q B^{qs}$$

the seasonal MA components of order $Q$.

Typical methods of estimating the model parameters are either the least squares method and/or the maximum likelihood methods. These methods are briefly reviewed under the assumption that the identified tentative ARIMA and SARIMA models for a given time series $Y_t$ model in equation 2 and 3 above can be re-written for error term (assuming that$\delta = 0$) as equation 4 and 5, respectively:

$$\epsilon_t = \phi(B)(1 - B)^d Y_t \theta^{-1}(B)$$

$$\eta_t = \phi(B)\theta^{-1}(B)\Phi(B^s)w_t \Theta^{-1}(B^s)$$

3.2. In-sample measures

Given time series $Y_t$ where $t = 1, 2, \ldots, T$, there may be several competing ARIMA/SARIMA models for forecasting. According to Wei (2006), the models can be compared for goodness of fit using Mean Percentage Error (MPE), Mean Square Error (MSE), Mean Absolute Error (MAE) or Mean Absolute Percentage Error (MAPE), Akaike’s Information Criterion (AIC) and the Bayesian Information Criterion (BIC), depending on the model selection criteria.
The smaller the value of the statistic the better.

The crucial part in ARIMA/SARIMA models is to examine the model residual to identify if they are distributed normally around zero over the time period given. Here the graphical visualisation such as residual histogram and qq-plot could be of assistance. However, the most commonly used statistic to assess if the residuals are white noise process is the Ljung-Box Statistics which test for autocorrelation at lag k to see if the residuals are approaching zero and it is also a $\chi^2$ distribution with m degrees of freedom for larger sample size n. This statistic can be mathematically represented as follows:

$$LB = n(n + 2) \sum_{k=1}^{n} \left( \frac{\hat{\rho}_k^2}{n-k} \right)$$

where $\hat{\rho}_k^2$ is the squared autocorrelation at lag k for the selection of the model autoregressive and moving averages and $\hat{\rho}_k$ is computed by equation 7.

$$\hat{\rho}_k = \frac{\sum_{j=1}^{n-k} (w_j - \bar{w})(w_{j+k} - \bar{w})}{\sum_{j=1}^{n} (w_j - \bar{w})^2}$$

4. Model empirical results and analysis

4.1. Sample data

The historical VAT data spanning from April 2009 to March 2020 (108 observations) was obtained. However, for the period April 2009 to March 2018, the VAT payments were levied at 14% and the remaining April 2018 to March 2020 at the rate of 15% (see figure 1 below). The VAT monthly data in Figure 1 clearly indicate an increasing trend and seasonal patterns over a fixed period with a peak in March every year. These suggest trend and seasonality in the data.
The remainder of this section focuses on the fitted model, some measure of accuracy and prediction/forecast thereof.

4.2. Fitted SARIMA model

The data in Figure 1 was then reduced to only cover the 14% rate horizon (April 2009 - March 2018) for the purpose of modelling and prediction. The natural logarithm transformation was applied to the data for normality and smooth modelling. Assuming no change on the 14% VAT rate, $ARIMA(0,1,1)(0,1,1)_12$ was fitted to the data to predict the collection for 2018/19 and 2019/20. The first differencing was applied to remove the trend and also seasonal differencing to remove seasonality in the data. The mathematical representation of the fitted model is shown in equation 8.

$$W_t = (1 + \theta_1 B + \Phi_1 B) \varepsilon_t$$

where $W_t = \nabla y_t = y_t - y_{t-1}$, $y_t$ represent ln(VAT), $\theta_1$ represent the first moving average, $\Phi_1$ the first seasonal moving average, $\varepsilon_t$ the error term, B represent the backshift operator with the effect $B^n(W_t) = W_{t-n}$, $B^n(\varepsilon_t) = \varepsilon_{t-n}$, $n = 1,2,3,...,p$ for autoregressive component of the model, $n = 1,2,3,...,q$ for moving average and $n = 1,2,3,...,Q$ for seasonal moving average.

Table 1 presents the parameters from the SARIMA model fitted to the natural logarithm transformed VAT data, which includes the coefficient (coef), standard error (s.e.), t-ratio and the p-values to check the significance of the coefficients. Table 1 clearly indicate that the log transformed data is explained by the first moving average and the first seasonal moving average.
### Table 1. Model coefficients and statistics

<table>
<thead>
<tr>
<th></th>
<th>$\theta_1$</th>
<th>$\Theta_1$</th>
</tr>
</thead>
<tbody>
<tr>
<td>coef</td>
<td>-0.809</td>
<td>-0.582</td>
</tr>
<tr>
<td>s.e.</td>
<td>0.075</td>
<td>0.121</td>
</tr>
<tr>
<td>t ratio</td>
<td>-10.749</td>
<td>-4.824</td>
</tr>
<tr>
<td>p-value</td>
<td>6.01E-27</td>
<td>1.41E-06</td>
</tr>
</tbody>
</table>

Source: Author’s computation

### 4.3. In-sample measure of accuracy

Table 2 shows the measure of accuracy on the data for the 14% rate horizon (the reduced data) to reveal the model performance which can be referred to as error measurement.

