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ORIGINAL PAPER

The Cost of Collection Taxes: Evidence from Romania

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Abstract:
The achievement of high performance levels in fiscal administration is a key goal for governments aiming to ensure the welfare of their citizens. To assess the efficiency and effectiveness of tax administration, relevant indicators are used, as proposed by the European Organisation of Supreme Audit Institutions (EUROSAI), which categorizes them into three main groups: quality and service, compliance, and cost.

Quality and service indicators focus on aspects like waiting times for taxpayers or their satisfaction with service quality. Compliance indicators gauge how well taxpayers fulfil their fiscal obligations. Cost indicators account for administrative expenses related to tax collection.

Administrative costs play a crucial role in tax collection. Efforts to reduce these costs, without compromising revenue collection, are pivotal. However, international comparisons of the "cost of collection" ratio can be challenging due to factors such as varying tax structures, administrative differences, and changes in tax policy, which are beyond operational efficiency and effectiveness.

In the case of Romania, administrative costs were determined as a proxy for tax collection costs. The "cost of collection" ratio in Romania for 2022 was calculated to be 1.76, indicating relatively high administrative costs.

Although the "cost of collection" ratio is a valuable measure for evaluating tax administration performance over time, its applicability to international comparisons is limited due to the complex factors that influence this ratio. Consequently, additional considerations, such as disparities in tax structures, differences in revenue administration, and varying administrative functions, are essential for understanding the full context of tax collection efficiency and effectiveness.

Keywords: tax cost, public cost, tax performance, compliance, cost of collection ratio.
JEL Classifications: D61, H21, H27, K34

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Introduction

Reaching the highest level of performance for fiscal entities represents a goal pursued by any government aiming to enhance the welfare of the governed populace. Hence, it is of paramount importance to identify pertinent indicators that allow for a precise and objective assessment of how public resources are managed (Olimid, 2014; Mitu & Stanciu, 2023).

According to EUROSAI (European Organisation of Supreme Audit Institutions, 2008), the relevant performance indicators employed by fiscal administrations can be categorized into three primary domains: quality and service, compliance and cost.

Quality and Service: Indicators such as measuring the number of minutes a taxpayer waits on the phone to obtain information or gauging a taxpayer's satisfaction with the manner in which their inquiry was handled are frequently utilized to assess the overall quality of fiscal administrations and the quality of services provided to taxpayers.

Compliance: Tax compliance or tax non-compliance is a concept pertaining to the manner in which a taxpayer fulfils their fiscal obligations. According to the OECD (2004), indicators in this category encompass aspects related to: registration in the system; timely filing or lodgement of requisite taxation information; reporting of complete and accurate information (incorporating good record keeping); and payment of taxation obligations on time.

Cost: This category encompasses the administrative burden or the fiscal administration's cost. As early as 1776, in "*The Wealth of Nations,*" Adam Smith noted that the activities related to tax collection and management entail several costs, namely *administrative and enforcement costs, evasion costs, and compliance costs*. Today, despite the extensive theoretical literature on this subject, few governments genuinely track and determine these costs.

Balancing cost efficiency, mitigating compliance risks, and maintaining quality services is a challenging endeavour. The efforts made by certain government fiscal administrations in this regard clearly highlight the significance of fiscal costs for the efficient functioning of the entire tax system (Klun, 2003; Matei et al., 2007; OECD, 2013; Díaz de Sarralde Míguez, 2018).

Every imposed tax involves an expense for both the state that collects it and the taxpayer who pays it. Collecting taxes, fees, and contributions is a fundamental means for governments to generate public revenue, enabling the financing of investments in human capital, infrastructure, and the provision of services for citizens and businesses. Jrbashyan and Harutyunyan (2006) emphasize that the interdependent relationship between the state and taxpayers incurs several costs, which can be categorized into administrative costs and compliance costs. Administrative costs are those generated during the tax collection process by the government, while compliance costs pertain to the expenses incurred by taxpayers to fulfil their tax obligations. In the same vein, in their study, D'Andria and Heinemann (2023) underline the need for a relevant distinction between public and private costs.

This paper will focus on public (administrative) costs.

Public Costs (Administrative)

The efficiency of the tax system depends not only on a well-defined and prudent fiscal policy but also on the efficiency of the fiscal administration itself.

The complexity of the tax system, the numerous reporting obligations that taxpayers must fulfil, the need to inform taxpayers, the necessity of managing legislative changes and potential subsequent disputes, and more, all require a proper public infrastructure and a competent workforce to efficiently handle various aspects of tax laws and procedures.

The Theoretical (Potential) Tax Revenue (TTR) is determined by multiplying the Effective Average Rate (or the Actual Tax Rate, which is the tax rate obtained starting from the legal tax rate and considering all existing tax deductions) – EAR – by the Taxable Base (TB). To obtain the Total Net Revenue (TNR) remaining at the disposal of the state, the total Public Costs (Administrative) (PC) are subtracted from TTR.

$$TNR = (TB \times EAR) - PC \qquad (1)$$

This means that a portion of tax revenues must finance tax authorities, their infrastructure, personnel, legal expenses for managing disputes, collection costs, and other related expenses. As can be observed from the mathematical relationship above, in order to maximize the portion of revenue available to the government, the primary focus should be on reducing PC (public costs) without, however, affecting the overall size of the revenue remaining at the state's disposal (TNR).

