ANALYSE

ECONOMY AND FINANCE

ROMANIA'S WEAK FISCAL STATE

What explains it and what can (still) be done about it

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This study aims to establish the causes for Romania's fiscal weakness and propose legislative and administrative reforms that could remedy the situation.

The results lay the blame on the poor institutional capacity of the Romanian revenue agency (ANAF) and the undertaxing of firms and the wealthy via legislative reforms that have cut tax levels and administrative practices that tolerated tax avoidance for these categories of tax payers relative to consumers and employees.

If the Romanian government could follow into the footsteps of Bulgaria and other new EU member states, it would avoid the near-permanent fragility of its finances and be better situated to close the educational, health, social and infrastructural gaps that separate Romania from its regional peers society despite robust economic growth.

FRIEDRICH EBERT STIFTUNG

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Content

MEASURING THE ROMANIAN FISCAL STATE

Sophisticated societies cost a great deal of tax revenue. One of Romania's most important challenges is that most of the public goods that matter are underfinanced by the state. Take education. Public spending on education is a strong predictor of strong and sustainable economic development (Kruss et al 2015; Tomic 2015). Yet Romania only spends 2.7 % GDP on education. This is not some "postcommunist" destiny. Indeed, it is a choice. Poland and Hungary spend nearly 5 percent. Moreover, the conjuring up of fiscal constraints and lower GDP is a dismal excuse. A poorer country, Bulgaria, spends 3.5 percent.

What do these factoids matter for? They matter for the counterfactual that Romania could almost double education spending without taking on debt or cutting from other budget items if it could increase tax revenue by an additional 2.5% GDP (to reach the CESEE region's revenue performance) and spent it all on education. As it is the case with the undersupply of infrastructure, healthcare, public R&D, heritage preservation, affordable housing, environmental protection or welfare spending, Romania's developmental gaps owe a great deal to its emaciated fiscal state.

Surely, there have been some marginal successes. The efficiency of corporate income tax collection increased slightly in 2018, for example. Yet this study shows that significant revenue increases demand system-wide reforms. If Bulgaria's successes at revenue reforms are any indication, such system-wide transformations would take five years, assuming that tax brackets are not increased. Indeed, if we look at the average performance of Romania's neighbors in East-Central Europe (ECE), collecting 30 percent of GDP in the government coffers may seem like a heroic effort in Bucharest but not in other capitals in the region.[1]

IMPORTANCE, OBJECTIVES AND LIMITATIONS

The fiscal state is a country's organizational complex of public revenue collection agencies (Bonney 1999). The capacity of the fiscal state is high when it delivers enough revenues to the public budget to avoid sovereign debt problems (bailouts, defaults) and to fund collective goods essential for social and economic development (today that means public health, education, infrastructure, social safety nets, research and development, environmental management) at the average level of countries with the same level of development. The revenue authorities' role is to collect sufficient revenue to spend and to make sure that all taxpayers contribute to government funding according to the tax code.

The Scandinavian countries or France are examples of strong fiscal states (Esping-Andersen and Korpi 1986; Stephens 1996; Benner 2003). At the other end of the spectrum one finds states that repeatedly find themselves in the position to ask for international financial assistance ("bailouts") and whose levels of funding for collective goods are consistently below peers. For example, Nigeria, Ecuador, Uruguay, and Argentina had on average four sovereign defaults since 1975 while Pakistan and Romania have spent the most years in some form of IMF assistance since 1990 (Reinhart and Rogoff 2009).

In between lie a wide spectrum of intermediary cases. The US government, for example, consistently avoided sovereign default yet it fails to collect enough revenue to fund collective goods at the average level of other high-income countries, with R&D being the only exception (Mazzucato 2015). Asian developmental states experienced a one-off sovereign debt crisis (1997-1998) and, apart from education and R&D they spend less on collective goods than East European states situated at comparable levels of development. At the same time, they collect very close to the statutory rates and have the capacity to commit and intervene credibly in the form of policies directed towards growth (Sindzingre 2007).

This paper has three objectives. First, it aims to provide a multi-faceted and comparative measurement of Romania's fiscal state. Second, it attempts to get at the less explored causes of the low revenue curse by analyzing the legislative and administrative parameters of the Romanian fiscal state relative to the suggestions of peer-reviewed research on revenue collection and uses comparative analysis to provide realistic policy options. Third, based on this, it aims to provide advice on how these weaknesses can be overcome.

In terms of scope, this paper does not aim to provide an inventory of analyses and policy measures already provided by experts in the IMF, OECD, the EU or Consiliul Fiscal. Indeed, it would be of little interest to undertake a synopsis of their

1 See the dedicated IMF report on the issue: https://www.imf.org/en/Publications/CR/Issues/2018/06/06/Romania-Selected-Issues-45944

excellent studies. Tempting as it may be due to its embrace of taxation strategies that a few years ago were talked about only in the tax justice community, merging the policy options that emerge from the 90-page IMF official view on corporate taxation published in 2019 would not do justice to the work that went into it. "Best practice" compilations can be useful but they do not warrant a research paper. Instead, the goal of this endeavour is to take a fresh look at roadblocks and opportunities applicable to the task of increasing revenue collection and explore the policy implications of relevant peer-reviewed research in economics and political economy that has not yet made it onto the policy advice ledger of international financial institutions. As such, the paper combines the metastudy approach, descriptive statistics and an in-depth statistical case study based on an original dataset.

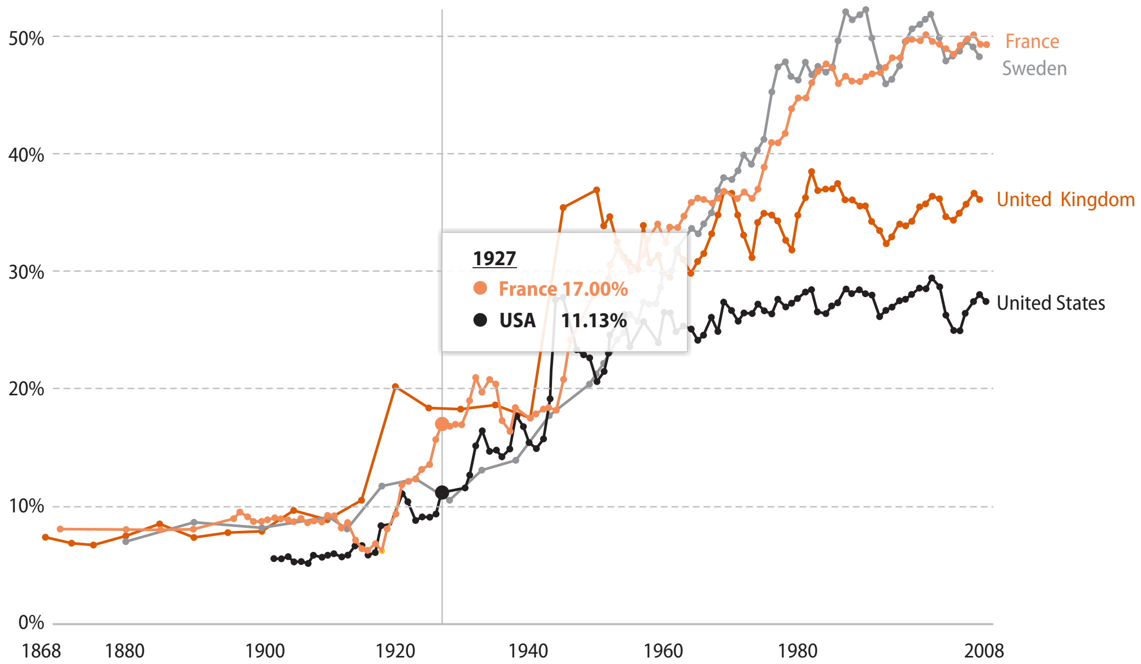
The analysis presented below relies extensively on publicly available statistics from Eurostat, OECD, MIT Atlas of Economic Complexity and Ameco. Our research strategy was also calibrated by interviews and correspondence we conducted with eight senior staff in ANAF, the Forecasting Commission and the Ministry of Finance. Moreover, Cornel Ban had conversations on the topic with Lennart Wittberg, the heads\ of the research divisions of the Swedish evenue agency on the occasion of an academics-meet-practitioners event at the European University Institute that led to the publication of Sven Steinmo's essential book *Leap of Faith: The Fiscal Foundations of Successful Government in Europe and America*.

The paper is organized as follows: the first empirical section situates the Romanian fiscal state in comparative perspective; the second section asks who should be most targeted by revenue collection reforms given the structural characteristics of income/wealth distribution and the economy; the third section draws on peer reviewed research to suggest how one can tax better; the final section introduces a statistical study of productivity levels in foreign and domestic companies in top 100 firms as a first step to address the thorny questions about the distribution of the tax burden between domestic and foreign capital.

THE ROMANIAN FISCAL STATE IN COMPARATIVE PERSPECTIVE

Historically speaking, Romania's tax revenues in 2017 (15.42 percent of GDP) were at the levels of France in 1926 and the US in 1942 (Piketty data in figure 1). This is a dismal picture given the country's near-permanent budget deficits, underprovided public services and infrastructure. For relief, one could point out that fiscal capacity tends to be low in developing countries (Besley and Persson 2013) and that in a dependent market economy such as Romania's tax collection is harder due to the tax planning capabilities of multinationals.

Figure 1:
Tax revenue as a percentage of GDP
Taxes (including social contributions) as a share of national income



Source: Piketty (2014)

Yet Romania is neither Europe's only emerging economy, nor is it its most dependent one. Other CESEE countries (Hungary, Czech Republic, Slovakia) are small open economies that are even more dependent on multinational capital and therefore more exposed to their transfer price operations (Bohle and Greskovits 2019; Ban 2019; Fabry 2019). Indeed, not all dependencies are fiscally equal and by most metrics of fiscal capacity, in 2017 Romania was emerging Europe's fiscal laggard. For an immediate regional comparison, figure 2 shows that while Bulgaria escaped the stagnant revenue curse that dogged Romania throughout the 2000s, Romania's performance on tax revenue as a share of GDP fell to new lows even as its GDP grew faster that Bulgaria's. If one factors in social security contributions (figure 3), Romania remains a laggard still. Indeed, this country is the only CESEE country whose aggregate tax revenue collection decreased during its first ten years of EU membership (figure 3).

Figure 2:
Tax revenue (% of GDP)
International Monetary Fund, Government Finance Statistics Yearbook and data files, and World Bank and OECD GDP estimates.

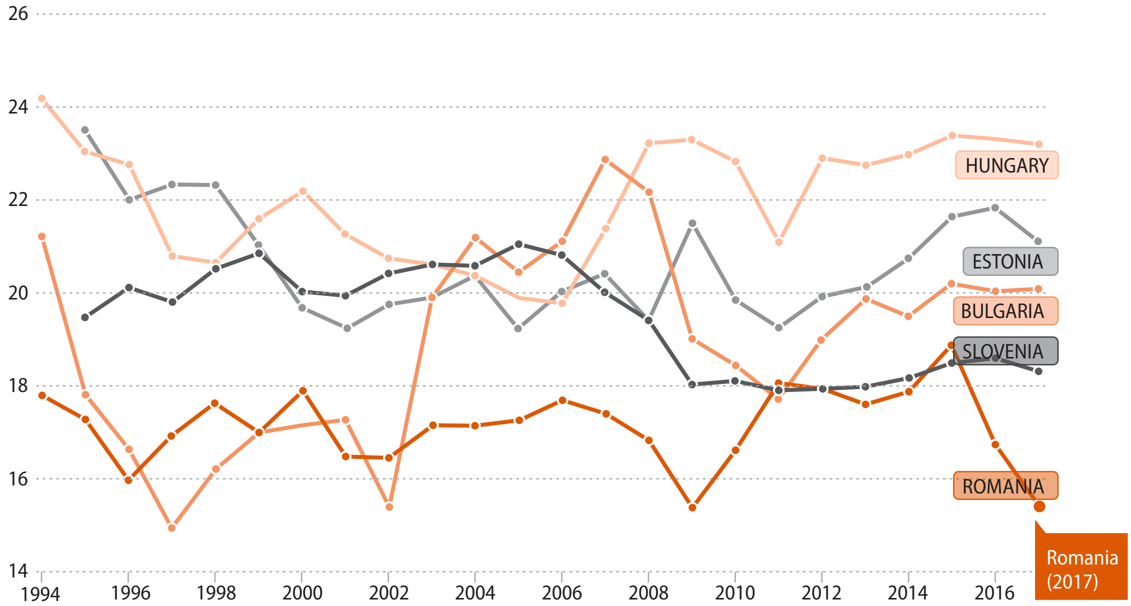
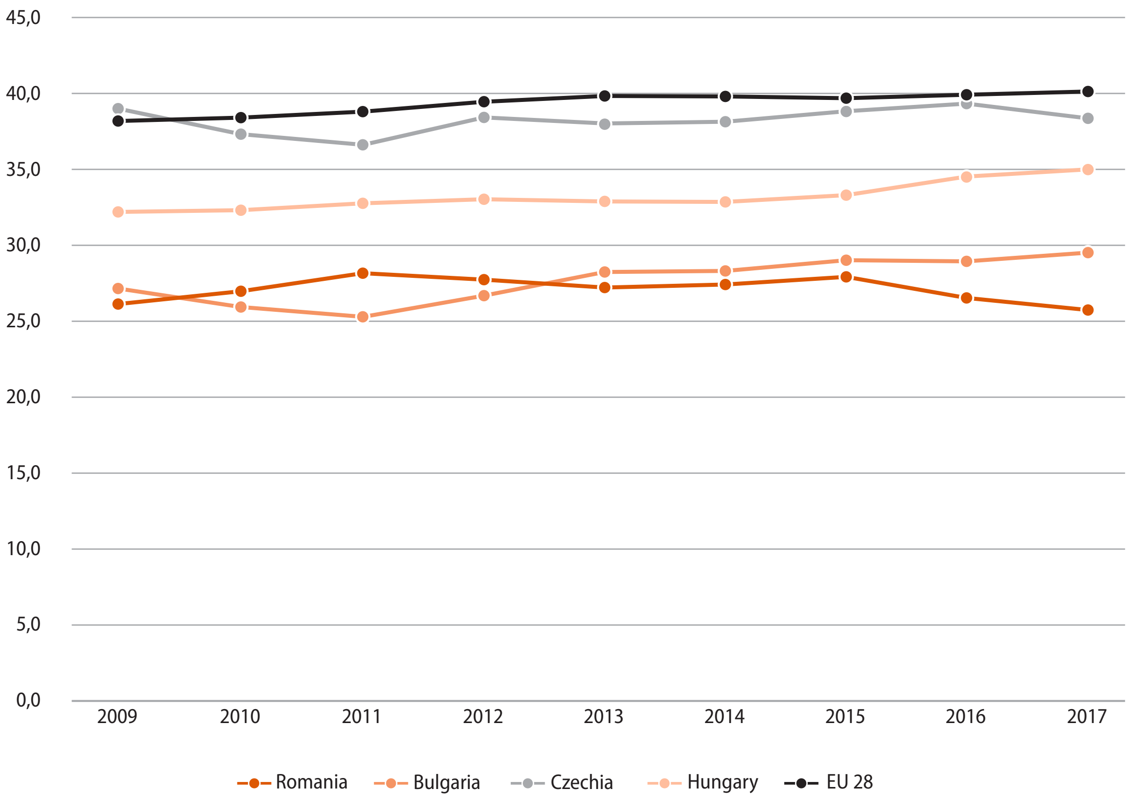


Figure 3:
Total receipts from taxes and social contributions (incl. imputed social contributions) after deduction of amounts assessed in % of GDP)



Source: https://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS?end=2017&locations=RO-BG-HU-PL-CZ-SI-EE-RS-UA&start=1994