### Table 2. SARIMA measure of accuracy

<table>
<thead>
<tr>
<th>Error measures</th>
<th>ME</th>
<th>RMSE</th>
<th>MAE</th>
<th>MPE</th>
<th>MAPE</th>
<th>MASE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0.03026194</td>
<td>0.1041971</td>
<td>0.07390177</td>
<td>-0.3163756</td>
<td>0.7552092</td>
<td>0.6604111</td>
</tr>
</tbody>
</table>

Source: Author’s computation

As discussed in section 3.2, the most crucial thing in ARIMA/SARIMA models is to examine the model residuals in order to identify if they are distributed normally around zero. This can be achieved through visualisation of the residuals as shown in figure 2.

![Figure 2. Residuals histogram and Q-Q plot](source)

Source: Author’s computation
The two plots in Figure 2 shows the distribution of the residual overtime. It can be observed from the plots above that most of the values are spread around the zero mean. Thus, the residual histogram and the q-q plot seems to confirm the independence of the residuals.

The Ljung–Box test with a chi-squared of 21.435 from 20 degrees of freedom gave a p-value of 0.372 was obtained from the model. This is an indication of uncorrelated residuals which are assumed to be coming from a well specified model and for this reason the model will be used to predict VAT historical payments.

The model’s good fit on the sample data enables the model to be used for forecasting purposes with some level of accuracy. Depending on the tolerance level or error range, the model can be regarded as good. The rule of thumb error preference is the 5% error rate.

Table 3 compares the actual and the model fitted values for the fiscal year 2009/10 to 2017/18. Although the model performance was poor for the years 2010/11 and 2011/12, for the recent years the same model performed much better at an error rate lower than 5%.

### Table 3. Actual and models fitted values in rand million

<table>
<thead>
<tr>
<th>FY</th>
<th>Actual</th>
<th>Fitted</th>
<th>% Error</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009/10</td>
<td>147 943</td>
<td>147 853</td>
<td>0.1%</td>
</tr>
<tr>
<td>2010/11</td>
<td>183 572</td>
<td>202 533</td>
<td>-10.3%</td>
</tr>
<tr>
<td>2011/12</td>
<td>191 021</td>
<td>206 283</td>
<td>-8.0%</td>
</tr>
<tr>
<td>2012/13</td>
<td>215 023</td>
<td>217 136</td>
<td>-1.0%</td>
</tr>
<tr>
<td>2013/14</td>
<td>237 668</td>
<td>240 557</td>
<td>-1.2%</td>
</tr>
<tr>
<td>2014/15</td>
<td>261 295</td>
<td>263 353</td>
<td>-0.8%</td>
</tr>
<tr>
<td>2015/16</td>
<td>281 101</td>
<td>283 135</td>
<td>-0.7%</td>
</tr>
<tr>
<td>2016/17</td>
<td>289 167</td>
<td>297 803</td>
<td>-3.0%</td>
</tr>
<tr>
<td>2017/18</td>
<td>297 992</td>
<td>303 941</td>
<td>-2.0%</td>
</tr>
</tbody>
</table>

**Source:** South African national treasury and own computation

### 4.4. SARIMA model predictions/forecasts

Table 4 below presents the actual and model prediction for the year 2018/19 and 2019/20 and the difference thereof.

### Table 4. Actual and models predicted values in rand million

<table>
<thead>
<tr>
<th>FY</th>
<th>Actual (at 15%)</th>
<th>Prediction (at 14%)</th>
<th>Difference(Impact)</th>
<th>% Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018/19</td>
<td>324 765</td>
<td>311 223</td>
<td>13 542</td>
<td>4.2%</td>
</tr>
<tr>
<td>2019/20</td>
<td>346 747</td>
<td>326 703</td>
<td>20 044</td>
<td>5.8%</td>
</tr>
</tbody>
</table>

**Source:** Author’s computation

Assuming no change on the 14% VAT rate, the model fitted to the data predicted the collection of R311.2bn and R326.7bn for 2018/19 and 2019/20 respectively with 5% tolerance (error) level. The difference between prediction (at 14% rate) and actual realisation of R324.8bn and R346.7bn for the same period (at 15% rate) was computed to obtain the impact. Based on the model fitted, a percentage increase in VAT rate increased its payments...
by 4.2% in 2018/19 and 5.8% in 2019/20. This results in a slight increase in the total state revenue of 1.1% and 1.5% in 2018/19 and 2019/20 respectively.

Figure 3 below shows the VAT historical actual and forecast for financial year 2020/21 at 15% rate. The SARIMA model forecasted R313.9bn to be collected for the same period. This is lower than the collected net VAT for the period 2019/20 of R346.7bn by roughly R22bn. The lower collection is due to the covid-19 impact on revenue collection.

