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**Workshop 2: Financing Governance: Managing Commitments Over the Long Term**

**Improvement of government financing through non-conventional methods: reducing the administrative costs in the public sector**

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## Abstract

The paper aims to emphasize the relative recent preoccupations of several European states and even of EU about reducing the administrative costs and contribution of this process to local and national development, increasing the GDP etc.

Recent appreciations of the European officials reveal estimations that a reduction by 25% of the administrative costs could lead to an increase of GDP by 2-3%.

Mechanisms of coordination for national policies are already operational even if their results are not yet visible.

Oriented mainly towards the private sector, the issue of reducing the administrative costs remains up-to-date also in the public sector. Moreover, even in the context of the current economic crisis, the reduction of the administrative costs represents an important resource for financing the development of the public sector at local level and the macro-economic policies.

Therefore, in this context, the paper comprises:

- Synthetic and comparative analyses about the content and results of the national policies for reducing the administrative costs.
- Considerations concerning the enlargement of the mentioned policies on the economic and social processes specific for the public sector.
- Models to evaluate the impact of reducing the administrative costs on financing the public sector, based on input-output analysis materialised through the production function.
- Emphasizing the effects on long term of reducing the administrative costs and substantiating the policies for financing national or local governance.

## Introduction

Financing the economic and social activities on a central or local governance level is mainly performed through public budgets. The public budget, no matter the level at which it is constituted, becomes a tool of economic and social policy with multiple attributes, the most important one being the balance between two components: revenues and expenditures. The conceptual essence of a public budget begins with unanimously accepted considerations according to which the public budget, as part of the public economy, is a mean to satisfying the collective needs and, as a consequence, “cannot leave the needs unsatisfied, by lacking sufficient provisions, but it also cannot forecasts more revenues than it is necessary to cover the collective needs, because the goods storage is not the foremost goal”.<sup>1</sup>

In this context, the efficiency and the effectiveness of applying the economic and social policies become fundamental principles of public budget execution. Accomplishing these principles enforces a flexible construction of the public budget that would allow resources to be reallocated during and in between budgetary rubrics. The flexibility can lead to a better financial administration if it is accompanied by financial policies and proper application mechanisms through which the resources with an improper final destination could be discharged and reallocated. At the same time, the considered financial policies also contain or must also contain mechanisms for supplementing the public budget revenues. In this framework, we are introducing the present paper’s demarche, i.e. identifying the policies and strategies for reducing the administrative costs thus improving the financing of the governmental policies.

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<sup>1</sup> Matei, A., (2003), “Economie Publică. Analiza economică a deciziilor publice”, Economica Publishing House, Bucharest, Romania, pp. 18.

## **Chapter I. Reducing the administrative costs: programs and mechanisms**

### **I.1. The general conceptual framework**

For the public sector the field literature reveals a certain specificity regarding the expenditures' efficiency. Thereby, Stiglitz (2000) presents explanations of inefficiency in the public sector,<sup>2</sup> that refer to the organisational and individual differences, among which: the role of political concerns, absence of competition, absence of incentive pay, difficulty of firing reduces incentives, as well as the pursuit of bureaucratic objectives – maximising the size of organisation. Similar analyses can be found in Bailey (2002), Connolly and Munro (1999) or Matei (2003). With regard to the structure of the governmental expenditures, for the OECD countries, for example, this comprises: government consumption (20-25%), transfer payments (15-18%), subsidies (2-4%), interest paid (7-8%) and capital expenditure (2-4%). By analysing the weight of the public expenditures in the GDP, Connolly and Munro (1999) reconfirm their growth tendency in accordance with Wagner's Law, as well as in the theories regarding "fiscal illusion" or Baumol Effect.<sup>3</sup> For Romania, Andrei, Matei, Stancu and Andrei (2009) test the validity of Wagner's Law for the aggregated governmental expenditures, the average elasticity being non-linear and top-heavy.

Public expenditure represents "the ensemble of annual expenditure with public nature of a country, financed on the basis of public budgetary resources".<sup>4</sup> In fact, public expenditure reflects the political choices of the Government, representing costs of the elements of economic policy aiming to deliver public goods. These costs relate to delivering goods through the budget of the public sector or represent expenditure in the private sector, induced by regulations and laws made by the public sector.