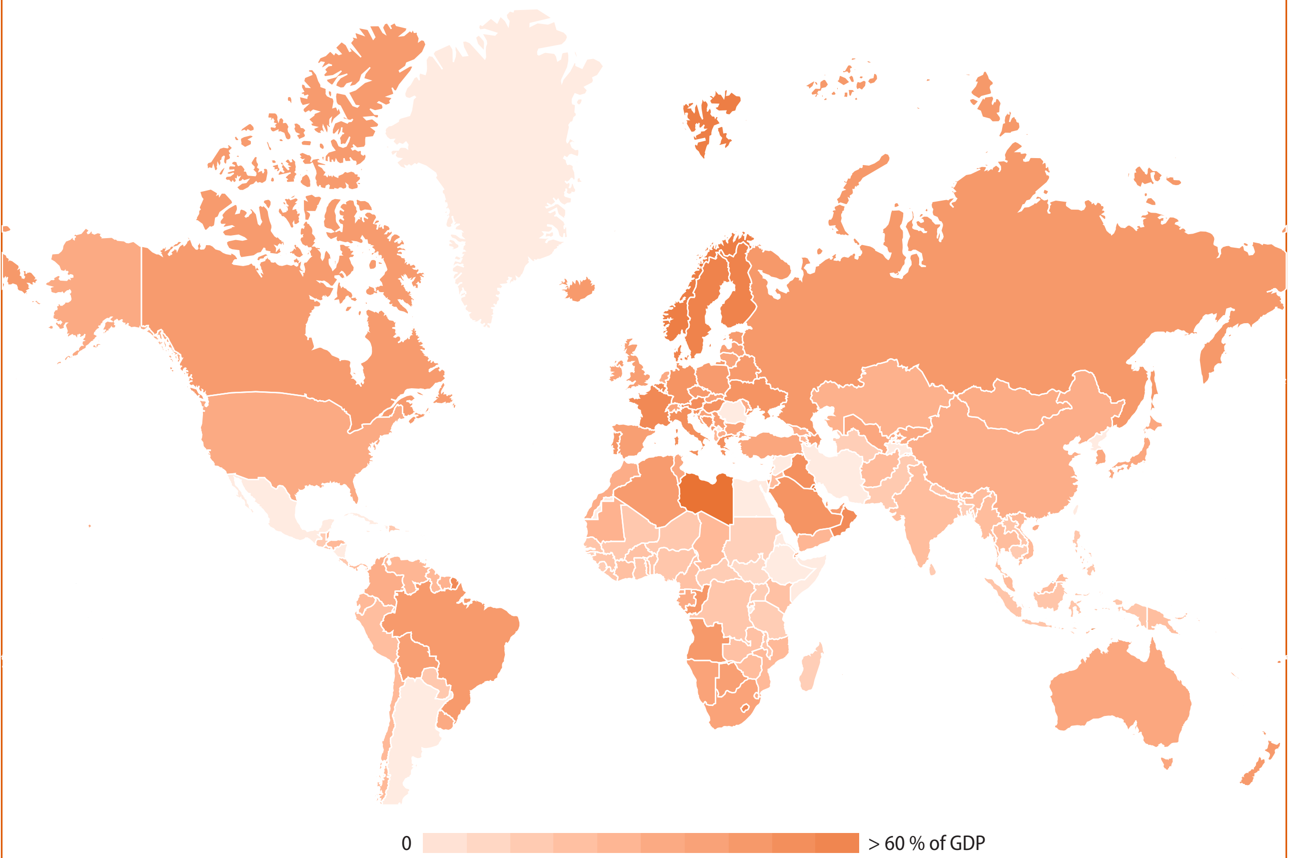
The dismal picture persists if we look a more global look at general government revenue (33.7 percent of GDP), with Romania scoring below all regional peers (other than Lithuania) and, most intriguingly, below some countries with much lower GDP per capita (Bolivia, Botswana) or higher corruption (Greece, Italy) (figure 4).[2]

Table 1:
Government revenues as a share of GDP

TIME	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Bulgaria	35.2	33.2	31.9	34.1	37.5	37.9	38.7	35.1	36	38.3
Poland	37.6	38.4	39	39.1	38.4	38.7	39.1	38.7	39.8	41.4
Portugal	40.4	40.5	42.4	42.7	44.8	44.4	43.8	42.9	42.4	43
Romania	30.3	33.1	34.1	33.7	33.3	34.1	35.5	31.9	30.9	32.3
Czechia	38.7	39.3	40.3	40.5	41.4	40.3	41.1	40.2	40.5	41.7
Latvia	34.9	36.7	36.1	36.7	38.5	36.6	36.6	36.9	37.5	37.8
Hungary	46	44.8	44.2	47.1	47.6	47.5	48.7	45.4	44.6	44.4
Slovenia	43.5	44.6	44.2	45.4	45.7	45.3	45.9	44.3	44	44.3
Slovakia	36.3	34.7	37	36.6	39.4	40.2	43.1	40.2	40.6	40.8
Lithuania	35.8	35.6	33.7	33.1	32.9	34.1	34.8	34.4	33.6	34.6
European Union	43.6	43.6	44.1	44.7	45.4	45.1	44.7	44.7	44.8	45.1

Source: Eurostat

Figure 4:
General government revenue as a percentage of GDP



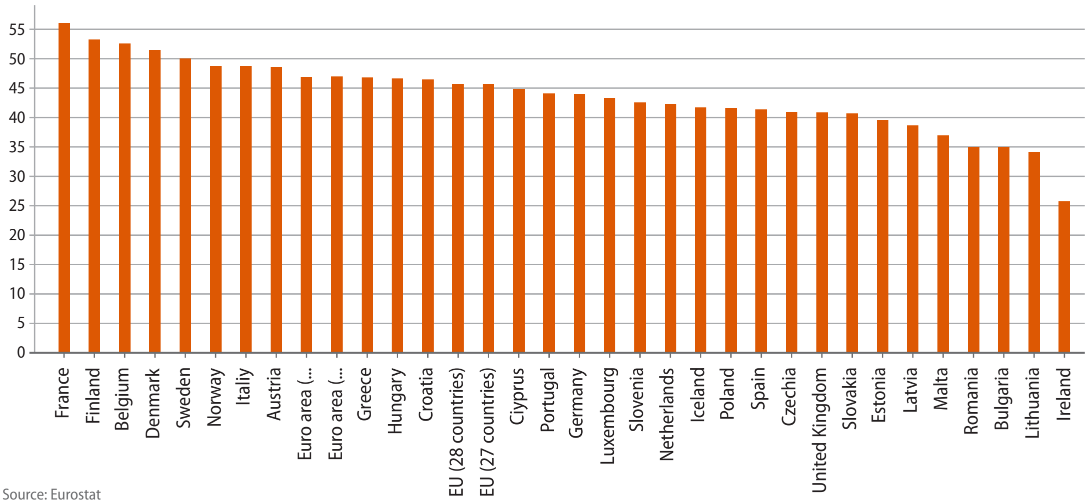
Source: https://www5.wider.unu.edu/#/?graph=map&indicators=3&activeIndicators=3&activeYear=2012

2 Comparative calculations with 2012 data.

Recently, the IMF calculated that if Romania could manage to converge not to core Europe, but, more modestly, to CESEE countries, it could rake in the revenue needed to address its recurrent sovereign bond market vulnerabilities and close its glaring social deficit. The Fund's conclusions are clear:
"Considering the average tax efficiency for the main three taxes (VAT, CIT, and PIT), if Romania would raise efficiency to the average level of other CESEE countries, the overall revenue gain could be conservatively estimated at about 2.5 percentage points of GDP. Moreover, raising tax efficiency to the level of the best performers in advanced Europe or Estonia would bring higher revenue for Romania, estimated in the range between 5-6 percentage points of GDP in the medium-term" (Babici et al 2018: 12).

As the figure 5 below shows, the country's fiscal needs are dire: at comparable needs, total government expenditure as a share of GDP is far below that of the Visegrad countries. This entails pressures to run procyclical fiscal policies and a high risk of sovereign default, bailouts and vicious circles of capacity weakening under structural reforms.

Figure 5:
Total general government expenditure - % of GDP



Source: Eurostat

Most importantly, however, poor revenue collection means a high risk of sovereign default and international financial assistance programs that come with strings attached. Asking for IMF assistance is a nuclear option for governments. It is a signal that the country cannot borrow from the market at sustainable interest rates (Moschella 2010; Clift 2018). In this regard, Romania had by far Europe's highest number of IMF programs since 1990. The IMF records show that this country signed a stand-by IMF agreement every 2.5 years between 1990 and 2013. In contrast, during the same period Hungary and Poland concluded one every 10 years.

The problem with this semi-permanent IMF administration of the Romanian macroeconomy from the perspective of revenue collection is twofold at the very least. First, the analysis of revenue collection by the Romanian Fiscal Council shows that the implicit tax rates (the difference between statutory rates and the rates at which the state actually collects taxes) drop during recessions managed via bailouts (Consiliul Fiscal 2019), with all the deleterious social and economic consequences that come with that. Even if one goes by conventional economic analysis, states with agencies that are capable to increase revenue and collect international financial assistance can minimize the damage done to the prospects of recovery by avoiding procyclical cuts in public spending during bust cycles and weak fiscal states trying to discipline finance may be unable to obtain confidence effects even during boom cycles (Blanchard and Leigh 2013). It is to this multi-faceted aspect of the state that the paper turns to next.

Of course, as we saw in the case of the Baltics or Ireland during the crisis, fiscal rectitude does not always protect one against a bond market panic (Matthijs and Blyth 2015; Jones and Kelemen 2016; Schelkle 2017). Indeed, in a financial system where sudden stops are not "black swan" events, nothing can replace a supportive central bank (Gabor and Ban 2016). Once frowned upon by economists as an inflationary risk and source of distortion in the market, direct debt monetization received new respectability among some in the elite of mainstream economists given the low inflation environment after 2008 (De Grauwe 2018; Della Posta 2018). One need not be a financial nationalist to emphasize this, as seen in the UK and the US, where the central banks rolled out debt monetization programs (an operation that turns the central bank into a lender of last resort to the government) (De Grauwer 2018; Gabor and Ban 2016). However, outside of the unusual case of Hungary, debt monetization has generally been controversial among postcommunist central bankers in general and the Romanian central bank in particular. [3]

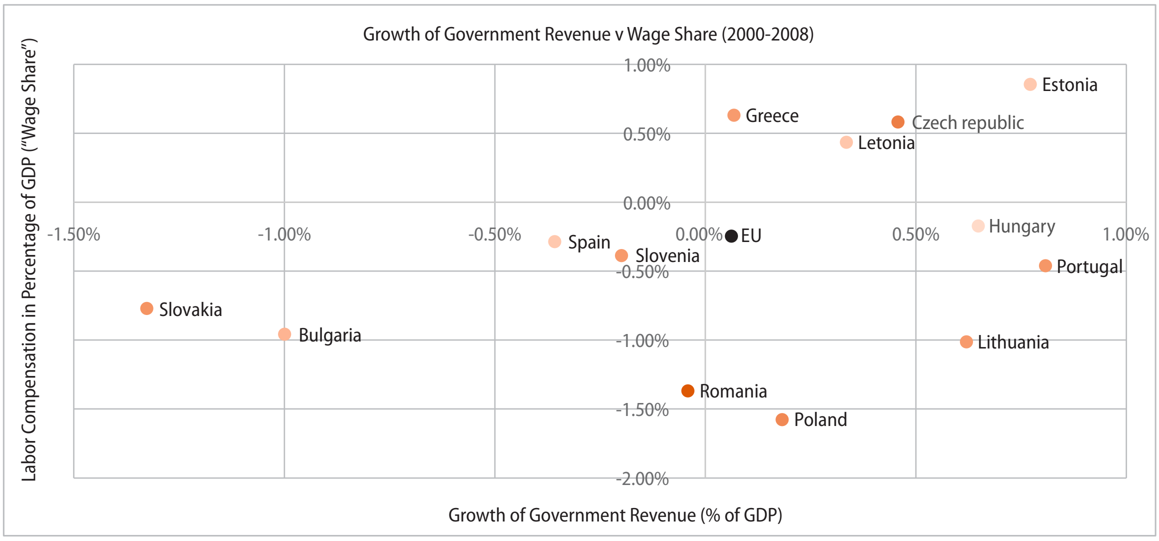
Second, there is strong empirical evidence that despite the Fund's technical assistance provided to the state, the IMF programs hollow out state capacity. The analysis of a unique and massive dataset of individual conditions between the IMF and its borrowers from 1985 to 2014 showed that "structural conditions"

3 Author conversation with senior BNR economists (December 2018).

or the specific conditionalities that require the overhaul of the state administration and the restructuring of the domestic economy end up reducing state capacity across the board (Reinsberg et al 2019). The mechanisms of this weakening are also clear if one looks at granular analyses of the IMF's programs in Romania during the 1990s and early 2000s (Gabor 2010; Ban 2016).

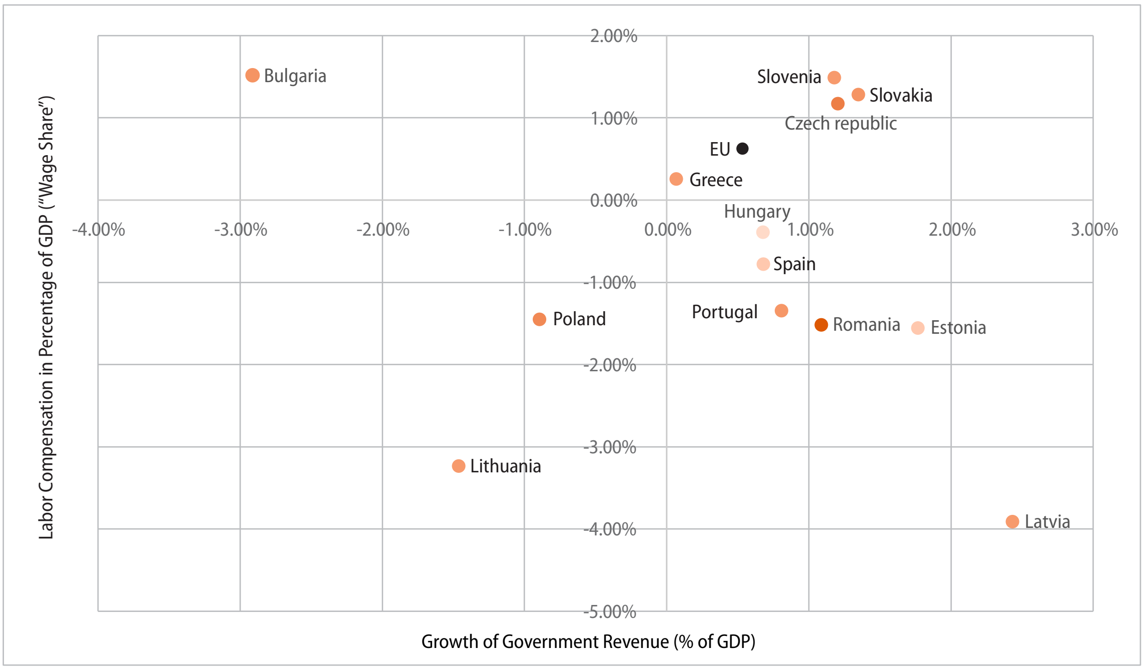
However, such analyses do not isolate the specific effect on revenue collection capacity. To address this gap we looked at the case of revenue collection in Romania in a broader cross regional perspective that factors in the wage share as the fundamental metric of progressive distribution of resources in a society. The following picture emerges from the analysis: Romania had constant decreases of both wage share and government revenue rates (figures 6 and 8), with the big exception being the Great Recession (2009-2012), an economic cycle when government revenue slightly increased, presumably as a result of international economic conditionalities imposed by the Troika (figure 7). The main take-home lesson from this is twofold: revenue collection is improved only as a response to international coercion following major macroeconomic failures and even when progress is made it is quickly reversed, with even the best boom years providing no impetus for revenue collection reforms. The less socially regressive and economically procyclical alternative is to boost revenue collection in times of high economic growth, such as the period of uninterrupted output growth that started in 2011.

