

Tax Collection Costs in Romania

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Abstract

The paper computes how much government did pay in order to collect 1 unit of taxes in Romania over 2004 – 2015 period. The cost of tax collection is derived from the Ministry of Finance spending budget, while the amount of taxes collected comes from the consolidated budget execution. Scaling the two metrics, I obtained the cost of collecting 1 unit of taxes. As additional metrics that captures the same effect, I computed the share of tax collection costs to GDP. I argue that given that the cost of tax collection in Romania is higher than the OECD average tax collection cost, any tax reform that would increase even further these costs is not feasible, especially when its impact on the amount of revenue collected is not known. This conclusion is further backed up by the tax collection costs to GDP ratio which almost doubled over the course of the period.

Key words: tax collection costs, tax revenue

J.E.L. Classification: H20, H83

1. Introduction

Tax collection is one of the central features of any tax system. Taxes should not only be assessed properly, but also should be collected as efficiently and effectively as possible. The words of Adam Smith, "Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state" (*Wealth of Nations*) never ceased to prevail.

That is why, when new tax reforms are proposed, the policy makers should not only look upon how much money did new taxes bring to public treasury or how much redistribution is achieved among taxpayers, but also they have to consider how much new taxes would cost to deal with. No doubt that assessing the costs of the new tax administration is a difficult task, but the expected trend of these costs are quite straightforward to anticipate. Would new taxes eventually increase or decrease the existing tax costs? Answering this question will provide an argument which may help policy makers to better justify their intended tax reforms. Bringing into this picture the actual amount of the existing tax costs and comparing with international similar metrics provides an even better image of the overall effects of the tax reform.

Romania presently enjoys a flat tax system with respect to both personal and corporate income taxes, being enrolled in the group of flat tax countries which exclusively come from the former communist bloc. In fact, among new EU member states, only Poland and Slovakia do not have nowadays a flat tax rate. Still, Slovakia used to have a flat rate until 2012. One of the main advantages of a flat tax rate resides in its simplicity which increases compliance and lowers the administrative burden both for taxpayers and tax authorities, which ultimately means lower tax collection costs. Thus, given the absence of various tax deductions and tax credits, it is expected that a flat tax system come with lower collection costs than a progressive tax system. Consequently, when governments want to drop flat tax, they need to look upon not only at the revenue side of the budget, but also on the expenditure side, i.e. tax collection costs. At the end, it is a matter of efficiency and effectiveness. Efficiency means lower expenditures incurred by tax

authorities, while effectiveness means higher compliance from taxpayers. How these are affected by dropping the actual flat tax rate? Can we have simultaneously a flat tax rate and a generous system of tax deductions? If not, and a progressive tax rates system is about to be introduced, does the additional budget revenues (if any) justify the deal, taking into consideration the associated tax administration costs?

The paper computes the tax collection costs for Romania for 2004-2015, puts the figures into international perspective by comparing to the OECD countries and makes policy recommendations accordingly. The rest of the paper is organized as follows: section 2 describes data and methodology, section 3 presents the results, while section 4 concludes.

2. Data and methodology

In order to assess the cost of tax collection I gathered data on how much the Romania's Ministry of Finance spent every year. Basically, based on the assumption that the main mission of Ministry of Finance is to collect taxes to the central budget, I used the annual spending of the Ministry of Finance as a proxy for the tax collection costs. Of course, in different countries the Ministry of Finance may have different duties, for instance duties related to the general economic policy, financial regulation and even monetary policy. However, this is not the case of Romania, where a Ministry of Economic Affairs always existed, where the financial regulation is delegated to an autonomous body and where the monetary policy is under the authority of the Central Bank. Consequently, the main duties of Finance Minister are budget execution (which includes tax collection) and public treasury and public debt management (which depends heavily on tax collection). I argue that the other remaining tasks (auditing, international cooperation, etc.) of the ministry are only marginal and also connected to tax collection and thus, do not affect significantly my proxy, neither in terms of the magnitude of the costs, neither in terms of its economic meaning. Put it more radically, if it weren't taxes (which obviously is not realistic), it weren't the Ministry of Finance. Moreover, disentangling the Ministry of Finance annual spending between tax collection activities and the other remaining activities is practically impossible given the available data. The data is presented in Appendix A.