In principle, a simple tax system where most or all reporting obligations are managed electronically would likely result in minimal expenses for the public budget. Simplicity in tax rules would make it easier to identify and rectify errors and anomalies, reducing the number and average duration of disputes and collection efforts. Unfortunately, at least in Romania, nothing is simple. Romania's tax environment is highly volatile, and the use of IT elements is still in its early stages. Biriș et al. (2023) note that the current Tax Code retains less than half of its initial provisions as published in 2016. It has been amended by 107 primary legislative acts, resulting in 554 modifications (an average of 74 changes per year), not including changes to local taxes. The changes have often been chaotic and have failed to overall improve the budgetary situation, even resulting in a decline in revenue as a percentage of GDP, despite years of economic growth. The outcome of this instability and lack of computerization was ultimately a decrease in budget revenues by 0.53% of GDP in 2022 compared to 2016.

Administrative costs are those incurred by governments to collect tax revenues (taxes, fees, and contributions) and to enforce tax regulations. These costs encompass the collection, administration, and management of the tax collection system (Vaillancourt, 1989).

According to Araki and Claus (2014), the relevant indicators to determine efficiency and effectiveness that are often calculated by tax administration bodies are the *administrative expenditure (cost) as a percent of GDP* or *cost of collection ratio*.

There are few available estimates of public (administrative) costs. For instance, Vaillancourt and Clemens (2008) estimate the costs of public fiscal administration to range between 0.2% and 0.5% of GDP. Similar findings from prior literature at the international level are reported by Evans (2003). In the case of Romania, Lazăr (2017) estimates these costs to be in the range of 0.91% to 1.88% of GDP.

The cost of collection ratio is a standard measure of efficiency often adopted by tax administration bodies, comparing the annual costs of administration with the total revenue collected over the fiscal year. The ratio is computed and published by many tax administration globally. Asian Development Bank - ADB (2022) methodology calculates this indicator by comparing the annual expenditure of a tax administration, with the net revenue collected over the course of a fiscal year. It is generally expressed as the cost to collect 100 units of tax revenue. A downward trend of the ratio can constitute, all the other things being equal, evidence of a reduction in relative costs (improved efficiency) or improved tax compliance (improve defectiveness) (OECD, 2013).

Considering the multiple similarities in the methods of tax collection administered by various national fiscal administrations, there is a natural tendency to make comparisons of cost of collection ratio between jurisdictions (as in the case of the European Union). However, such a comparison must be approached with a high degree of caution. The reasons for caution stem from a multitude of factors that can influence the ratio and are not linked to changes in the efficiency and/or effectiveness of a tax administration, rendering this kind of comparison highly uncertain on an international scale (OECD, 2023). Among these factors, some prominent ones include (ADB, 2022; OECD, 2023):

- *Changes in tax policy:* In theory, a policy decision to increase the overall tax burden should, all other things being equal, improve the cost/revenue relationship by a corresponding amount, but this has nothing to do with improved operational efficiency or effectiveness;
- *Macroeconomic shifts:* Substantial changes over time in economic growth rates and inflation etc. or economic downturns, as widely seen with the pandemic in 2020 (Georgescu & Georgescu, 2023), are likely to have a different impact, from one jurisdiction to another, on the overall revenue collected by the tax administration and the cost-revenue relationship;
- *Atypical spending by the tax administration:* From time to time, the tax administration may find it necessary to make unusually high investments, such as the construction of a new information technology infrastructure, the acquisition of more costly facilities or a significant expansion of the workforce. These investments are likely to raise the overall operational expenses in the medium term, and unless offset by efficiencies that may take some time to materialize, they will affect the cost-to-revenue relationship;
- *Competence changes in the scope of revenue collection:* Occasionally, governments opt to transfer the responsibility for collecting specific revenues from one agency to another, and this can have an influence on the cost-revenue dynamic etc.

However, when viewed domestically, by implementing corresponding adaptations, monitoring the *cost of collection ratio* can be a useful metric for assessing the administration's long-term revenue collection performance trends. Determining the *cost of collection ratio* by tax type, it may also help inform policy choices around how particular taxes may be administered and collected.

Cost of collection ratio in Romania

In order to assess the cost of tax collection related to the central administration, we gathered data on how much the Romania’s Regional General Directorates of Public Finance spent every year. Basically, based on the assumption that their main mission is to collect taxes to the central budget, I used the annual spending of the Regional General Directorates of Public Finance, General Directorate for the Administration of Large Taxpayers and National Agency for Fiscal Administration as a proxy for the tax collection costs. Starting from the premise that the main duties of these fiscal Directions are budget execution (which includes tax collection) and public treasury. We consider that the other remaining tasks (auditing, taxpayers' advice, etc.) are only marginal and also connected to tax collection and thus, do not affect significantly the proxy, neither in terms of the magnitude of the costs, neither in terms of its economic meaning. Moreover, disentangling the annual spending between tax collection activities and the other remaining activities is practically impossible given the available data. It should also be noted that although the Ministry of Finance often refers to the principle of transparency, unfortunately data is not always available on the budgetary execution of the budgets of the Regional Directorates. Therefore, where it was not possible, we used the forecasted amounts and not the actually spent ones. Calculations were made for the year 2022. The data is presented in table 1.