Figure 6:
Government revenue and wage share



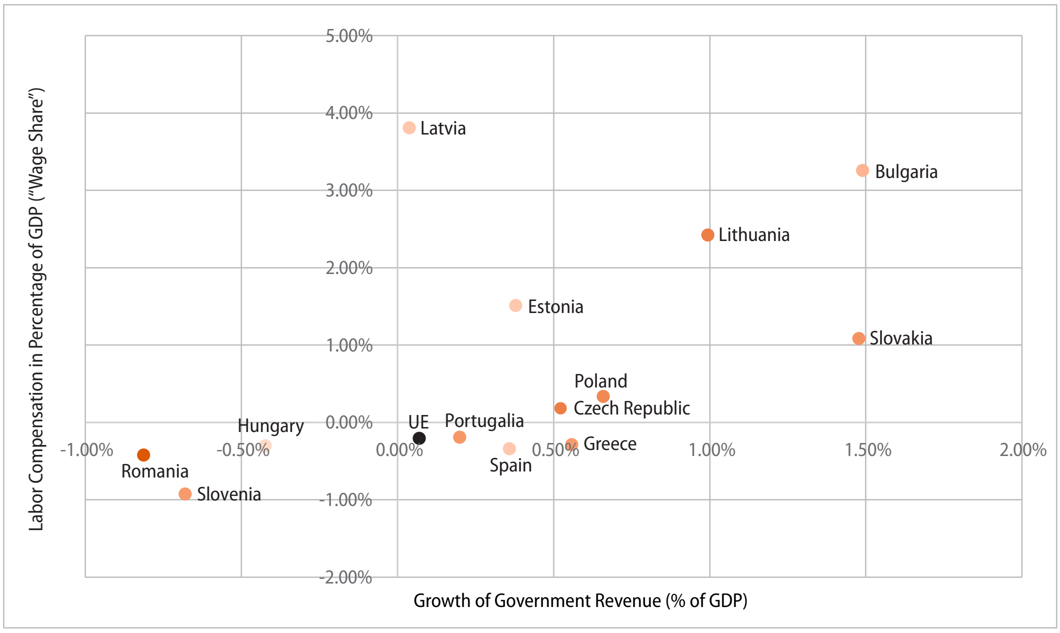
Source: Eurostat and authors' calculations

Figure 7:
Growth of Government Revenue v Wage Share (2009-2012)



Source: Eurostat and authors' calculations

Figure 8:
Growth of Government Revenue v Wage Share (2013-2018)

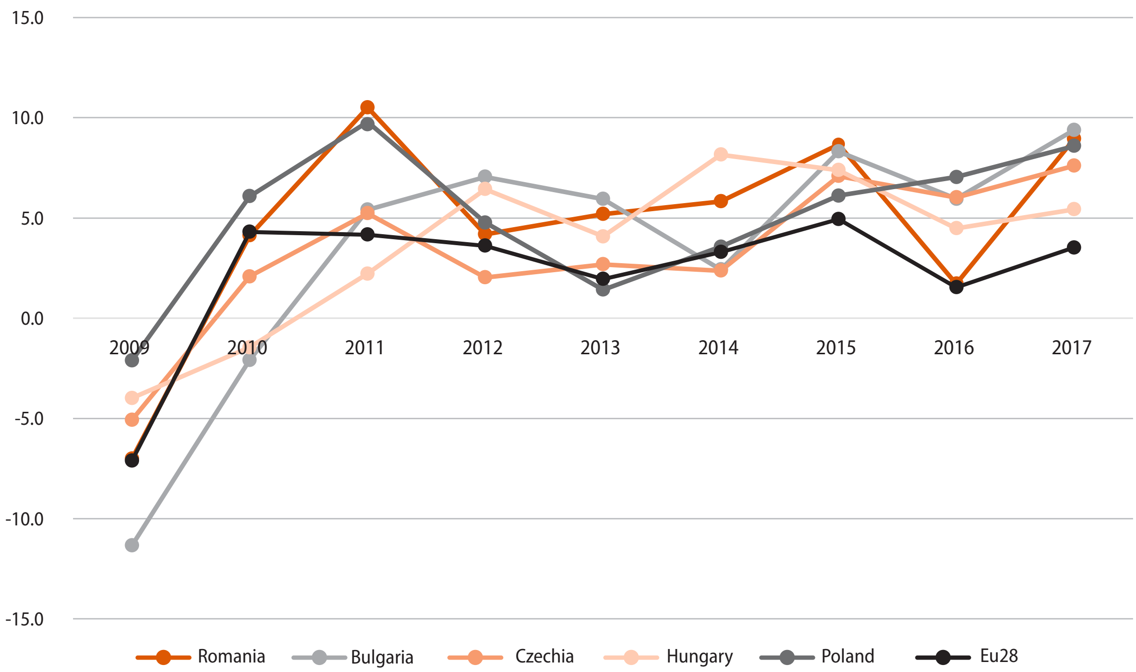


Source: Eurostat and authors' calculations

Finally, even when a weak fiscal state is not in a balance of payments crisis (such as the Romanian state during the past seven years) it nevertheless sees its policy space (and therefore its democracy) more constrained by bond market sentiment. Critical in this regard is the policy space the state has, given the leverage that financial institutions have over the state as a debt issuer. In this regard the Romanian state performed increasingly worse than Hungary, the region's most indebted and financially nationalist government.

The only hopeful sign from the Romanian fiscal state is that that year on year growth rates of total receipts from taxes and social contributions (including imputed social contributions) have increased in Romania above the EU average and at the front of the regional peer group (figure 9). However, this piece of good news is dampened by the negative relationship between economic growth rates and share of tax revenue in GDP since the recovery began.

Figure 9:
Year on year *growth* rates of total receipts from taxes and social contributions (including imputed social contributions) after deduction of amounts assessed but unlikely to be collected (%)



Source: Eurostat

THE DISTRIBUTIONAL MATRIX OF TAXATION

Who carries the heaviest debt burden and who gets relief? In law and in deed the Romanian state overwhelmingly relies on consumption and labor taxes to finance itself while sheltering capital and property. Like its regional peers, Romania raises a significant share of revenue from consumption taxes (26 percent of total tax revenue) and social security contributions (31 percent of total tax revenue), similar to other CESEE countries. However, Romania raises less from direct taxes on personal and corporate income. For taxes on personal income and property, the revenue yield in Romania—and more broadly in CESEE countries—is about half compared to that in advanced Europe (Babici et al 2018).

Figure 10 below shows that taxes on capital and property account for between 10 and 12.5 percent of GDP between 2004 and 2016 while taxes on the income of corporations cover between 2 and 3.2 percent of GDP during the same period. Figure 13 shows how this system compares with the EU average.

Figure 10:
The distribution of the real tax burden (43.5 billion euro budget in 2016)

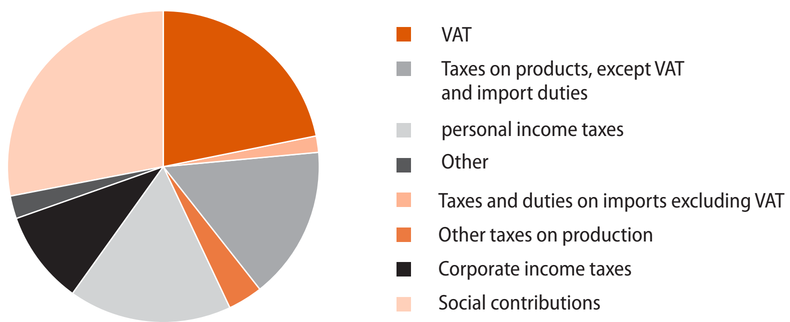
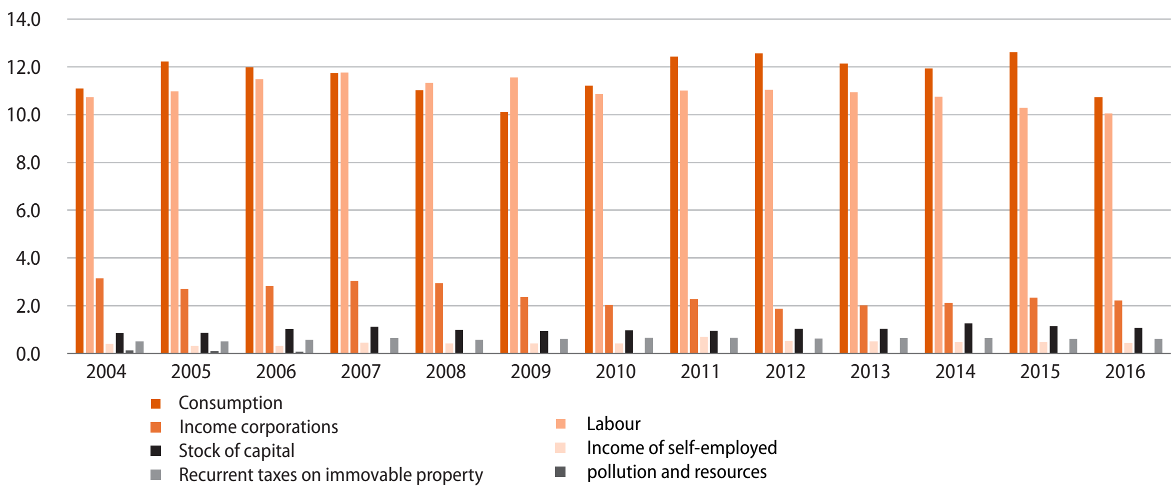


Figure 11:
Share of various tax categories in GDP



In terms of variation across time, while VAT slightly increased on average (with a predictably significant dip in 2008-2009, during the worst of the Great Recession), as soon as Romania joined the EU a yawning gap opened between personal and corporate income taxes in GDP (figure 12).

Figura 12:
Types of taxes as a percentage of GDP across time

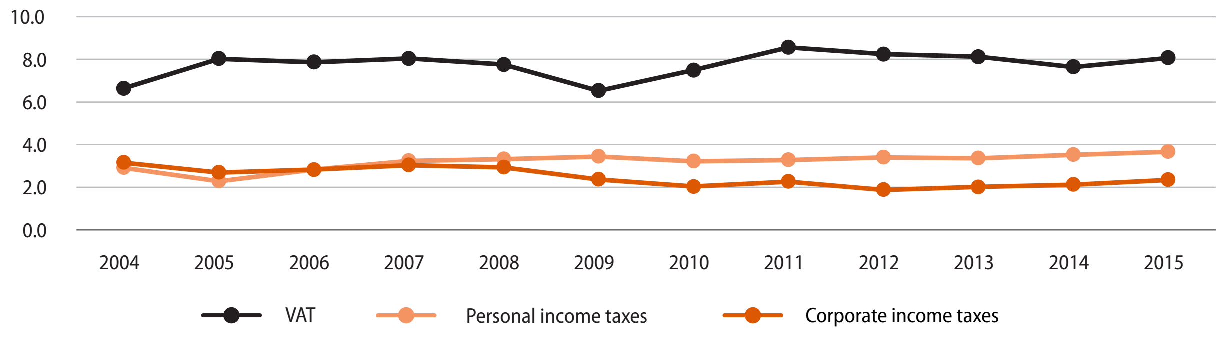
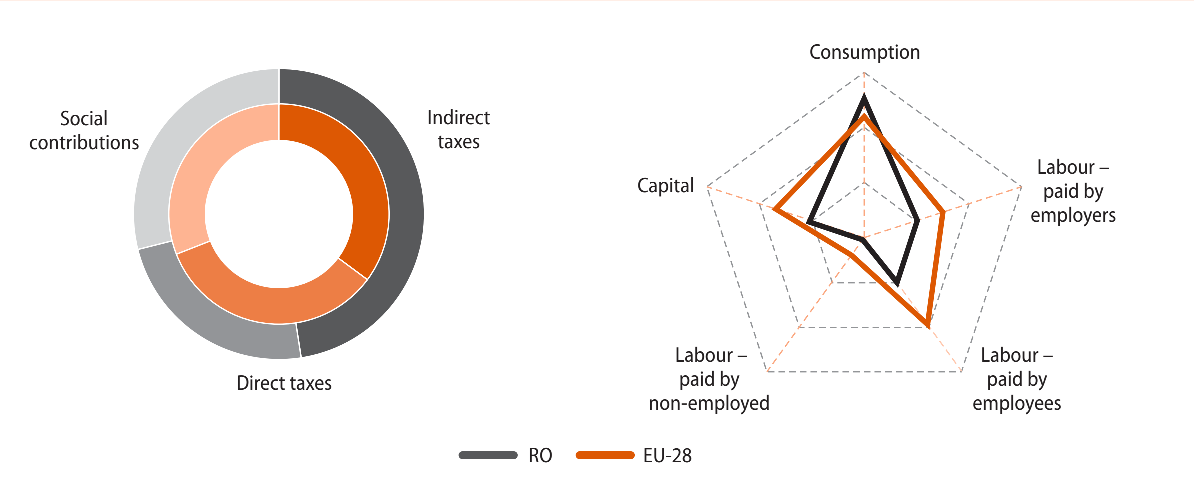


Figure 13:
Tax revenues by main taxes, compared to EU-28, 2015 (in % of total taxation (left graph) and in % of GDP (right graph))



Source: DG Taxation and Customs Union, based on Eurostat data

Overall, this is due in part to drastic changes in the statutory architecture of taxation adopted during the past fifteen years, with regressive measures dominating. Thus, the progressive income tax system with a statutory marginal income tax of 40 percent on the highest earners and 24 percent on corporate income was replaced in 2005 with a low flat rate of 16 percent for both categories of income. Second, there have been several waves of cuts in employers' social security contributions, with their wholesale transfer onto labor completed in 2018. Third, capital and the wealthy received exemptions on capital gains realized by non-residents, deep cuts on dividend tax for all shareholders (from 16% to 5 %) as well as on corporate residential taxes, deductions on financial investments, tax exemption for reinvested profits, and exemptions from mandatory health contributions for people who obtain revenues from investment (dividends, interests). Capital taxes levied on the net worth or value of assets owned or transferred in the form of legacies or gifts are low in the EU (0.3 percent of GDP on average) but are non-existent in the Baltics and Romania.

In comparative terms, Romania is among the Baltic-Balkan group of EU countries where taxes on income and wealth are half the level of EU member states with extensive redistribution systems. Thus, in Sweden, Belgium and Finland, these taxes raise 18.9 %, 16.9 % and 16.6 % of GDP respectively, in bold contrast with Lithuania (5.4 % of GDP in 2017), Bulgaria (5.7 % of GDP), Romania (6.1 % of GDP) and Croatia (6.3 % of GDP). Tax rates aside, the efficiency of corporate income tax collection is very

Table 2:
Efficiency of collecting corporate income tax

Country	Statutory CIT rate. (%)			Implicit Tax Rate* (%)			Tax efficiency index Rank** (%)			Place		
	2016	2017	2018	2016	2017	2018	2016	2017	2018	2016	2017	2018
BG	10.0	10.0	10.0	4.6	5.1	5.1	0.46	0.51	0.51	1	2	1
CZ	19.0	19.0	19.0	7.0	7.0	7.0	0.37	0.38	0.37	2	3	3
EE	20.0	20.0	20.0	4.4	4.0	5.3	0.22	0.20	0.26	10	10	8
LV	15.0	15.0	20.0	4.5	3.7	3.4	0.30	0.24	0.17	5	8	10
LT	15.0	15.0	15.0	3.5	3.3	3.4	0.24	0.22	0.23	8	9	9
HU***	19.0	9.0	9.0	6.0	5.2	3.8	0.31	0.58	0.42	4	1	2
PL	19.0	19.0	19.0	4.4	4.7	5.2	0.23	0.25	0.27	9	6	7
RO	16.0	16.0	16.0	4.4	3.9	4.5	0.27	0.24	0.28	6	7	5
SI	17.0	19.0	19.0	4.3	4.8	5.2	0.26	0.25	0.27	7	5	6
SK	22.0	21.0	21.0	7.0	7.2	6.5	0.32	0.34	0.31	3	4	4

Source: Consiliul Fiscal

low in Romania. The table below shows that Romania lags far behind Hungary, Bulgaria and the Czech Republic in terms of implicit tax rates[4] despite some improvements in 2018.

