A brief by Chr. Michelsen Institute (CMI) and Centro de Estudos e Investigação Científica (CEIC)

ANGOLA BRIEF

February 2014 Volume 4 No.1

Poor revenue forecasting
A major challenge for sound fiscal policy in Angola

Photo: Odd-Helge Fjeldstad

Fiscal policy is the use of government revenue collection (taxation) and expenditure (spending) to monitor and influence the nation's economy. A major challenge facing fiscal policy and implementation of the ongoing non-oil tax reform in Angola is the inability to provide reliable revenue forecasts for planning and budgeting purposes. Accurate revenue forecasts are a key element for the design and execution of sound fiscal policies. Large forecast errors can lead to substantial budget management problems. While forecast errors can never be entirely avoided, in Angola budget revenue estimates systematically deviate from actual revenue receipts. This brief argues that a combination of technical and political issues contribute to explain the huge gaps between reported and projected revenues.

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UNRELIABLE PROJECTIONS

One of the key objectives of the Angolan tax reform project (*Projecto Executivo da Reforma Tributária - PERT*) is to increase non-oil tax revenue. This ambition has its roots in the crisis in 2008-2009 where collapsing oil prices resulted in the accumulation of massive arrears as very little revenue came into the treasury. In 2011, a very ambitious increase in non-oil revenue from 7.5 per cent to 10.2 per cent of GDP was projected for the 2012 fiscal year (a 43% increase from Kz 701.2 bn to Kz 1004.4 bn in nominal terms).[1] At the time of the projection it was seen by observers, including the IMF, as being highly ambitious. The Angolan government has a poor track record in producing in-year and year-end budget reports to monitor the extent to which the budget is adhered to by the administration. A year-end budget execution report for 2012 has not yet been published.[2] An in-year report covering the first three quarters of 2012 has been published, but data is presented in a way that makes it difficult to compare the non-oil projections directly.

Despite the difficulties in making comparisons the mentioned report did already at the time of its release indicate that revenue collection was falling significantly behind projections on non-oil taxes whereas oil related taxes were keeping the overall figures less off target. For example, the Personal Income Tax (which in the report is split into employees, self-employed and individual capital income) stands at only

39.8 per cent of the forecast. Of the projected individual capital income only 4.2 per cent had been collected.[3]

In the background analysis report accompanying the 2014 budget proposal the figure for the total 2012 non-oil revenue collection is reduced to 6.6 per cent of GDP, which is a long shot from the optimistic 10.2 per cent target (Table 1). This represented Kz 723.2 bn in revenues or a miniscule 2 per cent increase in non-oil revenues collected in 2011 (in nominal terms). Even with the historic low inflation of about 9 per cent this represents a contraction in non-oil revenues in real terms.

TABLE 1: NON-OIL REVENUE FORECASTS AND ACTUAL IN NOMINAL TERMS AND AS PERCENT OF GDP

	2011	2012	2013	2014
Non-oil revenue forecasted	662.3	1004.4	1119.2	1226.9
Non-oil revenue actual	710.6	723.2	916.5*	NA
Forecasted to GDP	7.9	10.2	9.4	9.6
Actual to GDP	7.5	6.6	7.8*	NA

** Preliminary figures*

Surprisingly, in spite of the shortfall in 2012, an even higher nominal increase in non-oil tax revenues was then projected for 2013. As reflected in Table 1, the projected non-oil tax revenue for 2013 was 9.4 per cent of GDP, which would require a more than 55 per cent increase in nominal terms from Kz 723.2 bn in 2012 to Kz 1,119.2 bn in 2013. Whereas the non-oil revenue-to-GDP of 9.4 per cent ratio is more modest than the 10.5 target in 2012, possibly taking higher oil prices into account, this still represents a very optimistic target. Already in the 2014 budget proposal the 2013 figure is revised considerably downwards to 7.8 per cent of GDP or Kz 916.5 bn in nominal terms. If patterns repeat, this figure is prone to be reduced even further when the final figures become available.

A hike is forecasted yet again for 2014 with a projected increase to 9.6 per cent of GDP. In nominal terms, this would require a 34 per cent increase in revenues from the revised 2013 figure. This pattern seems to indicate a systematic bias towards very high increases in non-oil revenue which is undermining fiscal planning and bear witness of a revenue forecasting system that is disconnected from reality.

A RECENT TENDENCY

Interestingly, the problems in forecasting seem to be more of a recent than a historic problem. As figure 1 illustrates the massive 'optimism' kicks in from 2012 whereas projections in previous years had been relatively accurate with actual non-oil revenues exceeding the forecasted amounts slightly in 2008, 2009 and 2011. It should be noted that the forecasts of 2009 and 2010 benefit from being taken from the revised budget produced much later in the year. Also bear in mind that the 2013 figure for actual revenue is a preliminary figure which is likely to be revised further downwards as noted above.