![Figure 3](image_url)

**Figure 3. ln(VAT) and forecast for 2020/21 in rand millions**

*Source: Author’s computation*

Table 5 unfold or disaggregate the 2020/21 forecast shown in figure 3 to monthly and cumulative forecast for the same period the actual for April and May 2020. Though there was an increase from 14% to 15% in VAT rate, the pandemic shock overwrites this increase and lowers the VAT collection.

<table>
<thead>
<tr>
<th>Month</th>
<th>Year</th>
<th>Point Forecast</th>
<th>Cum. Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Forecast</td>
<td>Lo 95</td>
</tr>
<tr>
<td>Apr</td>
<td>2020</td>
<td>18 777</td>
<td></td>
</tr>
<tr>
<td>May</td>
<td>2020</td>
<td>16 040</td>
<td></td>
</tr>
<tr>
<td>Jun</td>
<td>2020</td>
<td>24 503</td>
<td>19 433</td>
</tr>
<tr>
<td>Jul</td>
<td>2020</td>
<td>26 314</td>
<td>20 714</td>
</tr>
<tr>
<td>Aug</td>
<td>2020</td>
<td>25 970</td>
<td>20 296</td>
</tr>
<tr>
<td>Sep</td>
<td>2020</td>
<td>27 967</td>
<td>21 704</td>
</tr>
<tr>
<td>Oct</td>
<td>2020</td>
<td>26 514</td>
<td>20 436</td>
</tr>
<tr>
<td>Nov</td>
<td>2020</td>
<td>27 228</td>
<td>20 846</td>
</tr>
<tr>
<td>Dec</td>
<td>2020</td>
<td>29 318</td>
<td>22 302</td>
</tr>
<tr>
<td>Jan</td>
<td>2021</td>
<td>28 106</td>
<td>21 244</td>
</tr>
<tr>
<td>Feb</td>
<td>2021</td>
<td>27 200</td>
<td>20 432</td>
</tr>
<tr>
<td>Mar</td>
<td>2021</td>
<td>35 964</td>
<td>26 851</td>
</tr>
</tbody>
</table>

*Source: Author’s computation*

5. Discussion

The SARIMA model was used to model the monthly VAT collection contributing to the total state revenue. It was observed that the models captured the movement of these taxes with high precision. The monthly forecast was then aggregated to form SARS fiscal year forecast. These models are preferred for short term predicting/forecasting hence updating the model is necessary.

The measures of accuracy i.e. Mean Error, Root Mean Squared Error, Mean Absolute Error, Percentage Error, Mean Percentage Error and Mean Absolute Percentage Error were used to show model strength.

The SARIMA model was fitted on the 14% rate data. The model predicted R311.2bn and R326.7bn for 2018/19 and 2019/20, which is a difference of 4.2% in 2018/19 and 5.8% in 2019/20 compared to the actual realisation at 15%.

Generally, the use of the SARIMA model assumes the continuation of historical patterns but giving more weight to recent occurrences. This makes the model to be more reliable when short term predictions are made. However, the SARIMA model performance can be severely affected by unexpected shocks.

The Covid-19 pandemic which started to impact the world economy towards the end of calendar year 2019 impose a challenge on revenue collection. The unexpected pandemic shock (or outliers) will reduce the VAT maximum revenue collection for fiscal year 2020/21, resulting in lower overall collection. Estimates from the IMF, Reserve Bank and Organisation for Economic Co-operation and Development (OECD) suggest that economic growth in South Africa will contract by between 6 and 7 percent in 2020 (National Treasury, 2020). This will negatively affect both VAT on local consumption of goods and VAT on imports. South Africa has already seen lower import growth from the last quarter of the 2019/20 fiscal year, because of restrictions on international trading necessitated by the growth in COVID-19. This was evident in the top 10 trading countries, particularly China which makes up 20% of South Africa’s dutiable imports.

The South African government also imposed a hard lockdown on March 27, which lasted for over 60 days. The lockdown resulted in job losses as most businesses did not operate and some such as liquor, cigarette, recreation and restaurants were completely not allowed to operate.

The SARIMA model forecasted R313.9bn to be collected for 2020/21, a negative growth in VAT collection of 9.5% for the same period from the positive growth rate of 6.8% in 2019/20.

6. Conclusion and recommendations

A percentage increase in VAT rate increased its payments by 4.2% in 2018/19 and 5.8% in 2019/20. This results in a slight increase in the total state revenue of 1.1% and 1.5% in 2018/19 and 2019/20 respectively.
Furthermore, the model forecasts R373.6bn to be collected in 2020/21 at 15% rate.

The usage of these type of models will assist the South African government in their budgetary plans and future decisions by taking into account more accurate projected VAT collection. However, monitoring of the model is crucial as the prediction power deteriorates in the long run.

An increase in the tax rate increases the state tax, as a result government can fund social programmes and public investments that stimulate economic growth and development. However, the tax burden can also initiate or increase tax avoidance resulting in an expansion of the tax gap. This study recommends the balance between the increase in the tax rates and social benefits.
References


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