The perusal of tax legislation published in Monitorul Oficial shows that overall regressive tax system was buffered by a few timid changes since 2015: (a) the abandonment of the high and flat VAT rate of 24 percent in favor of a lower (19 percent) and progressively differentiated one (lower rates for food, water, books, medicines) (b) the increase the personal deductions for individuals on minimum wage and (c) a progressive corporate income tax on microenterprises depending on their number of employees.

4 According to Eurostat the implicit tax rate measures the average effective tax burden for by using an approximation of a potentially taxable base that is comparable across countries.

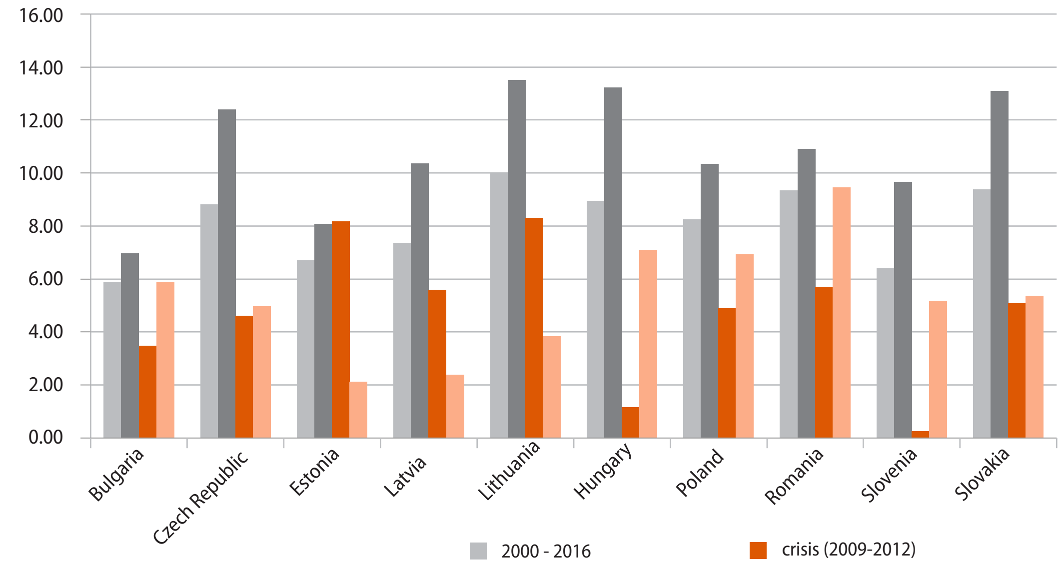
WHAT TO TAX BETTER

FIRMS

Romania can tax more from a vibrant economy based around a manufacturing base well-plugged in global supply chains that are in turn clustered around West European orchestrating firms. Multinational firms invested 75 billion euro in Romania, account for 49 percent of business turnover and occupy strategic positions in high value added and high returns sectors such as auto, electronics, ITC, logistics and finance. With few exceptions (agriculture, furniture, constructions and tourism), Romanian capital is poorly internationalized and plays the role of supplier to the multinational sector. It has been estimated that without MNCs Romania would see its exports fall by 70 percent and its GDP by 30 percent. MNCs were also were considerably larger than their Romanian counterparts (while there were 322 foreign owned firms with rollover over 50 million USD, only 138 Romanian owned firms could boast this size) (Piarom 2018).[5]

Largely a result of the internationalized supply chains brought by MNCs, Romania regained a consistent share of industry in its GDP. Between 2004 and 2008 the growth of the turnover rate-or the total of all sales- in the manufacturing sector grew faster in Romania not only relative to the liberal Baltic models, but also relative to all the other DMEs (Eurostat 2012), with energy, automotive, steel and chemicals dominating the top 50 firms by size. In 2018, at 21 percent of GDP, the Romanian manufacturing sector's share of the economy puts Romania is in the same league with Slovenia, Slovakia and Hungary, rather than with the less industrialized Baltic states or Bulgaria. Compared to the 1990s, exports in 2010s were 600 percent larger and their share in the GDP increased. Since the recovery, Romania has had the greatest average annual growth rate in exports in the region, with FDI accounting for 70 percent of total exports of goods and 56 percent of services by 2015 (BNR 2016: 14-15).

Figure 14:
Average annual growth rate in exports (select periods)



Source: AMECO and author's calculations

5 Romania is not unique in this regard. A rich literature showed that most CESEE countries are dependent market economies (DMEs) whose most vibrant manufacturing, banking and service sector cores are controlled by multinational capital (Nolke and Vliegenthart 2009; Drahokoupil and Myant 2016; Scepanovic and Bohle 2018; Tarlea and Freyberg-Inan 2018). The trade-off between the dominant position of foreign capital and the capacity to harness FDI to increase the complexity of exports is the fundamental characteristic of the DMEs (Nolke and Vliegenthart 2009; Johnson and Barnes 2015).

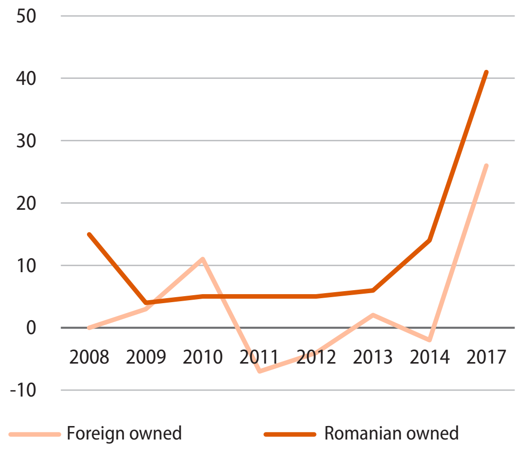
Moreover, the contribution of exports to GDP growth over the 2008-2015 period is in the same league with Slovakia and the Baltics and far outstrips that of traditional export champions like the Czech Republic and Hungary (figure 14). With its 1.2 million industrial workers, Romania has the sixth largest manufacturing labor force in the EU27[6] (Ban 2019). All this does not fit squarely with the conventional representation of Romania as a deindustrialized economy with too little wealth left to tax.

Contrary to the popular opinion, Romania's industrial base is not in a low value-added trap and, as such, the country's declining tax revenues appear to be even more surprising. In relative terms, Romanian exports are quite similar to the dependent market economy model specific to the Visegrad countries. In the ranking of export complexity done by MIT's Economic Observatory, the level of complexity of Romanian exports has gone from a low level in the early 2000s to ranking close to the Netherland's (albeit lower that in Hungary, the Czech Republic or Slovakia). Surprisingly, it is higher not only relative to medium-income Bulgaria and the Baltics, but also to Spain and Portugal, two high-income European economies.[7] Within the DME world, Romania's export profile is virtually indistinguishable from Poland in terms of their complexity (see MIT Atlas of Economic Complexity). In contrast, the Baltic states and Bulgaria have export profiles that put them in the company of commodity exporters (Brazil, Canada), traditional low-end manufacturing economies (Portugal) or war-ravaged economies (Lebanon, Serbia, Bosnia).

The most important fiscal consequence that can be derived from the dependent nature of the Romanian economy is that collecting taxes on corporate income would be much harder in DMEs due to the fact that, by their nature, MNCs are better positioned than domestic firms to legally minimize their tax footprint via transfer prices and skilled use of tax arbitrage.
Romania has had strong export growth driven predominantly by multinational firms accounting for more than two thirds of Romanian exports. In terms of value added these exports have been increasingly complex and are hardly distinguishable from those of regional CESEEE peers in both dollar and GDP terms. Moreover, the average productivity of foreign owned firms is twice as big as that of Romanian owned firms, a gap that could be explained in part by the fact that the bulk of foreign capital is in manufacturing while that of Romanian capital is in services, where productivity gains are harder as a rule (Piarom 2017: 4).

All this should translate into higher profitability ratios and therefore into higher taxable income. In reality, the 38,000 foreign owned firms active in Romania in 2014 posted net loses of 28 billion RON and net profits of 26 billion RON. In contrast, the 422,000 Romanian owned firms posted 19 billion RON in loses and 33 billion RON in profits (figure 15). This asymmetry is tempered by profit margins: 6 percent for Romanian owned firms and 5 percent for foreign owned firms (Piarom 2017).

Figure: 15
Net revenues in Billion RON (net profits minus net losses)



Source: Piarom 2017 and author's calculations

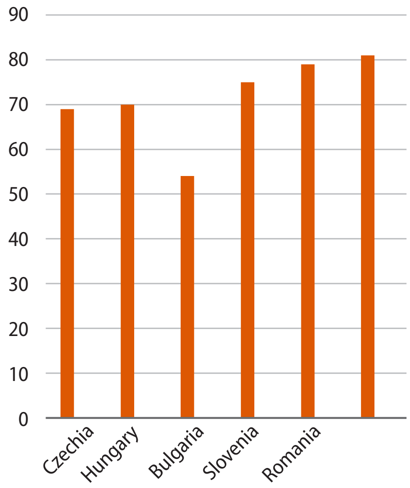
Yet despite this remarkable industrial growth and increasing value added in the export sector, the Romanian public purse benefits less than that of regional peers that have had a less impressive performance. At 2.01 percent of GDP, the level of CIT collection (using ESA 2010) is extremely low in Romania. The continuous shrinking of CIT-based revenues over the past five years appears as surprising due to high GDP growth and profit growth rates (Consiliul Fiscal 2018: 55), leading to measures such as the tax on business rollover for firms with incomes lower than1 million euro. The dividend tax cut also damaged revenues with a fall of 16 percent (270 million RON).

As the figure 16 below shows (2016 data), Bulgaria (a country that lags behind Romania in GDP and export growth) is a regional role model in terms of the share of CIT collected relative to the low statutory rate. Indeed, with a CIT of 10 percent, Bulgaria collects more in GDP from corporations than Romania does at 16 percent. The low Bulgarian CIT is not necessarily the answer to the curse of low revenues from corporate incomes. The further analysis of implicit tax rates and, by definition, of the share of lost taxes, shows that Czech Republic is at the top with almost twice the level of implicit CIT rate compared to Romania and Poland but also with a statutory CIT rate at 26 percent. Indeed, labor and consumption have a less favorable treatment in terms of both statutory and implicit rates.

Next, compare the low efficiency of CIT collection with that of VAT collection. Even though Romania is a regional laggard here as well (three times the EU 28 median), its government loses only 35 percent of the statutory VAT levels, compared to almost 80 percent of the statutory CIT levels (figure 18). The contrast is starker still regarding the difference between the implicit and the statutory personal income tax (PIT), where Romania has a solid performance with only 20 percent lost taxes (figure 17).

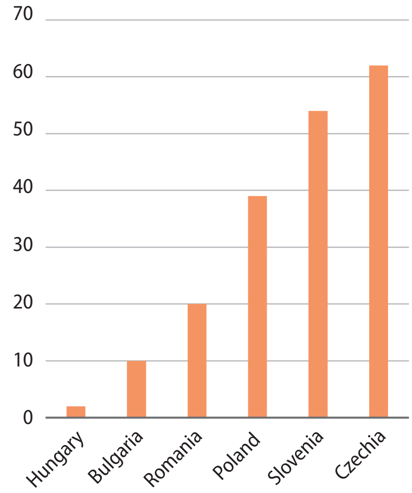
6 Eurostat, Manufacturing Statistics.
7 MIT, The Observatory of Economic Complexity, http://atlas.media.mit.edu/rankings/

Figura 16:
CIT gap.



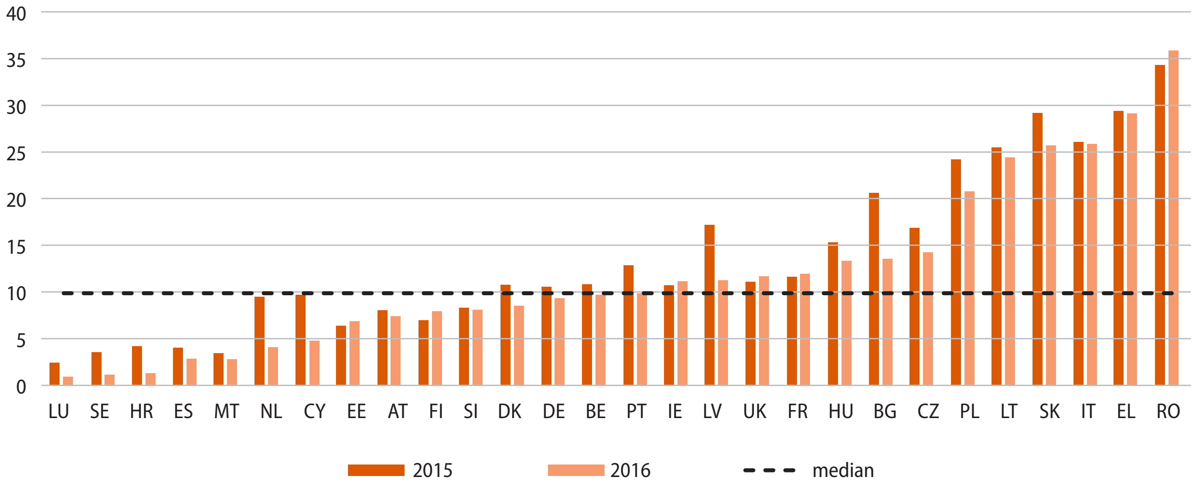
Source: Eurostat and Consiliul Fiscal with authors' calculations

Figura 17:
PIT gap.



Source: Eurostat and Consiliul Fiscal with authors' calculations

Figure 18:
VAT gap



Source: Eurostat

Where are corporate income taxes being leaked? We hypothesized it would be in tax havens yet Zucman's *Missing Wealth of Nations* dataset tells us that in Romania barely 7 percent of owed CIT is lost, that is…52 million euro, hardly enough to make a dent into the missing billions one would expect to find. How about non-performing loan tax write offs? This was a known tax dodging opportunity yet loses here amount to a low 80 million euro.

All this is puzzling because the average non-OECD country loses 1.5 percent of their revenues as a result of base erosion by multinationals in particular (Tax Justice 2019). A developing country with weak governance and whose economy is dominated by multinationals and weakened by a large informal sector depends heavily on tax payments by multinationals in the formal sector (Gordon and Li, 2009; UNCTAD, 2015; Johanssen et al 2017). The problem with this is twofold. First, from Fuest, Hebous and Riedel (2011, 2013) 's study using micro-data on the capital structure of German multinational firms we know that the use of internal debt in foreign affiliates is more sensitive to tax incentives in developing countries than in developed countries. Second, by their nature multinationals enjoy more tax dodging opportunities via base shifting than domestic firms.

The main profit shifting techniques the literature dwells on are mispricing between affiliates and strategic balance sheet allocation. mispriced goods and services transferred between affiliates Specifically, goods and services transferred between affiliates are overpriced when they are transfererd from low-tax to high-tax affiliates and underpriced when they flow in the opposite direction (Cristea and Nguyen, 2016; Hebous and Johannesen, 2015). Second, income-generating assets (say, patents) and financial assets are moves to low-tax affiliates whereas cost-generating liabilities (say external and internal debt) are allocated to high-tax affiliates (Karkinsky and Riedel, 2012; Buettner and Wamser, 2013; Ruf and Weichenrieder, 2012). Through such techniques the yearly government revenue via profit shifting sits at $130 billion for U.S. multinational firms

(Zucman, 2014); $100-240 billion globally (OECD, 2015), $90 billion and $100 billion for developing and developed countries respectively (UNCTAD, 2015). The Romanian authorities need to get better at finding out what the figures for Romania are in the first place. As the case study at the end of this study shows, ANAF needs to bolster its capacity to offer public data on taxes and revenues and get better at tracing the missing income of corporations. We can speculate that the culprit is within group transfers and not tax havens, a hunch that has been somewhat bolstered by a leading Romanian tax law firm known in the corporate world, Ţuca Zbârcea & Asociații Tax, who indicated that this holding structure lays no tax costs on capital and dividend flows within the same company.[8]

WEALTHY HOUSEHOLDS

Household wealth in Romania is not insignificant (425 billion in 2017) and this is particularly the case of the wealthiest 10 percent (who own 60 percent of total wealth) and of the millionaire class (known as High Net Worth Individuals in financial parlance, or persons whose investible assets, such as stocks and bonds, exceed a US$1 million).