When presented as non-oil-revenue-to-GDP the pattern is similar. As figure 2 illustrates, the 2008 forecast was also very optimistic. The gap between budget and actual revenue closes progressively towards 2011 before the massive gap in 2012. The non-oil-revenue-to-GDP figure is highly influenced by the impact of oil revenues on the size of GDP. Angola had very high oil revenues in 2008 (Kz 2,603 bn) and exceptionally low oil revenues in 2009 (Kz 1,165 bn). With non-oil revenues increasing in absolute numbers the GDP ratio automatically goes up in 2009. In 2010 oil prices rebounded strongly (the revised budget increased the oil revenue projection with almost Kz 900 bn) again pushing the ratio of non-oil revenue to GDP down below 8 per cent of GDP. In 2011, oil revenues broke new records but non-oil revenues also performed strongly, possibly reflecting the impact of the first year of the tax reform.

The problem in 2012 seems to be that as oil revenues continued to grow, the non-oil revenues stagnated leading to the large gap between forecasted and actual non-oil revenues. Looking at the targets for 2012, 2013 and 2014 it may be suspected that the 'optimism' is driven by an ambition or a wish of reaching a 10 per cent of GDP target. Whereas the projected tax revenue in absolute numbers increased dramatically in 2012, 2013 and 2014 (see figure 1) it can be noted that the non-oil-revenue-to-GDP for these years is more or less constant around 10 per cent of GDP (see figure 2).

In any case it must be a quite uncomfortable finding for the leaders of the tax reform that the gap between the actual non-oil tax revenue and the forecast has been widening substantially after the introduction of the tax reform as this is usually a key indicator showing the need for reform. This is an issue that needs to be dealt with urgently by moderating the overoptimistic forecasts and become more realistic.

WHAT EXPLAINS THE UNRELIABLE PROJECTIONS?

When asked about the reasons for the inaccurate forecasts the management of the Executive Tax Reform Unit and the National Revenue Department provided two main reasons. First, they referred to the delay in introducing revised industrial (corporate) and personal income tax. This is

FIGURE 1: FORECASTS VS. ACTUAL REVENUE (BN KZ NOMINAL)

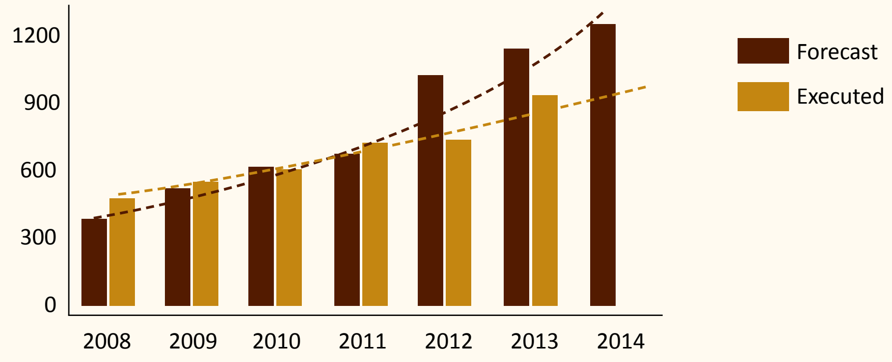
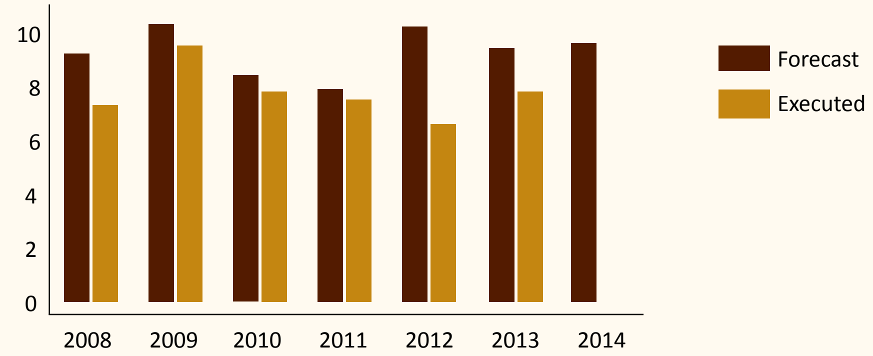


FIGURE 2: FORECAST VS. ACTUAL REVENUE (NON-OIL-REVENUE-TO-GDP (%))



an interesting argument as the main change to the Industrial Tax code is a reduction in the statutory rate from 35 to 30 per cent, in order to reduce the tax burden of the companies. Thus, everything else being equal, we would expect less revenue from this tax, unless the adoption of the reformed tax was accompanied by strengthened collection and enforcement mechanisms (as has been the case for the property tax).