The data on taxes collected were gathered from the annual budget execution reports. I collected total budget revenues, among which fiscal revenues have the largest share, as expected. The budget revenues refer to the overall budget revenues, namely consolidated budget revenues, which aggregates all the budgets, either central or local budgets, after controlling for intergovernmental transfers. The main taxes for which I collected data were: personal income tax, corporate income tax, value added tax, excise duties, customs duties, real-estate taxes and social security contributions. The first five taxes are going to the state budget, real-estate taxes are owed to the local budgets, while social security contributions are going to the social security budget. The Ministry of Finance collects all taxes, except real-estate taxes which are collected by the local authorities. The data is presented in Appendix B.

After collecting annual data on taxes and Ministry of Finance spending, I computed the tax collection costs in two versions.

First approach consists in computing the share of Ministry of Finance spending in various metrics of taxes collected: i) fiscal revenues plus social contributions; ii) fiscal revenues; iii) only taxes owed to the state budget (corporate income tax, personal income tax, value added tax, excise duties). The main variable of interest is Ministry of Finance spending to taxes owed to state budget ratio (last row). The other variables complements the picture of tax collection costs and provides a better understanding of the overall context. As suggested by OECD, a „downward trend can constitute evidence of a reduction in relative costs (i.e. improved efficiency) and/or improved tax compliance (i.e. improved effectiveness)“.

Second approach consists in computing the Ministry of Finance spending to GDP ratio. This metrics suggest how much of the GDP is dedicated to tax administration,

3. Results

The results are presented in Table 1.

Table no 1. Ministry of Finance spending to taxes collected ratio

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
MoF spending to fiscal revenues + social contributions	0.91	1.38	1.38	1.37	1.45	1.52	1.46	1.84	1.69	1.50	1.79	1.88
MoF spending to fiscal revenues	1.37	2.12	2.09	2.06	2.20	2.35	2.17	2.72	2.46	2.19	2.62	2.66
MoF spending to taxes owed to state budget	1.59	2.44	2.38	2.29	2.41	2.58	2.38	2.96	2.73	2.45	2.95	2.98

Source: Own computations based on Appendix A and Appendix B

The tax collection costs in all three versions gradually increased during the period covered. The costs almost doubled from 2004 to 2015, which shows that tax collection had become increasingly expensive (in relative terms), suggesting a lack of efficiency of tax authorities. The biggest annual increase was in 2005 when the major tax reform was implemented, namely the flat tax adoption. This indicates that a major tax reform comes with increased associated costs, which are expected to decrease once the new supposedly simplified tax system is properly (re)adjusted. However, this was not the case of Romania, where the adoption of flat tax triggered an ever increasing tax administration costs (as share of tax revenues). I argue that this was determined by the fact that flat tax did not increase the tax revenues to GDP ratio as table 2 shows.

Table no 2. Tax revenues to GDP ratio in Romania (%)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Fiscal revenues to GDP	17.89	17.84	18.99	19.54	18.66	17.47	18.19	19.11	19.49	19.04	18.53	19.63
Fiscal revenues + social contributions to GDP	27.02	27.35	28.81	29.48	28.27	26.94	27.12	28.35	28.32	27.73	27.08	27.81

Source: Own computations based on Appendix B

In spite of tax cuts triggered by flat tax adoption, the share of tax revenues to GDP varied too little during this period. The expected effects of flat tax (Lazar, 2010, p. 32) were not confirmed in terms of tax revenues to GDP ratio. Since the tax administration costs increased nominally (as an effect of implementing the flat tax as well as the EU acquis), but the tax revenues relative to GDP remains relative constant, the Ministry of Finance spending to tax revenues ratio increased constantly throughout the period.

With regard to the other metrics designed to capture the tax collection costs, namely the Ministry of Finance spending to GDP ratio, the results are presented in Table 3.