Thanks to Credit Suisse's *Global Wealth Report*, we know that Romania had in 2017 14, 302 individuals worth between 1 and 5 million USD, 1,042 worth between 5 and 10 million and 26 worth more than 100 million USD. Overall, they represent the top 0.01 percent of the population.

Table 3:
Average real growth rates of GDP, export and household consumption

Average Annual Real Growth Rate, 2000-2018			
	GDP	(A) Export	(B) Household Consumption
European Union	1.6	4.6	2.5
Bulgaria	3.7	5.9	7.8
Czech Republic	2.9	8.4	6.4
Estonia	4.0	6.4	8.0
Latvia	3,9	7.3	7.7
Lithuania	4.1	10.0	8.3
Hungary	2.4	8.6	5.3
Poland	3.7	8.3	6.2
Portugal	0.7	4.6	2.9
Romania	4.0	9.5	9.7
Slovenia	2.4	6	3.5
Slovakia	3.9	9.1	8.6
Turkey	5.2	6.4	9.1
Serbia	3.3	12.7	5.2

Source: Authors' calculations based on Eurostat

The 2019 inflation report of the Romanian central bank locates the source of the largest increases in household wealth in the appreciation of real estate and financial securities, two areas in which ANAF seems to have underdeveloped expertise/attention to date. The same report certifies that most of the benefits of growth of the past eight years have gone to the top 20 percent of the income distribution. Indeed, since Romania is the CESEE country with the best performance on real GDP, export and household consumption growth during the 2000-2018 period one would expect to have higher not lower tax revenues (table 1).

According to a recent study, the top 0.01 percent hide 25 percent of their income from the tax revenue authorities. In contrast, everyone else hides less than 5 percent (Alstadsæter, Johannesen, and Zucman 2019). There is no valid reason to assume that Romania would be different. Given this unequal distribution structure and economic performance, one would have expected that ANAF's Large Taxpayers Division would focus its efforts on the winners of this long cycle of economic expansion. Certainly, given their political clout or access to professional tax and asset management services, a society's wealthiest citizens are harder to tax than those with average or low incomes (Alstadsaeter et al 2018; Zucman 2015).

However, between 2012 and 2015 ANAF audited only 96 of the top 0.01 percent and the total amount of retrieved tax money was a paltry 35 million RON (or 7.4 million euro), the cost of two villas in downtown Bucharest. Remarkably, there is no data on the 2015-2018 period, the years with the highest growth. As for taxing the real estate boom it suffices to say that the share of taxes on immovable property (mostly real estate) hovered around 0.6 percent of GDP (Eurostat).

All of this points at the need for more tax pressure at the top, via wealth taxes, real estate transaction taxes, dividend tax, estate taxes above certain thresholds, higher VAT on luxuries and highly polluting consumption, financial transaction taxes (Bagwell and Bernheim 1992; Slack and Bird 2014; Presbitero si colegii 2014; Zucman 2014; Piketty and Zucman 2015; Tørsløv et al 2018). Recent research shows that progressive wealth taxes are efficient and can bring additional percentage points of GDP into the public purse)Saez and Zucman 2019).

As indicated in the cited BNR report, Romania's largest fortunes do not come from personal income but from real estate and financial instruments, will less weight given to dividends, cash and trusts. The Romanian society needs to decide if it is willing to bear the pain of recurrent costs of health, education and infrastructure budgets or to demand the adequate taxation of the wealthy. In practice this would mean steep taxes at the top (in the US it was proposed 2 percent on fortunes over 50 million USD and 6 percent for fortunes over 1 billion USD).

8 https://www.zf.ro/special/romania-tara-atractiva-investitori-punctul-vedere-taxelor-impozitelor-acestia-au-relatii-bune-autoritatile-impactul-schimbarilor-legislative-fiscale-business-tax-and-legal-conference-and-workshops-18429242?fbclid=IwAR1EB3b7gnQmIfM4SJ2dd_I_4Pov9IpL-lOSSmNRItcveq4sbv6ChCiMPyU

The operationalization of a progressive wealth tax is less complicated than in seems. Saez and Zucman (2019) give specific indications in this regard. Listed companies have market values, luxury goods and most financial instruments being traded are evaluated by insurers and real estate is evaluated by real estate traders and assessors. There are reliable European protocols for estimating the worth of unlisted companies. Donations to offspring can be taxed while third party reporting and FATCA-style legislation can close the loop of enforcement, with everything hinging on upgrading ANAF's audit capacity for the challenges of working with the economic elite. Even states with comparably low institutional capacity such as Colombia where third party reporting was deployed, a 1 percent wealth tax only reduced reported wealth by 2-3 percent (Avila si Avila 2018). To ensure the political legitimacy of these reforms the additional revenue thus obtained can be earmarked for uncontroversial budget items such as clinics, hospitals, ambulance, kindergartens, palliative treatment etc. To top it off, a progressive wealth tax would force top earners to move their money from real estate (a new trend for the ITC upper strata) towards areas with higher productivity activities (say startups) that benefit from a more favorable tax treatment.

HOW TO TAX BETTER

LEGISLATIVE REFORMS

To be serious about revenues, Romania needs to first adopt clear and multipartisan political commitment at the highest level recognizing the linkage between regressive taxation and weak tax collection as an existential threat to the Romanian society and economy. In this regard, there is strong empirical evidence that without a strong sense of fairness produced by progressive taxation, attempts to raise more revenue will likely be met with anti-tax backlashes, as seen in Bolivia in 2003 (Fairfield 2003). This entails making the tax system more progressive overall by shifting more of the tax burden on corporations and the wealthy. To this end the legislative power could institute several reforms that have been empirically associated with success on this front.

Whatever the economic merits of progressive taxes over flat ones given the small number of taxpayers with high personal earnings, there is a considerable evidence that progressive personal income tax regimes affect the tax morale of broad majorities and are, therefore, important from a revenue collection perspective. What ties together the generators of tax morale is the sense of fairness that comes with progressive taxation. Thus, progressive tax systems with simple rates promote societal cohesion by reducing wealth and income inequality (Saez 2017), incentivize work effort (Pantya et al 2016), bolster satisfaction (Oishi et al 2018) and, if coupled with quality public services, increase voluntary compliance (Scheve and Stasavage 2016) for both low income and high-income groups (Berens and Schiller 2016).

Moreover, in line with the same fairness hypothesis, a study of support for progressive taxation in Eastern Europe found that distrust of the legal system and a conviction that tax authorities treat certain people more favorably than others increase support for progressive taxation. This finding suggests that progressive PIT might be understood by the public as a fairness measure vis-à-vis inequalities arising due to corruption (Domonkos 2015).

Going beyond personal income tax, the low hanging fruit in this area are the highly visible tax breaks for real estate transactions and the ultra-low tax on dividends. Thus, in 2017 real estate transactions under 95,000 euro were exempted from taxation, leading to an 80 percent contraction of tax collection from this tax (about 87 million euro) (Consiliul Fiscal 2018: 58). Given average real estate prices, the measure clearly benefited higher income groups. Furthermore, after 8 consecutive year of pesky economic growth marked by unprecedented corporate profits, the Romanian state collected barely 5 percent in dividend tax, or a paltry 360 million euro, that is around 70 kilometers of highway. The heavily procyclical dividend tax cut from 16 percent to 5 percent in 2017 led to a contraction in dividend tax revenue by 16 percent in the following year. In contrast, revenues from PIT increased in line with output growth (Consiliul Fiscal 2019: 57).

Perhaps most importantly, given the widespread view that the multinational corporations so structurally important to dependent market economies such as Romania have strong incentives to minimize their tax footprint via transfer prices and financial activities (Bryan et al 2017; Ylönen and Teveinen 2018; Khouri et al 2019), legislation should be adopted that could upgrade the legislative framework for this very specific challenge. Based on OECD research, it can be argued that the legislation should require multinational corporations, both public and private, to file country-by-country reports and, upon filing, make those reports freely available to all tax administrators, without requiring separate treaty or other agreements. The country-by-country reports should be available to the public within 30 days of filing. MNCs should also be required to disclose the names of natural persons who are the ultimate beneficial owners of the shares in corporations and update those names in public corporate registries available online. Furthermore, they should identify in their annual, publicly available corporate reports all of their subsidiaries, and not just the subset of "significant" subsidiaries. These measures are in the spirit of the European Union's Anti-Tax Avoidance Directive (ATAD).

Finally, the parliament should strengthen the independence, resources and embedded autonomy of ANAF. Given its strategic role for the functioning of the state, society and economy, the staff of ANAF should represent an elite bureaucratic corps with safe budgets, performance-based promotion, competitive salaries and professional prestige. To this end, a responsible Parliament should not only bolster the independence of ANAF so that it becomes immune to political pressure, a boilerplate recommendation, but also to "lock in" multiannual financing for a considerable expansion of ANAF's technical and staff capabilities in exchange for the adoption of hiring and promotion protocols inside this institution. This "grand bargain" could be a kind of "refoundation" or constitutional moment at a time when ANAF wages are becoming more dignified and pressure is increasing for higher revenues from multiple political and economic forces.

In addition to this, the scholarship on successful institutional transformations emphasizes the adoption of reflexive reforms requiring an understanding of ANAF's own limits in a dependent market economy, the possibilities of transnational networking with peers in high revenue countries engaged in the fight against transnational corporate and HNWI tax dodging and, finally, close links to and accountability to society (the so-called "embedded autonomy" (Evans 1995).

A particularly relevant faced of embedded autonomy that emerges from economic research on taxation is the collection of most taxes through third party institutions such as employers, banks, investment funds and pension funds. While personal income taxes are reported by employers on behalf of the state, leading to high levels of tax enforcement for personal income tax (the PIT tax gap is the smallest), third party reporting in Romania does not cover a large fraction of taxable income. Or, it has been amply documented that even in more developed institutional contexts (the US, Denmark) the evasion rate for personal income is 56% when there is 'little or no' information reporting, while it is less than 5% when there is substantial information reporting (Kleven et al 2011).

The finding held when tested in 14 advanced countries over a very long time period for both personal income taxes and value-added taxes. Of particular relevance for the puzzle of high growth-decreasing revenues situation of Romania is that the well-known positive correlation between tax take and GDP per capita across countries at a point in time is driven entirely by modern third-party reported taxes, while there is no correlation with traditional self-reported taxes. Finally, the Romanian economic structure anchored around 1000 companies owning almost half seems encouraging as the same study found that tax take and tax compliance are positively associated with firm size both across countries and across firms within a country. Indeed, the evidence is overwhelming that large and complex firms can serve as third-party intermediaries and make it relatively easy to collect taxes from households (Kleven et al 2016). The main implication of this analysis for the case of Romania is that ANAF should significantly expand the use of such third-party firms and particularly of banks and other financial institutions- in tax reporting.

ADMINISTRATIVE REFORMS

Research capacity

As our case study below shows, it is very difficult to undertake precise research on Romanian firm-level tax data without enormous resources and, consequently, it is difficult to adjudicate debates on what types of taxpayers are favored and who is not, who wins and who loses and what should be done. The capacity to generate, analyze and proactively publish detailed data is the hallmark of capable tax administration at a time when transnational price transfers, digitalization and financialization make the job of preventing base erosion a challenging task.

We therefore suggest that special emphasis should be put on establishing a new research department based on highly successful and transparent models such as the Swedish one. The research division of ANAF should be the repository of the most advanced knowledge and information in tax economics, politics and sociology. While international researchers were able to point out that even high capacity states dominated by domestic firms such as France and Germany have estimated revenue losses from profit shifting to the tune of 21 and respectively 28 percent of collected corporate income tax revenue (Tørsløv et al 2018), such research endeavors would be virtually impossible in Romania. One could hypothesize that in a weaker state with an economy dominated by multinationals such as Romania's, the loses would be greater. The result is a heated and empirically shoddy debate on winners and losers in taxation that cannot be adjudicated based on reliable data.

Voluntary compliance capacity

Designing strategies aimed at ensuring compliance, without adequately addressing the concerns of potential taxpayers, is bound to produce only limited success. ANAF recognizes this and made voluntary compliance its main strategic objectives (e.g. ANAF 2018: 3). Evidence from developing countries with low levels of tax capacity strongly suggest that individuals with a positive experience of state services delivery are more likely to express belief in an unconditioned citizen obligation to pay tax. Indeed, activating this particular social exchange mechanism is the most reliable political-economic means to increase voluntary compliance (Bodea and LeBas 2014; D'Attoma 2017). However, this is a long term and politically complicated task in the content of countries known for the weak political commitment to improved state service delivery such as Romania (Ban 2016; 2019). In the short term, there are low hanging fruit in the area of pure administrative terms.

Some of ANAF's reported voluntary compliance measures yielded some success. There has been an abrupt jump in tax obligations on foreign income between 2012 and 2019 (albeit from a very low level) owing to ANAF's proactive education of HNWIs of their duties to pay tax on that income. With Norwegian assistance ANAF has a functional Integrity Agency (ANAF 2018: 45).

Other measures are less compelling. Posting brochures on a limited topic (tax instalments) on the website or setting up Facebook sessions with low attendance rates appear of limited use given the low rates of able internet use among many categories of taxpayers and general disbelief that egovernment can be one of the realities of the Romanian state. The establishment of the ANAF call center was a step forward in bringing ANAF closer to the citizen in more impersonal settings. However, judging from the long waiting times and low number of phone calls (172,506 in 2017) relative to the taxpayer base it appears that the center is severely understaffed.

ANAF should consider using other evidence-based measures that could increase voluntary compliance by mandating the following. Based on existing studies one can start with faster dispute resolution and tax refund processing as mechanisms that reduce uncertainty and frustration while boosting a sense of procedural justice among citizens with a widely reported low trust in tax authorities (Goben and van Dijke 2017). Next, it may make sense to go beyond lip service and performance when inviting taxpayer feedback on services, and participatory citizen involvement in the piloting of new tax measures. The evidence from economic psychology studies is that having voice on tax contributions and on tax distribution leads to higher compliance (Casal et al 2016). In general compliance with state regulations increases with the degree of involvement of societal actors in rule design (Malesky and Tausig 2016);

ANAF could also be more pedagogical with less fiscally sophisticated taxpayers and consider tax education rather than immediate penalties for small and medium tax payers finding themselves in unsystematic breach of tax obligations. Field experiments found that friendly treatment of taxpayers by the tax office in auditing processes (Feld and Fey 2007) and trust in tax authorities (Kastlunher and Kirchle 2010) increases tax compliance. In countries as different as Australia and Malaysia the absence of tax knowledge among individuals and SMEs was found to lead to non-compliance behavior, either intentionally or unintentionally (Mckerchar and Hansford 2015; Loo et al., 2009). Deductions for taxpayers using of voluntary real time tax audits/online pre-filling procedures also seem to work. There is strong evidence that such procedures strongly correlate with high performance by improving accuracy of submissions (Ibrahim and Curtis 2011; Beck and Lisowski 2013; Okello 2014). Consider also the iconic study of Swiss cantons studies between 1970-1995 which found that the tax authorities in Switzerland behaved as if they were aware of the reaction of taxpayers to being treated with respect or not and were aware that deterrence is only one of the motivational forces in getting people to pay their taxes. A 'respectful' relationship of the tax authorities to the taxpayers crowds in tax morale while an 'authoritarian' relationship using instruments of deterrence reduces the incentives to evade taxes but the tax morale is undermined or crowded out. However, the authoritarian approach crowds out tax morale more strongly when citizens belong to high political participation categories while a respectful approach crowds in tax morale more strongly when the citizens score high on this variable (Frey and Feld 2002).