Cost of collection ratio is determined as follows (Jrbashyan and Harutyunyan, 2006):

$$\text{Cost of collection ratio (\%)} = \frac{\text{Administrative cost}}{\text{Tax revenues}} \times 100 \qquad (2)$$

Table 1 thou. Lei

No. crt.	Tax administration name	Forecasted costs (budgeted amounts)	Actual costs (budget execution)	Data considered
1.	Regional General Directorate of Public Finance Brașov	340.814	317.130	317.130
2.	Regional General Directorate of Public Finance Bucharest	315.247*	ND	315.247
3.	Regional General Directorate of Public Finance Cluj	325.482	324.143	324.143
4.	Regional General Directorate of Public Finance Craiova	286.471	264.747	264.747
5.	Regional General Directorate of Public Finance Galați	374.366	315.634	315.634
6.	Regional General Directorate of Public Finance Iași	317.624**	ND	317.624
7.	Regional General Directorate of Public Finance Ploiești	384.941***	ND	384.941
8.	Regional General Directorate of Public Finance Timișoara	231.772	231.604	231.604
9.	General Directorate for the Administration of Large Taxpayers (DGAMC - GDALT)	65.211	ND	65.211
10.	National Agency for Fiscal Administration (ANAF – NAFA)	357.969	ND	357.969
Administrative cost (Total annual costs of tax administration) – 2022[1]				**2.894.250**
Tax revenues (total tax revenues - total tax revenues related to local budgets) - 2022[2]				**164.351.500**

Abbreviations: ND = No data; MF = Ministry of Finance; NAFA = National Agency for Fiscal Administration; GDALT = General Directorate for the Administration of Large Taxpayers

*2021 available date (no data has been identified for the year 2022)

** 2019 available date (no data has been identified for the year 2022)

*** 2023 available date (no data has been identified for the year 2022)

Source: [1]Authors' compilation based on data provided by NAFA - https://www.anaf.ro

[2]Authors' compilation based on data provided by MF - https://mfinante.gov.ro

In the case of Romania, for the year 2022, applying the data from table 1 in calculation formula 2, the cost of collection ratio is 1.76. Asian Development Bank - ADB (2022) shows that, for many national revenue bodies, the value of the ratio typically falls within the range 0.50 to 1.0 and fluctuates over time owing to the sorts of factors mentioned above. These results indicate relative high cost of collection ratio computed for Romania. However, as already pointed out, this kind of comparison can be extremely unreliable in an international context.

Conclusions

For the correct management of financial resources, any government should minimise the costs of managing and maintaining the tax system (administrative costs) that's why the determination of efficiency and effectiveness indicators is always an essential step.

Tracking the *cost of collection ratio* a helpful measure to see the trend over time of the administration's work to collect revenue, and if it was calculated gathered by tax type, it may also help inform fiscal decision-makers around how particular taxes may be administered and collected.

Nevertheless, when considering its applicability for international comparisons, it becomes apparent that the *cost of collection ratio* has severe limitations. While domestic administrations can potentially account for the factors mentioned above, extending this analysis to the international level presents significant challenges. International comparisons entail the need to address the following complexities:

- *Disparities in tax rates and structures*: Tax rates and the composition of tax structures substantially influence aggregate revenue and, to a lesser degree, cost considerations. For instance, comparing the cost-to-revenue ratio between high-tax and low-tax jurisdictions is unrealistic due to their widely varying tax burdens;
- *Variations in the scope and nature of administered revenues:* Differences can arise in the types of revenues administered. Some jurisdictions have multiple major tax authorities operating at the national level, or they may have a prevalence of direct taxes at the federal level, while indirect taxes are primarily administered by separate regional or state authorities. In contrast, certain jurisdictions have a single national authority responsible for collecting taxes for all levels of government, encompassing federal, regional, and local levels. Similar complexities arise in the collection of social insurance contributions;
- *Differences in administrative functions:* Tax administrations can have diverse scopes of responsibilities across jurisdictions. For example, in some cases, tax administrations manage activities unrelated to tax collection, such as the administration of specific welfare benefits or national population registries. Conversely, in other cases, certain tax-related functions are outsourced to other entities, like debt collection enforcement. Furthermore, societal perspectives can influence the range of services provided and the way an administration operates, significantly impacting the cost-revenue relationship.

Lastly, it's essential to note that the *cost of collection ratio* disregards the revenue potential of a tax system, for example, the difference between the amount of tax actually collected and the maximum potential revenue. This aspect gains particular significance in international comparisons because administrations with similar cost-to-revenue ratios can still differ significantly in terms of their overall efficiency and effectiveness.

Authors' Contributions:

The authors contributed equally to this work.

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