Table no 3. Ministry of Finance spending to GDP ratio

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
MoF spending to GDP ratio	0.25	0.38	0.40	0.40	0.41	0.41	0.39	0.52	0.48	0.42	0.49	0.52

Source: Own computations based on Appendix A and Appendix B

The numbers shows that the development over time of Ministry of Finance spending to GDP ratio follows the same pattern as Ministry of Finance spending to taxes collected ratio (table 1). The share of tax administration costs to GDP ratio is twice in 2015 as oppose to 2004, the biggest annual percentage increase being in 2005 (again).

Putting these figures into context by comparing to OECD countries tax collection costs reveals no enthusiasm for Romania. The average tax cost per 100 units of taxes collected is 0.99 in OECD 30 countries in 2009 (OECD, 2011b), with highest costs in Slovak Republic (2.41), Poland (1.72) and Japan (1.71) and lowest in Sweden (0.4), Iceland (0.32) and Switzerland (0.31). The situation stays the same when looking upon total revenue body expenditure as share of GDP. The average for OECD 24 countries is 0.26 (OECD, 2011b), with highest shares in Belgium (0.51), Netherlands (0.51) and Hungary (0.45) and lowest in United States (0.08), Iceland (0.08) and Switzerland (0.03). However, these figures have to be interpreted with caution because of several factors that affects tax collection costs among which the most important are: different tax rates and different tax bases, institutional design and tasks of tax authorities, macroeconomic conditions, etc.

5. Conclusions

In the brink of a much debated tax reform, the paper investigated the cost of tax collection in Romania over 12 years from 2004 to 2015. I found that tax collection costs increased gradually over this time, irrespective of how they were computed. This raise happened in spite of flat tax adoption which supposed to bring simplicity and efficiency to tax administration process. Meanwhile, the Romania accession to EU triggered administrative costs increases in order to adopt the EU acquis, therefore it is not feasible to say that the increase of tax collection costs was caused only by internal factors. But, what can be said is that flat tax did not make money pouring in the public treasury (table 2). The increase of administrative costs of the revenue body (Ministry of Finance), mostly determined by the EU accession was not accompanied by an increase of tax revenues to GDP ratio, which explains the development over time of both of the metrics that proxied tax collection costs. This suggests a lack of efficiency of the tax authority body which, in spite of spending more, did not collect more (in relative terms).

The proposed tax reform which consists in generous deductions together with a tax rate cut (from 16% to 10%) would generate higher administrative costs (claiming deductions is not as simple and not as cheap as one would think) and would not bring more money to the budget. Moreover, deductions value less when the tax rate is low, therefore administrative costs induced by deduction claiming may be higher relative to the actual tax savings that the taxpayer could get. Therefore, increasing tax rate while simultaneously granting more deductions would not only reduce the administrative cost relative to the potential tax savings, but also would bring more money to the public treasury.

6. References

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Appendix A The Ministry of Finance annual spending during 2004 – 2015 (thou RON)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Total spending	606,926	1,093,327	1,331,738	1,575,847	2,065,932	2,071,637	2,019,389	2,852,500	2,802,626	2,609,102	3,273,120	3,680,848
Current spending	536,287	928,394	1,094,377	1,493,885	1,962,199	1,919,806	1,889,619	2,425,540	2,648,919	2,321,101	3,203,678	3,586,941
Personnel spending	335,628	481,724	637,960	854,097	1,079,667	1,015,221	855,507	1,679,397	1,681,686	1,898,542	1,927,424	1,994,673
Goods and services spending	90,281	220,484	218,318	207,035	364,654	292,339	256,766	355,496	2,697,811	239,329	262,625	255,442
Capital spending	68,734	160,614	232,219	75,930	95,628	151,831	140,943	426,960	172,269	303,053	77,491	116,159

Source: Ministry of Finance Reports available at: <http://www.mfinante.gov.ro/pdfbuget.html?pagina=acasa>