Cooperative programs with large corporate taxpayers

Two high-collection jurisdictions (Holland and Denmark) used innovative tax cooperation mechanisms (Stevens, Pheijffer et al. 2012; Elkjær and Kühn Pedersen 2011) whereby revenue authorities and the largest corporate taxpayers preemptively secure tax compliance via thorough information sharing and tax assessments (Elkjær and Kühn Pedersen 2011). It is of note that although the pilot version of the Danish program faced external resistance from corporate interest groups and from Big Four tax consultants, the tax authority (Skat) went ahead with it anyway and made in permanent.

In 2018, around 30 of the largest Danish corporate taxpayers (with 800 subsidiaries) participate and they are the corporations that close to 60 pct. of all corporate tax. The program is a grand bargain between the state and capital whereby the participating corporations gained the possibility of getting direct fast responses and real-time clarifications from Skat, minimizing the risk of re-active audits and a concomitant heightened predictability of their tax affairs is an important element (despite Skat answers not being binding). The process highlighted that even in Denmark the majority of the corporations do not have structures to document their tax risk and elaborated internal controls to tackle these risks. Moreover, following the program the firms stood to work with more competent and engaged Skat employees specializing in large firms. In exchange, Skat got better operational and real time oversight of how things are actually donedone in different parts of the organization being taxed. This had critical effects on staff training, as they learned how to work with and assess tax risks and internal control in multinational settings.

Anti-base erosion in multinational corporations

Aggressive tax planning has become the bane of modern states (Eccleston 2018; IMF 2009) and, therefore, the disruption of the most aggressive tax planning schemes of the largest individual and corporate taxpayers should come first in coercive capacity strengthening. Spread out in complex wealth and value chains and enrolling the expertise of Big 5 accounting firms, multinational corporations legally get away with profit shifting to the tune of $500 billion in dodged tax across the world each year (Tax Justice 2019). Overall, non-OECD countries lose 1.5 percent of GDP worth of revenue every year as a result of tax base erosion, with these operating less through effects on real investment decisions than through profit shifting. The revenue losses through avoidance activities associated with tax havens also seem to be more of a concern for non-OECD members and they amount to 1 percent of GDP in the long run. The largest fall in revenue from the corporate income tax as a percent of total revenue in the non-OECD group was recently recorded in upper middle-income states such as Romania (Crivelli et al 2015).

Indeed, even the IMF joined the OECD in calling for the end of the “arm's-length principle” in international taxation that splits the profits of multinationals between countries. Transfer pricing refers to the prices in place for such transactions within MNEs. Intra-group cross-border transactions, conducted at a price (i.e. a “transfer price”), are legal features of MNEs and it is through them that the most aggressive tax planning operations take place.

Starting with 2013, new international standards and guidelines under the G20/OECD BEPS (Base Erosion and Profit Shifting) initiative delivered a scathing review of the status quo yet without going to root cause of the spillovers that are structurally integral to multinational firms. The alternative being broached is formulary approach to profit attribution whereby tax is paid where real business happens not where profits are shifted to minimize tax obligations. According to the IMF, this 'would greatly reduce the scope for profit shifting' and confirms that if multinationals were to be taxed in line with where their employees actually work, developing countries would see their tax revenue rise by over 30 per cent on average.

The current environment in EU politics and expertise is friendly towards this form of capacity building (Roland 2018). In March 2018 the EU finance ministers have unanimously approved new rules that require advisors to report "potentially aggressive" tax schemes, the latest step in European efforts to clamp down on cross border tax avoidance. From mid 2020, accountants, banks, lawyers and other financial advisors who design or promote cross-border schemes with tax-avoidance markers will have to report the scheme's details to national authorities with 30 days of its creation. Schemes for all types of direct taxes - including capital gains, corporate, inheritance and personal income - are covered by the new directive.

The new rules aim to both deter professionals from creating new schemes to dodge tax and also to notify national authorities quickly of new structures enabling them to target audits and close loopholes. In 2018 the Romanian authorities have, under EU pressure, closed one of the most glaring forms of tax dodging (anonymous shares) yet to date ANAF has not developed the organizational capacity to monitor compliance with the reporting requirements for these professional intermediaries.

A positive step in the direction of a thorough review of the fraudulent operations of offshore entities has been the 2014-2020 Norwegian and EU-funded training program that will give ANAF specialized staff for these activities (ANAF 2018: 46). However, a lot more is needed regarding ANAF expertise on offshore entities. The easiest and first step should in this regard should be adopted not by ANAF but by state aid agencies. Thus, UNCTAD (2015) shows that the average rate of return on foreign direct investment in developing countries decreases rapidly with the share of investment deriving from offshore financial centers, which is suggestive of profit shifting. Such entities should be blacklisted by the state aid agencies.

Moreover, although the IMF has encouraged all countries to establish or reinforce teams specialising in transfer pricing, provided documentation to support their assessments of whether prices are distorted, and referred countries to other institutions' training courses, no measures to this end have been adopted by the government. Despite this, ANAF annual reports pay scant attention to transfer prices. According to ANAF's latest annual report (ANAF 2018: 37), its transfer pricing audits raked in an additional 56 million euro in 2017, a paltry sum. More proactive measures regarding transfer pricing can include setting fixed prices for different goods/services to pre-empt transfer prices and ask for TA resources to this given the involvement of many other organisations and preferring to focus its TA on its other comparative advantages. Unfortunately, to date, the IMF has not engaged extensively with discussions on unitary global taxation of countries and formulary apportionment of resulting revenues, including the 2015 suggestions of the Independent Commission on the Reform of International Corporate Taxation (ICRICT).

Crack down on corporate debt

ANAF needs to crack down on corporate tax debt. In late 2018 the Ministry of Finance estimated that 63 million RON were lost due to insolvency, less than 6 percent of the tax arrears were retrieved and 28,000 firms were in various stages of insolvency. The changes to the insolvency law in September 2018 were a positive step in the direction of using chains of insolvency to dodge taxes. The government delegated in the management the insolvent firm were bolstered by enabling them to track corporate estate management operations, making opening insolvency procedure dependent on paying a share of the tax arrears, transforming tax arrears into shares. However, to date the institutional capacity to do this remains in the work in progress stage and there are no concrete plans for training the professionals needed to engage in the strategic litigation required by a serious tax debt crackdown. On the contrary, much of the ongoing conversation is about the prospect of a tax amnesty.

Last but not least it is important to keep in mind that there are important links between voluntary compliance and coercion. For example, coercion works best when taxpayers have higher levels of trust in the state. A study of Romania, Russia, Hungary and Austria found that tax compliance depends on the factors perceived trust in the authorities and perceived power of the authorities, but trust on the one hand fosters voluntary compliance whereas power on the other hand leads to enforced compliance. The study confirmed that the highest level of intended tax compliance and the lowest level of tax evasion were found in conditions of high trust and high power (Austria, Hungary) compared to low trust and low power (Romania, Russia) (Kogler et al 2013).

Critically engage with the trade-offs of simplification

Simplification has emerged over the past few decades as a silver bullet of improved revenue collection. The logic is intuitive: complex procedures and lengthy tax filing processes alienate the taxpayer and reduce her level of voluntary compliance. According to Pricewaterhouse Coopers's Paying Taxes databases, between 2004 and 2017 Romania has been a top performer in terms of reducing the number of hours needed to deal with taxes as well as that of payments. This is true for both labor income and corporate profits. Contrary to the media hype, in Romania the number of tax payments for labor income has come down from 72 in 2014 to 1 in 2017, which puts Romania next to top performer Denmark. The same is true of corporate income payments, which have shrunk from 4 to 1 during the same period.

However, in other areas Romania outdid Denmark, with the number of hours needed to complete tax procedures in Romania being half the number that Danish firms and workers spend. Given that Denmark is about as good as one can be in terms of the costs of paying taxes, one wonders if the underperformance of the Romanian system in terms of simplification has not come at the cost of diminished legibility for the tax authorities in ANAF given their reduced levels of automation relative to their Danish counterparts in Skat.

Make the Romanian ITC "miracle" revolutionize revenue collection

Successful revenue mobilization hinges on managing information and leveraging the power of big data. Most of the countries that made dramatic increases in revenue collection have taken advantage of IT system. Georgia has automated most processes, including e-filing while instituting a system for information sharing among tax authorities, taxpayers, and banks, as well as a one-stop Internet portal. Even low-income countries such as Cambodia, Guyana, and Liberia have likewise computerized the administration of their taxes and customs. Given the dismal state of digitalized revenue collection in Romania, perhaps the most realistic first step would be to start from the assumption that Romania has a level of institutional development comparable to Peru and Senegal and adopt the reforms suggested to these countries by institutional actors that have carried out in-depth research there (KfW, International Tax Compact), including a rigorous benchmarking of IT packages used by revenue collection agencies.[9]

The ANAF performance in this regard is lackluster. E-filing has become more common and several international programs introduced different software packages for various tax tasks. However, they are poorly integrated and the systems crash frequently. With the support of the World Bank, ANAF began in 2013 a modernization program (RAMP) focused on enhancing collection efficiency and tax compliance, with an integrated IT infrastructure at its core. After five years of delays and resources spent almost exclusively on consulting fees, the Ministry of Finance walked off the deal, with the breakdown of the program owing to the inability of the Romanian side to agree on something as minimal as the specifications of the IT infrastructure.

In the light of this failure and given the extraordinary complexity of revenue collection in complex economies today even in countries with more advanced revenue capacity, it is hard to be optimistic about the Ministry of Finance's planned National Centre for Financial Information, which will effectively deprive ANAF of a centralized data collection mechanism. This skepticism is emboldened by the fact that the government intends to digitalize revenue collection via a public private partnership-an organizational form that has had disappointing and in some cases criminal results in Romania's egovernment drive-and for twice as much the amount of the World Bank comprehensive modernization loan, which included digitalization. Moreover, even in countries that are much more developed institutionally, public-private partnerships are not utilized uncritically.[10]

One source of hope is the extended pool of human resources in Romanian ITC at a time of deep economic and technological change. According to the IMF, the increasing use of digital technologies throughout business and the rise of new business models heavily dependent on digital technologies, many of whom provide services in exchange for personal information pay high dividends and have high stock market valuations yet often paid relatively little tax. Given the Romanian ITC boom, ANAF should build a similarly mighty base in ITC and international legal expertise, a task that cannot be fulfilled without paying competitive wages to an elite corps of staff able to trace transactions, coordinate with foreign peers or handle complex jurisdictional battles. The U.K., for example, proposes allocating 'residual profit" partly by the value of user participation yet even for the IMF staff the task is extremely technical (IMF 2019: 15).

Unless reforms are adopted to increase the currently low levels of pay for ITC staff in central agencies of the Romanian state (ITC staff are paid 1800 RON in line ministries), this opportunity will be lost for the foreseeable future. In this case, Romania has little choice but follow India, Chile and Uruguay and withhold taxes on payments for advertising and other specified digital services made by residents to non-resident companies, this avoiding the need to apportion revenue attributable to domestic users· Such taxes are simpler to administer but are nevertheless easier to avoid by having related offshore entities purchase the services (IMF 2019: 17).

Finally, ANAF reforms should go beyond boilerplate recommendations. If the state wishes to make multinationals and the "new economy pay" it should equip ANAF to go beyond basic automation and surf the frontiers of new ITC technologies such as Blockchain, much like Estonia and Finland did (WU/NET Team. 2017). Blockchain is the technology developed behind Bitcoins and consists of a virtual distributed ledger (a chain) of digital records and transactions (blocks). Its usability in taxation is clear because blockchain data are created in "immutable distributed ledgers" (WU/NET 2017) and that these create "a transparent audit trail virtually immune to corruption and falsification" (ibid. 4). This, in turn, can build centralized registers of beneficial owners in transnational wealth chains (Bal 2018) and

"[C]an be used by the tax authorities to gain knowledge for instance about payroll systems and VAT payments in corporations on a real-time basis. This way of receiving data may potentially provide the tax authorities with a direct access to the corporations' financial records, as indicated in the citation just above. Having this direct access to data eliminates the necessity for control of any 'internal control' in a corporation as the tax authority itself already has this access." (Boll and Johansen 2018)
The evidence in this regard is overwhelming yet techno-optimism should be treated with caution in the light of more nuanced social science evidence. Thus, even states with superior bureaucratic capacity such as the Czech Republic have very uneven performance in terms of transparency and technical abilities (Mohelská and Sokolová 2017). Therefore, ICT "revolutions" in revenue collection are likely to be shaped by understudied local dynamics. For example, a study of revenue collection in the Philippines found that while the use of ICT made possible more transparent and accountable revenue generation systems to benefit both government and taxpayers, these results depended on the level of political leadership, the nature of articulation of the demand for ICT use, the ratio of benefit against cost, and the availability of technical skills and resources at the sub-national level. Only by boosting these can ICT be adopted, scaled, and used to achieve better governance (Canares 2016).

Improve data transparency

Serious analysis of revenue collection needs firm level data. As it stands, the authorities fail in their duty to provide the public with systematic and processed firm-level data. Thus, the Ministry of Finance publishes a limited number of financial indicators on its website, but these are protected by CAPTCHA codes and limit

9 https://www.taxcompact.net/documents/IT-Tax-Administration-Study.pdf

10 https://www.oecd.org/dac/evaluation/IOBstudy378publicprivatepar tnershipsindevelopingcountries.pdf

large-scale analyses. In turn, the data from the Registry of Commerce can only be accessed against a per-firm cost and is, at times, at odds with the data from the Ministry of Finance in what is yet another instance of the widely documented institutional weakness of the Romanian state (Adascalitei and Guga 2018; Volintiru 2018; Tudor 2018).

We suggest that the Ministry of Finance should proactively publish on its website systematic and consistent firm level data on taxable corporate profit and total profit taxes paid by companies, so that effective tax rates can be seen by all taxpayers. As a first step, the authorities should immediately release these indicators for the very large firms in ANAF's "large contributors" list. Encouraging the kind of data-intensive research that could adjudicate between various broad claims made about effective taxation in the Romanian corporate world would benefit Romanian authorities and Romanian citizens demanding the right to know how public goods can be better funded and researchers who study the patterns that publicly provided large scale firm level data might reveal. By uncovering inconsistencies in the data and patterns, researchers can help policymakers improve data collection while providing answers to policy puzzles and suggestions about how democratic demand for redistribution can be addressed given the existing resources.

The Ministry of Finance should also publish on its website the data on ultimate beneficial ownership (UBO) for the largest companies, with UBO transparency regarding the top 100 firms to be made a priority. The data we purchased from the Registry of Commerce proves the importance of UBO data: some firms are owned by Romanian subsidiaries of international firms. UBO data would allow for the fast identification of such firms as foreign, rather than domestic as in our sample. This would allow more precise identification of foreign ownership and of the ultimate source of capital.

Improve annual reporting

Annual reports should be more detailed and use more concrete language. To illustrate, in its reports ANAF does not provide clear evidence of voluntary compliance measures over time, which makes systematic evaluation virtually impossible. Moreover, ANAF yearly reports on voluntary compliance are dominated by vague statements that give the impression of little substantial work on voluntary compliance. To take but one example, it is reported that ANAF worked to improve its "communication with the relevant professional organizations that are active in the area of income tax collection," (ANAF 2018: 13). yet we are not told what those organizations were, what the communication consisted of and with what results for ANAF's voluntary compliance work.