The second reason given was that economic growth has been lower than estimated. The 2012 budget was based on a staggering growth projection of 12.8 per cent of GDP (up from 1.3 per cent in 2011). In the 2013 budget proposal it turns out that real GDP growth had actually been higher in 2011, registering 3.9 per cent of GDP, and the growth projection for 2012 was reduced to 7.4 per cent of GDP. The 2014 budget reveals that the actual growth figure for 2012 was 7.1 per cent. Growth projections for 2013 and 2014 are 7.1 and 8.8 per cent of GDP, respectively, with the projection for 2013 having already been lowered to 5.1 per cent. Overall, the picture resembles the one for non-oil revenue forecasts with overly optimistic growth projections which are then revised downwards and generally non-oil growth is expected to be higher than oil sector growth. This suggests that there is much truth to the second reason provided by the leaders of the tax reform referred to above.

It seems that a combination of political, economic and technical factors, explain the poor revenue forecasting and subsequent shortfall**,** including: (a) difficulties in diversifying the economy as fast as assumed by the forecasters and a remaining excessively narrow and volatile non-oil tax base (b) poor administrative capacity to assess the revenue base accurately; (c) tax evasion and resistance from taxpayers; (d) insufficient administrative capacity to enforce the taxes; (e) political pressure to provide optimistic non-oil growth and revenue projections; and (f) faltering political backing of the tax reform.

This indicates that there is a continued need to strengthen the administrative capacity of the tax administration with respect to revenue assessment and enforcement. However, the responsibility for the challenges in getting the revenue projections right does not fall exclusively on the tax administration within the Ministry of Finance. In Angola, it is not the Ministry of Finance, but the Ministry of Planning that prepares growth projections as part of its broader responsibility for the macroeconomic policies.

The Angola Brief series is an output of the CEIC-CMI Cooperation Programme for research in social and economic issues concerning Angola. The series aims to contribute research findings and policy recommendations to enhance public debate in and about Angola.

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This raises the question of whether the Ministry of Planning is adequately positioned and resourced to undertake this critical task and/or whether it is under political pressure to provide overoptimistic projections. If this is the case, such a strategy is neither conducive to the tax reform meeting its objectives nor to effective budgeting and management of Angola's public finances. A likely consequence of this is that the image of Angola will remain that of an underdeveloped country unable to put its own house in order, especially if oil prices should drop again as happened only 5 years ago.

Last but not least, if the political support from the highest levels is indeed faltering for the tax reform or being overridden by other priorities, international lessons show that it stands very poor chances of succeeding and the cost of keeping the reform initiative going should be reassessed critically.

CONCLUSION AND RECOMMENDATIONS

This brief argues that the pattern of overstated revenue forecasts is attributed to a combination of (a) the influence of political and economic factors, and (b) underdeveloped administrative capacities. It is not entirely clear whether any sophisticated forecasting methods are employed or if economic growth projections provided by the Ministry of Planning are adhered to by the revenue forecasters. This may be an indication of coordination or governance problems within the government. It may also be driven by a broader political agenda aspiring to produce tangible improvements in the quality of life of a broader segment of the Angolan population or merely deliver on the governing party's 2012 elections slogan of "grow more and redistribute better". Unfortunately, inflating growth and revenue projections is not only going to embarrass the government when figures need to be adjusted downwards (as in the presidential speech to the nation in October 2013), but also undermine efforts to improve income redistribution.

While biased revenue forecasts may be expected in a weak institutional environment, a combination of political and technocratic measures are required to develop more reliable revenue forecasts for planning and budgeting purposes in Angola. First, there is a need address the counterproductive political influence on growth and revenue projections. This should include the promotion of an open discussion of the impacts of skewed projections in the National Assembly. Second, there is need for more transparency in the budgeting process. Transparency is essential to reduce *ad hoc* and discretionary adjustments of the revenue projections. More detailed information can also contribute to improved data quality and increased accountability in the budget forecasting process by establishing mechanisms that provide assurances for the public and other interested parties of revenue forecasting credibility. Third, there is a need to improve the exchange of information and cooperation between government bodies in the revenue forecasting process. As part of this effort, the Government should review the Ministry of Planning's capacity to produce accurate growth projections. Independent oversight and scrutiny of projections versus executed figures should be guaranteed.

NOTES

1. Unless otherwise stated the figures quoted in this report are adopted from the Ministry of Finance's background analysis reports accompanying the budget proposals for 2011-2014 http://www.minfin.gv.ao/docs/dspOrcaPass.htm and http://www.minfin.gv.ao/docs/dspPropostaOrcam.htm

2. The Ministry of Finance submitted the year-end report (Conta Geral do Estado) for 2011 to the National Assembly in October 2013, but no report has been released for 2012.

3. The in-year report and accompanying spreadsheets can be found here: http://www.minfin.gv.ao/docs/dspRelExecOGE.htm

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ISSN 1892-3933