Appendix B. The budget revenues and GDP in Romania during 2004 – 2015 (mil. RON)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
TOTAL REVENUES	76,956.10	90,679.60	106,975.3	127,108.2	164,466.8	156,624.9	168,598.45	181,566.9	193,148.2	200,045.66	213,833.56	233,554.29
<i>Current revenues</i>	75,112.30	88,248.00	104,004.00	123,298.90	158,976.00	151,086.40	158,474.70	173,541.10	184,030.70	190,649.12	199,774.41	215,401.13
Fiscal revenues	44,249.60	51,540.60	63,792.40	76,365.80	94,044.40	88,324.30	93,060.10	104,687.00	114,044.60	119,109.73	124,973.94	138,302.15
Taxes on income	14,626.20	14,606.80	19,105.20	26,319.00	32,920.80	31,829.90	28,926.10	30,106.50	32,782.90	34,926.74	37,376.19	42,090.92
Corporate income tax	6,483.80	6,533.90	7,938.90	10,558.30	13,045.90	11,893.00	10,115.10	10,309.10	10,854.50	10,925.74	12,237.73	13,824.27
Personal income tax	7,122.70	6,748.30	9,763.80	14,374.90	18,365.70	18,551.40	17,956.80	19,076.40	20,956.70	22,735.89	23,691.81	26,640.10
Other income taxes and capital gains taxes	1,019.70	1,324.60	1,402.40	1,385.80	1,509.20	1,385.50	854.20	721.10	971.70	1,265.12	1,446.65	1,626.55
Real-estate Taxes	1,757.90	1,880.20	2,544.40	2,944.90	3,362.20	3,377.70	3,801.50	3,976.40	4,060.40	4,403.17	6,185.08	5,737.99
Taxes on goods and services	26,036.20	32,828.20	39,448.00	46,061.20	56,362.80	52,072.10	59,358.90	69,558.40	76,127.40	78,774.80	80,352.22	89,207.84
VAT	16,547.20	22,537.90	27,763.00	31,243.20	40,875.10	34,322.40	39,246.00	47,917.40	50,516.00	51,827.03	50,878.47	57,132.17
Excise duties	7,996.30	9,079.40	10,588.10	12,511.80	13,599.40	15,579.20	17,378.90	19,104.80	20,260.40	21,106.05	24,094.79	26,017.96
Other taxes on goods and services	1,492.70	452.90	380.80	242.60	86.30	55.70	107.20	302.50	2,081.59	1,521.36	2,589.07	2,701.74
Taxes on activities	758.00	746.60	716.10	2,063.50	1,801.90	2,114.70	2,626.80	2,233.70	3,269.40	4,320.36	2,789.89	3,355.97
Customs duties	1,751.10	2,186.90	2,596.20	855.70	962.00	655.50	574.00	673.70	707.30	619.98	642.99	815.98
Other fiscal revenues	78.20	38.40	98.70	185.00	436.80	389.10	399.60	371.90	366.70	385.04	417.47	449.41
<i>Social contributions</i>	22,587.60	27,475.60	32,981.40	38,843.00	48,419.80	47,872.00	45,697.20	50,637.30	51,658.30	54,378.94	57,612.09	57,603.96
<i>Nonfiscal revenues</i>	8,275.20	9,231.80	7,230.10	8,091.10	16,511.80	14,890.20	19,717.40	18,216.90	18,327.80	17,160.45	17,188.38	19,495.02
Subsidies	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Capital gains	459.30	752.40	1,012.50	904.60	915.30	547.00	682.80	766.00	652.70	649.67	1,072.63	918.21
Donations	1,384.50	1,679.20	1,897.10	2,869.50	2,817.10	2,959.10	4,054.10	765.50	442.80	200.63	89.23	6.26
Funds from European Union	0.00	0.00	0.00	0.00	1,758.50	2,099.00	5,394.10	6,108.80	7,979.10	8,911.48	11,099.67	16,978.21
Financial revenues	0.00	0.00	61.80	35.10	0.00	15.30	14.30	0.00	0.00	0.00	0.00	0.00
Other amounts	0.00	0.00	0.00	0.00	0.00	-82.00	-21.60	385.50	42.90	-365.25	272.72	-28.77
Other amounts from European Union	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1,524.89	279.25
GDP	247,368.00	288,955.00	335,900.00	390,800.00	503,958.70	505,503.00	511,581.00	547,829.00	585,200.00	625,617.00	674,300.00	704,542.00

Source: Budget reports available at: <http://www.mfinante.gov.ro/execbug.html?pagina=buletin>