Without concrete language and metrics about improvements it is impossible to provide accurate evaluations of this critical area of revenue collection capacity. Absent these changes, one may be tempted to infer that ANAF has not really done much with concrete results given its willingness to report metrics in the case of high net worth individuals' foreign income and lack thereof in the case of all other categories of taxpayers. This may be inaccurate but the burden of proof rests on ANAF to prove that it was otherwise.

TAXING AT THE SUMMIT: TOP 100 VERSUS THE REST

THE PREMISES OF THE CASE STUDY

In this case study, we look at the profitability of the 100 largest firms in Romania and investigate whether there are significant differences between domestically-owned firms and foreign firms.

The literature on tax havens finds wide differences in the levels of profitability of foreign and domestic firms (Torslov, Wier, & Zucman, 2018). Could Romania also be considered a tax haven?

To answer this question, we compare profitability rates of foreign and domestic companies and investigate whether there are large discrepancies between the two. Profitability is critical for discussions on taxation. In this section, we study whether there are significant differences in the profitability of foreign and domestically-owned companies.

The literature on FDI and international trade (Bellak, 2004) has shown that foreign firms tend to be larger and relatively more profitable, usually because they can leverage network effects or make use of advanced technology (Blomstrom, 1986). However, the more recent literature on profit shifting (Torslov, Wier, & Zucman, 2018) has shown that foreign firms tend to be significantly more profitable in tax havens, with no significant economic difference arising in non-haven EU countries. New studies on profit shifting in non-haven countries also find that foreign affiliates tend to be more profitable than domestic companies, but pay relatively less tax, which is consistent with the aggressive tax planning hypothesis (Palan, Murphy, & Chavagneux, 2013; Liu, Schmidt-Eisenlohr, & Dongxian, 2017).

Next, we ask how important financial activities are for top 100. As the most recent literature on profit shifting shows (Torslov, Wier, & Zucman, 2018) such activities can be used to move profits among the subsidiaries of the same conglomerate, thus minimizing the tax bill. In this section, we look at financial activity in order to gauge whether interest costs represent a disproportionate part of their costs. Such activity could signal internal debt shifting, namely companies using internal debt from a foreign affiliate in order to increase their deductible interest costs and decrease their total taxable profits.

WHY TOP 100?

Focusing on the top 100 is important precisely because they are not representative of the entire Romanian economy. Doing this analysis on the largest 1000 firms, let alone the entire population of firms, would perhaps lead to different conclusions. It is also important to point out that given the fact that Romanian statistical outlets do not have firm-level data organized by the location of shareholders, more extensive studies demand much larger financial resources than those available to us.

That said, the largest 100 companies form a solid basis for an initial research, as those firms are of critical importance to the Romanian economy and have characteristics that allow them to report reliable information. First, in 2017, these companies had total sales of 295 billion RON (61.7 bln euro). For comparison, Romania's GDP in that year was 211 billion euro. A single firm, Dacia-Renault, was responsible for 7.7% of total exports in 2012. Second, this elite group of firms have a low risk of reporting careless data. We expect that all companies in our sample have access to premium accounting services, such that they report high-quality data to the Romanian authorities. Finally, all firms can be found on the big contributors list compiled by ANAF (the Romanian internal revenue service), which makes it highly likely that their records are checked by the fiscal authorities.

Two caveats are in order at this point. First, given the small sample size in our study, we were unable to consider sector-level heterogeneity in profitability and effective tax rates. We believe such heterogeneity is relevant for a comprehensive analysis of corporate taxation and we intend to address it in future research. Second, to avoid misreading, we wish to stress that this study should not be read as a comprehensive analysis of heterogeneity in effective corporate taxation in Romania, but merely as an initial descriptive research. Its ultimate objective is to guide and invite future research into the topic, while alerting the public to the dire plight of transparent access to easy to process data on Romanian taxation.

The data covers selected indicators from the balance sheet and the P&L statements of the 100 non-bank firms with the largest turnover in 2017. It consists of two distinct datasets: the first covers a narrow range of financial indicators and ownership data and was purchased from the Romanian Registry of Commerce. The second dataset was downloaded from the Ministry of Finance's official website[11] and merged with data purchased from the Romanian Registry of Commerce.

11 Source: authors' own calculations.

It is important to note that our sample consists solely of unconsolidated firm data. With the exception of the OMV Petrom Group, which has two firms in our sample (OMV Petrom Marketing and OMV Petrom Gas), all other groups seem to be represented by a single firm in the top 100 of the largest firms. Furthermore, this also means that our ownership data is based on the immediate owner, rather than the ultimate beneficial owner. This distinction is important, as it probably severely underestimates the number of foreign-owned companies in the sample: if a company is owned by a domestic sister which is in turn owned by a foreign affiliate, it would show as a domestic company in our sample.[12]

Table 2 shows an overview of the countries where the shareholders of the top 100 largest firms reside. A firm is assigned to a country if that country is the largest owner of the firm. Thus, if 3 firms from country X each own 30% of the company and the rest of 40% is owned by firms in country Y, country X would be considered the source of the firm. In practice, as it can be seen in Table 8 in the Appendix, firms can be cleanly assigned to a country: 91% of the firms are owned in a proportion larger than 90% by residents of a single country, with the minimum standing at 51%. Overall, foreign capital is dominant, with nearly two thirds of top 100 listing their largest owner as non-resident.

Table 4
Ownership of the top 100 largest firms

Largest owner - country	Number of companies
Largest owner - country	**73**
Netherlands	26
Germany	14
France	6
Switzerland	6
Austria	5
Luxembourg	5
Italy	4
Cyprus	2
Belgium, Czechia, Hungary, UK, USA	1 each
Domestic - owned	**27**
Private	17
State-owned	10
Total	**100**

Table 4 also shows the large importance of foreign capital in the Romanian economy: of the 27 companies owned by shareholders who are Romanian residents, only 17 are privately-owned. The other 10 Romanian companies in the sample are at least partially state-owned: they cover strategic infrastructure, such as electricity generation and roads, or transports, such as the national railway company CFR and the flagship carrier Tarom. The Netherlands is the largest source of foreign capital in the sample: shareholders residing in the Netherlands own the majority of 26 of the largest 100 companies, comparable to all Romanian-owned companies, both private and public (27).

Overall, Dutch, German and French capital accounts for almost half of foreign owned companies in top 100.

Table 5 provides further detail about the companies in our sample and confirms the systemic importance of foreign capital in Romania. All the manufacturing firms in the top 100 are foreign-owned, with pharmaceuticals emerging as the only sector with a balance between foreign and domestically-owned companies. Next, the table shows the distribution of the largest Romanian companies, by industry and type of ownership. The energy, oil and gas sector contain the most domestic-owned companies (11), with retail and pharmaceuticals following at 4 and 3 firms, respectively. In the 6 industries featuring both domestic and foreign-owned firms, four feature domestic firms having on average larger total assets (agribusiness, oil, pharmaceuticals, retail) and two feature foreign firms being larger (IT, other).

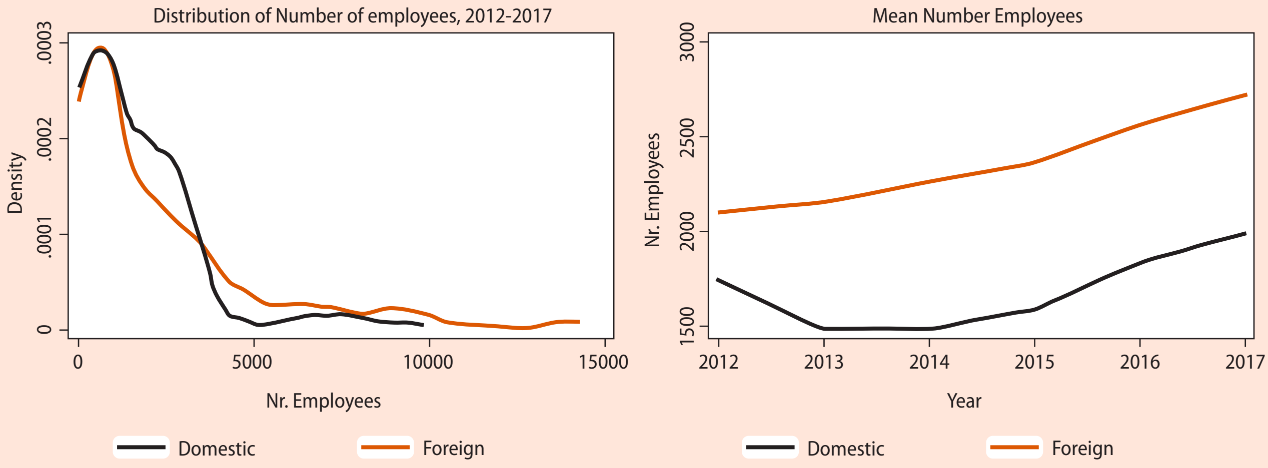
12 In our initial sample, there were 17 state-owned companies activating in sectors such as transport, oil and energy. We decided to exclude those from our analysis on profitability, effective tax rates and financial activities, as their objectives might include strategic, public goods and other non-market concerns that are not relevant for privately-owned companies.

Table 5:
Top 100 largest Romanian companies, by industry and type

Industry	Number Companies		Average Tot. Assets 2017 (RON mln)		Average Tot. Revenue 2017 (RON Mln)	
	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic
Agribusiness	8	2	162	843	262	775
Energy, Oil & Gas	8	11	1611	5452	3181	4327
ITC	3	1	4619	811	3351	1089
Manufacturing - Auto	23	0	2367	–	3351	–
Manufacturing - Other	13	0	2049	–	1993	–
Other	3	2	1803	472	1695	1695
Pharmaceuticals	2	3	1553	3348	1533	2734
Retail	10	4	2379	2608	3733	3193
State-owned other sectors	0	4	–	9533	–	1381
Tobacco	3	0	1611	–	4112	–

Figure 19 shows the number of employees in foreign and domestically-owned private companies. Again, the critical importance of foreign capital in the labor market is clear. Foreign companies tend to have more employees (see the second panel of Figure1). Both types of companies have been steadily growing in size in the period 2012-2017. In particular, the average foreign company increased 29%, from 2100 employees to 2718 employees, while the average domestic company increased only 14.4%, from 1741 to 1991 employees. However, it must be noted that this average contains important compositional effects: as shown in Table 4, the industries dominated by large domestic companies are different from those dominated by large foreign firms. In particular, the bulk of domestic companies operate in the oil and gas sector, which tends to be highly capital-intensive.

Figure 19:
Firm size: number of employees, excluding state-owned companies (2012-2017)



Kernel density no. employees, 2012-2017

Mean no. employees, 2012-2017

PROFITABILITY

Table 6 offers an overview of the profitability of privately-owned companies across a spectrum of indicators, such as gross profit as a percentage of total assets and net turnover as a percentage of total assets. It can be observed that average normalized profits are consistently larger for foreign companies, as opposed to domestic companies and the two types of firms look similar only regarding mean values of gross profit as a percentage of net turnover and net profit as a percentage of net turnover. At the same time, the profitability ratios show large variation across observations.

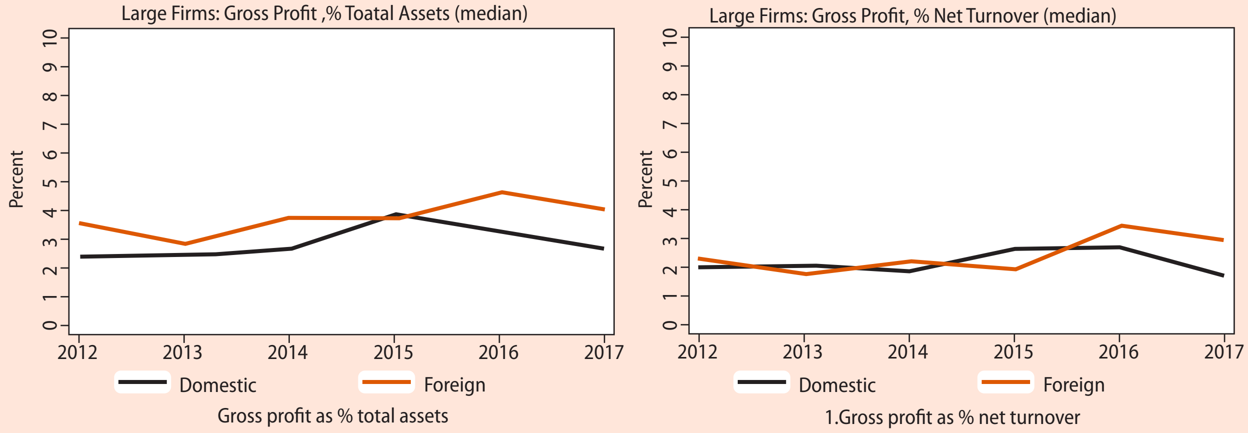
To illustrate, the largest losses, both as a percentage of total assets and of revenue, was registered by Blue Air in its first years of existence. Presumably, these were due to the large investments required for operating an airline. On the other hand, the most profitable company was Leroy Merlin in 2017 if measured by the percentage of net turnover and Continental Automotive if measured as percentage of total assets. State-owned companies were both the largest losers and the largest winners. However, given the small sample and the different governance system of these companies, we limited our analysis to privately-owned companies.

Table 6
Profitability ratios, excluding state-owned companies (2012-2017)

Indicator	Mean		Min		Max	
	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic
Gross profit, % total assets	4.24	2.82	-36.60	-75.48	41.97	17.00
Gross profit, % net turnover	3.55	3.03	-29.78	-54.41	36.83	19.81
Net profit, % total assets	3.39	2.08	-36.60	-75.48	35.14	15.00
Net profit, % net turnover	2.84	2.39	-33.87	-54.41	32.37	16.19
Net turnover, % total assets	158.02	173.57	0.98	14.89	576.51	871.12
Total debt, % total assets	38.37	41.32	2.26	6.15	133.29	90.71

That said, levels of profitability vary over time across the two types of firms. Figure 20 provides further insight into the profitability ratios of domestic and foreign companies. While in the period 2016-2017 foreign companies in the top 100 were indeed significantly more profitable than domestic ones, in 2014-2015, the opposite was the case, albeit the difference was significantly smaller. Thus, there is reason to believe that foreign companies in this sample are only slightly more profitable than domestic privately-owned companies. This is in line with the literatures on international trade (Bellak, 2004; Aitken, Hanson, & Harrison, 1997) so Romania is not an outlier in this regard, at least as far as top 100 is concerned.

Figure 20:
Profitability ratios, excluding state-owned companies



Finally, our findings are consistent with Romania *not* being a tax haven. While foreign firms tend to be more profitable than domestic firms, the difference is in the same order of magnitude, as opposed to the striking differences found in the literature on tax havens (Torslov, Wier, & Zucman, 2018).

IMPORTANCE OF FINANCIAL ACTIVITIES

In the period 2012-2017, Romania's transfer pricing rules included upper limits on interest paid, which were aimed at limiting this avenue for tax planning. However, this limit was not applied to interest from financial institutions (PKF International, 2016), which could give rise to the possibility of using internal group banks for tax planning.

Table 7 shows the relative importance of financial activities for private companies in our sample. It can be observed that while financial activities do not represent on average a large fraction of total activities, there are some outliers for which interest costs and financial losses represent more than 100% of total costs or income. Upon closer inspection (See Appendix, Table 9), we observe that the outliers date from 2012 and 2013, with all firms having financial costs to total costs ratio between 0 and 50% in 2016-2017.

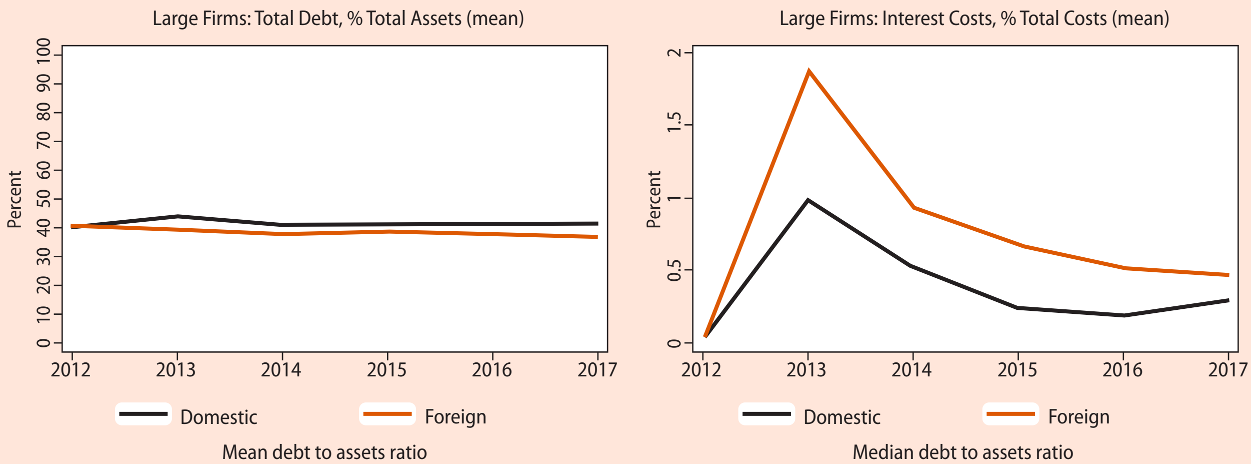
Table 7
Importance of financial activities, excluding state-owned companies (2012-2017)

Indicator	Mean		Min.		Max.	
	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic
Financial profit, mln RON	-14.35	-9.56	-501.13	-161.19	131.66	74.70
Financial income, % total income	4.56	3.86	0.00	0.00	540.13	77.82
Financial costs, % total costs	5.22	4.46	-0.34	0.00	372.61	53.11
Interest costs, % total costs	0.74	0.37	0.00	0.00	67.20	6.62

A natural question arises: are financial activities more important for foreign companies, relative to domestic companies? Table 4 would suggest so, albeit to a limited extent. This need not be driven by tax shifting incentives: on the one hand, foreign companies in our sample are mostly owned by large conglomerates which have access to sophisticated financial services. On the other hand, the private domestic companies in our sample have a relatively small international clout, which would suggest that they are limited to domestic financial services delivering tax footprint minimization.

Figure 21 shows debt to assets ratios and interest costs as percentage of total costs, by year and ownership type. Despite having smaller debt to assets ratio than domestic companies, foreign companies tend to spend more on interest costs. This is consistent with internal debt shifting hypothesis, but absent more data transparency, we are unsure of the economic significance of the tax saved.

Figure 21:
Debt ratios and interest costs, excluding state-owned companies (2012-2017)



To conclude, given the very small size of our non-random sample, we suggest more research is needed in order to establish whether the debt ratios are driven by tax planning or other concerns. Given the literature showing that even more capable states have so far failed to protect their tax base from the tax avoidance opportunities created by globalization (Tørsløv et al 2018), we think that future research could establish whether other avenues for tax base shifting have been used instead.

To conclude, in this case study, we investigated whether there are consistent differences in the profitability of privately-owned domestic and foreign companies, using a non-random sample of the 100 largest companies in Romania. We found that foreign companies tend to be more profitable and more financially active, but Romanian companies have higher debt ratios. Similarly, interest costs tend to represent a larger share of total costs in the case of foreign companies, which is consistent with internal debt shifting. One potential insight that follows from this is that if base erosion takes place, it does not come with drastically different patterns between foreign and domestic capital among the country's largest 100 firms. Tax justice experts we interviewed were not surprised by the findings and were of the opinion that post BEPS constraints in the EU the large (predominantly manufacturing multinationals) from top 100 are more reluctant to resort to levels of base erosion that would be drastically different from those of domestic firms.

Absent enormous resources, quality future research needs a radical package of measures on data transparency to be adopted by the fiscal authorities of the Romanian state. Without a doubt, future analyses would benefit significantly from a larger and more homogeneous sample. Yet that requires either much larger resources compiling firm-level data or, in the spirit of transparency and democratic accountability, unrestricted access to large-scale firm level data stored with ANAF and Ministry of Finance granted to researchers.

We strongly encourage further research into the topic of tax treatment of domestic and foreign firms. In particular, we suggest future studies should

(1) Broaden the sample to include at least all large contributors in Romania and analyze whether effective tax rates vary across sources of capital, sectors and time. Such endeavors require large research teams over long periods of time and it would be ideal that the job be carried out by a dedicated research division in ANAF or the Ministry of Finance. Furthermore, we believe that an evaluation of the effects of the introduction of the large contributors list and the reforms in ANAF's transfer pricing unit could be highly informative about the effect of salience and administrative capacity on corporate tax planning behaviour.

(2) Relate the reported profits of each corporation to its inputs of labor and capital and its tax incentive to engage in profit shifting with foreign affiliates, as done in the iconic Hines and Rice (1994) study. We find considerable promise in a more recent version of this approach (Johansen et al 2017) whereby the focus falls directly on a hard to challenge manifestation of profit shifting: multinational groups that consistently report zero profits in their high tax affiliates despite being profitable at the global level. This means an estimate of how the propensity to report zero profits correlates with the tax incentives to shift profits by asking "whether corporations whose foreign affiliates experience a reduction in the tax rate reduce reported profits relative to similar corporations in the same country whose foreign affiliates experience a constant tax rate" (Johanssen et al 2017: 3).

POLICY IMPLICATIONS

LEGISLATIVE REFORMS

- Progressive income and wealth taxes
- Higher dividend tax
- Removal of all tax breaks on real estate transactions and higher tax rates for these transactions

ADMINISTRATIVE REFORMS OF THE REVENUE AUTHORITY ANAF

- The strengthening of ANAF's institutional autonomy

- The establishment of a research department able to generate and process detailed tax data and make it publicly available

- Improved work conditions and equipment for ANAF staff

- Greater automation of ANAF operations via a new agreement with the World Bank based on the successful experience of Bulgaria

- Increase accountability via more detailed, concrete and legible reporting

More meritocratic staff selection and promotion mechanisms for ANAF so that this agency becomes an elite bureaucratic corps of the Romanian state. Specifically, we suggest that new staff should be hired based on their grades upon graduating the Tax, Public Finance and Customs School, their internship performance cards and their digital competencies. Tenure can only be granted following the successful passing of an exam at the end of the internship that tests their practical abilities with complex revenue collection procedures. The curriculum of the Tax, Public Finance and Customs School should be based on best practices and templates form countries where the government collects more than 40 percent of GDP.

TARGET LOW REVENUE COLLECTION FROM FIRMS AND THE WEALTHY

- Deploy digital processing capacities at the standard of the most advanced European countries;

- Deploy Blockchain to access income data in real time

- Crack down on corporate income tax arrears

Crack down on tax avoidance and transfer prices in particular via (a) blocking state aid to blacklisted firms (b) the shutdown of the holding regime that enables capital and dividend flows between companies with no tax consequences (c) enforcing OECD recommendations on making it a legal obligation for firms to publicly report all the income earned in the country (b) bolster ANAF capacity to operate internationally so as to better trace the tax avoidance schemes of corporations and the wealthy.

- Improve transparency via information exchange systems between ANAF and the largest corporate income taxpayers

BOLSTER VOLUNTARY COMPLIANCE

- Faster settlement of tax disputes

- Faster processing of tax rebate requests

- Replace authoritarian communication and the practice of automatic bank account blocking with more pedagogical forms of interaction when it comes to taxpayers finding themselves in a position of unsystematic breach of their tax obligations

- Higher tax rates for the top ten percent of households owning 60 percent if the total wealth stock in the country

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1.1. Appendix: alternative tax ratios

NOTE:

All data on financial indicators in this appendix, including data on gross and net profits, come from the Ministry of Finance, with the exception of the tax variables (Total Tax Paid and Profit tax Paid), which come from the Registry of Commerce.

In order to study whether there are differences in the effective tax rates paid by foreign companies versus domestic companies, we compiled a number of standardized tax ratios:

1. Difference gross-net profit, as a percentage of gross profit: this ratio is entirely based on public data from the Ministry of Finance and includes both corporate tax rates and other taxes, as explained in the main text. It is our main indicator.

While this indicator is very useful when the companies make large, positive profits, it can become misleading when profits are very small or negative. The reason is mechanic: if profits are negative, total corporate tax paid should be zero for that particular year, but other taxes might not be (for instance, the minimum profit tax, which needs to be paid regardless of the profit size). In case gross profits are positive, but very small, this indicator will have a very large value, but this will be driven by the other taxes, rather than the profit taxes. For large profits, profit taxes become the bulk of the difference between gross and net profits.

For this reason, in Table 5 and Table 6, we calculate each indicator both for the entire sample and for the sample with positive gross profits only.

Table 8
List of 100 largest companies by revenue in 2017

Position	Name	Country	% Owned
1	Automobile-Dacia S.A.	France	99.4
2	Omv Petrom Marketing S.R.L.	Romania	100.0
3	Rompetrol Downstream S.R.L.	Romania	100.0
4	British American Tobacco (România) Trading S.R.L.	Germany	100.0
5	Star Asssembly S.R.L.	Germany	100.0
6	Carrefour România S.A.	France	100.0
7	Dedeman S.R.L.	Romania	100.0
8	Lukoil România S.R.L.	Netherlands	100.0
9	Mol România Petroleum Products S.R.L.	Hungary	100,.0
10	Orange România S.A.	Belgium	99.2
11	Auchan România S.A.	Netherlands	77.6
12	Mega Image S.R.L.	Netherlands	100.0
13	Ford România S.A.	Netherlands	100.0
14	E.On Energie România S.A.	Romania	100.0
15	Profi Rom Food S.R.L.	Luxembourg	100.0
16	Metro Cash & Carry România S.R.L.	Netherlands	75.0
17	Petrotel - Lukoil S.A.	Netherlands	99.7
18	Arcelormittal Galati S.A.	Switzerland	99.7
19	Samsung Electronics România S.R.L.	Netherlands	100.0
20	Continental Automotive România S.R.L.	Netherlands	100.0

Nr. crt.	Denumire	Țara	% capital deținut
21	Autoliv România S.R.L.	Germany	99.0
22	Mediplus Exim S.R.L.	Romania	100.0
23	Electrica Furnizare S.A.	Romania	100.0
24	Selgros Cash & Carry S.R.L.	Germany	100.0
25	Rcs & Rds S.A.	Netherlands	93.6
26	Omv Petrom Gas S.R.L.	Romania	100.0
27	Altex România S.R.L.	Romania	100.0
28	„Hidroelectrica"	Romania	100.0
29	Continental Automotive Products S.R.L.	Netherlands	100.0
30	Renault Commercial Roumanie S.R.L.	France	100.0
31	Rewe (România) S.R.L.	Germany	100.0
32	Ameropa Grains S.A.	Switzerland	100.0
33	Societatea Complexul Energetic Oltenia S.A.	Romania	100.0
34	Porsche România S.R.L.	Austria	100.0
35	Adm România Trading S.R.L.	Netherlands	100.0
36	Fildas Trading S.R.L.	Romania	100.0
37	Cofco International România S.R.L.	Netherlands	100.0
38	Michelin România S.A.	Switzerland	99.9
39	Philip Morris Trading S.R.L.	Netherlands	100.0
40	Robert Bosch S.R.L.	Germany	100.0
41	Cargill Agricultura S.R.L.	USA	70.0
42	Pirelli Tyres România S.R.L.	Italy	100.0
43	Coca-Cola Hbc România S.R.L.	Netherlands	100.0
44	Arctic S.A.	Netherlands	96.7
45	Enel Energie Muntenia S.A.	Italy	78.0
46	Mercedes-Benz România S.R.L.	Germany	100.0
47	Delphi Diesel Systems România S.R.L.	Luxembourg	100.0
48	Oscar Downstream S.R.L.	Cyprus	95.0
49	Enel Energie S.A.	Italy	51.0
50	Schaeffler România S.R.L.	Germany	100.0
51	SN CFR Calatori	Romania	100,.0
52	Farmexim S.A.	Austria	88.8
53	Regia Nationala	Romania	100.0
54	A Pădurilor Romsilva Ra	Romania	90.0
55	Blue Air Aviation S.A.	Switzerland	63,.3
56	Tinmar Energy S.A.	Luxembourg	67.6
57	Silcotub S.A.	Netherlands	100,.0
58	Romania Hypermarche S.A.	Netherlands	100,.0
59	Bosch Autovehicule S.R.L.	Austria	100.0
60	Holzindustrie Schweighofer S.R.L.	Netherlands	100.0

Nr. crt.	Denumire	Țara	% capital deținut
61	Glencore Agriculture România S.R.L.	Romania	100.0
62	Electrocentrale Bucuresti S.A.	Netherlands	100.0
63	Bunge România S.R.L.	UK	98.7
64	Ursus Breweries S.A.	Romania	100.0
65	Arabesque S.R.L.	Romania	100.0
66	Sensiblu S.R.L.	Germany	100.0
67	Leoni Wiring Systems Ro S.R.L.	Luxembourg	98.3
68	Coficab Eastern Europe S.R.L.	Austria	100.0
69	Egger România S.R.L.	Germany	100.0
70	Marquardt Schaltsysteme Scs	Romania	71.2
71	Delgaz Grid S.A.	Romania	99.9
72	Procter & Gamble Distribution S.R.L.	Romania	100.0
73	Artima S.A.Azomures S.A.	Switzerland	100.0
74	Aptiv Tehnology Services & Solutions S.R.L.	Germany	100.0
75	Key Safety Systems Ro S.R.L.	Italy	100.0
76	Lear Corporation România S.R.L.	Luxembourg	100.0
77	Cez Vanzare S.A.	Czechia	100.0
78	Huawei Tehnologies S.R.L.	Netherlands	100.0
79	CN De Administrare A Infrastructurii Rutiere S.A.	Romania	100.0
80	Leroy Merlin România S.R.L.	France	100.0
81	Trw Automotive Safety Systems S.R.L.	Netherlands	100.0
82	Autonet Import S.R.L.	Switzerland	100.0
83	Columbus Operational S.R.L.	Netherlands	100.0
84	Tiriac Auto S.R.L.	Cyprus	100.0
85	Distrigaz Sud Retele S.R.L.	Romania	100.0
86	Heineken România S.A.	Netherlands	98.4
87	RADET	Romania	100.0
88	Celestica (România) S.R.L.	Netherlands	100.0
89	Smithfield Prod S.R.L.	Romania	90.9
90	Expur S.A.	France	100.0
91	Compania Nationala Posta Romana S.A.	Romania	100.0
92	Porsche Inter Auto România S.R.L.	Austria	100.0
93	Sanofi România S.R.L.	France	100.0
94	Network One Distribution S.R.L.	Romania	100.0
95	J.T. International (România) S.R.L.	Netherlands	100.0
96	Compania Națională De Căi Ferate „Cfr" S.A.	Romania	100.0
97	Eaton Electro Producție S.R.L.	Germany	100.0
98	Cameron România S.R.L.	Netherlands	100.0
99	Holcim (România) S.A.	Germany	99.7
100	Webasto România S.R.L.	Germany	100.0

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* Alexandra Rusu contributed the case study entitled "Taxing at the Top: The case of Companies in Top 100". The results, the interpretations and the conclusions of this report can only be attributed to the authors and not to the European Commission. Alexandra Rusu worked on this report prior to her employment at the European Commission. Any errors and omissions can only be attributed to the authors.

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What explains it and what can (still) be done about it

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The results lay the blame on the poor institutional capacity of the Romanian revenue agency (ANAF) and the undertaxing of firms and the wealthy via legislative reforms that have cut tax levels and administrative practices that tolerated tax avoidance for these categories of tax payers relative to consumers and employees.

If the Romanian government could follow into the footsteps of Bulgaria and other new EU member states, it would avoid the near-permanent fragility of its finances and be better situated to close the educational, health, social and infrastructural gaps that separate Romania from its regional peers society despite robust economic growth.

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