What we called in the introduction the administrative burden of private companies can be framed in this second category of expenditure. The costs from the first category are in fact public expenditure, as such, of which a part represents the costs of bureaucracy in any public administration. In an extended meaning for the administrative burden, the costs of bureaucracy are in this category for a public administration.

In the structure of the national or local budgets we find:

- *Exhaustive public expenditure* focused on procurement of goods and services (for example: labour, consumables) and capital goods (for example: investments of the public sector in streets, schools, hospitals);
- *Transfer public expenditure*, such as public expenditure for pensions, subsidies, interests, unemployment allowances.

In the general context of the public expenditures there are introduced and used a series of concepts important for the analysis we are carrying. Thus, in accordance with the International Standard Cost Model Manual and the EU Standard Cost Model Methodology (EU SCM) we will have:<sup>5</sup>

- **Compliance costs** are all the costs of complying with regulation, with the exception of direct financial costs and long term structural consequences. In the context of the

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<sup>2</sup> Stiglitz, J., (2000), "Economics of the Public Sector", third edition, W.W. Norton & Company, New York/London, pp. 205.

<sup>3</sup> Connolly, S., Munro, A., (1999), "Economics of the Public Sector", Prentice Hall Europe, p. 14-15. See also Andrei, Matei, Stancu and Andrei (2009), chapter X.6., pp. 320-330.

<sup>4</sup> Dobrotă, N., (coord.), (1999), „Dicționar de economie”, Economica Publishing House, Bucharest, Romania, pp. 98.

<sup>5</sup> *EU model – manual*, March 2006, p. 1

([http://ec.europa.eu/governance/impact/docs/sec\\_2005\\_0791\\_anx\\_10\\_en.pdf](http://ec.europa.eu/governance/impact/docs/sec_2005_0791_anx_10_en.pdf)); *International Standard Cost Model Manual – measuring and reducing administrative burdens for businesses*, October 2005, p. 7 (<http://www.oecd.org/dataoecd/32/54/34227698.pdf>).

Standard Cost Model, these can be divided into ‘substantive compliance costs’ and ‘administrative costs’.

- **Administrative costs (AC)** are defined as the costs incurred by enterprises, the voluntary sector, public authorities and citizens in meeting legal obligations to provide information on their action or production, either to public authorities or to private parties. The SCM defines administrative costs as the costs of administrative activities that businesses are required to conduct in order to comply with the information obligations that are imposed through regulation.<sup>6</sup>
- **Information** is to be explained in a broad sense, i.e. including costs of labelling, reporting, monitoring and assessment needed to provide the information and registration. In some cases, the information has to be transferred to public authorities or private parties. In others, it only has to be available for inspection or supply on request.
- An important **distinction** must be made between *information that would be collected by businesses even in the absence of the legislation* and *information that would not be collected without the legal provisions*. The costs induced by the latter are called **administrative burdens (AB)**. Some of the administrative burdens are necessary if the underlying objectives of the legislation and prescribed level of protection defined in the Treaties are to be met effectively; for instance where information is needed to make markets transparent. But there are also many cases where burdens can be streamlined and reduced without affecting the underlying objectives as such – the latter burdens are clearly unnecessary. The **administrative burdens** are that part of the administrative costs which are only incurred as a result of the regulations. Such costs are called *incremental costs* because, in the absence of regulation, they would not be incurred. Conversely, the *business as usual (BAU) costs* are the costs of the activities which businesses would continue to carry out even if the regulatory requirement were removed.

$$\boxed{\text{Administrative Cost}} = \boxed{\text{Business as Usual Costs}} + \boxed{\text{Administrative Burden}} \quad (I.I.)$$

Or,  $AC = BAU + AB.$

*BAU costs* are not considered in a baseline measurement because the reductions in regulatory requirements that are considered businesses’ usual activities will not result in actual reductions in business costs because businesses will continue to incur the costs to meet their own needs. Reducing the costs for business requires that the focus be on administrative burden.

*Third-party information obligation costs* arise from regulation requiring business to provide information to third parties, such as employees or consumers. The Netherlands and Denmark included third-party information obligation costs in their SCM baseline measurement. However, the UK Standard Cost Model Manual<sup>7</sup> states that third-party costs are excluded from the baseline.

<sup>6</sup> “Estimate of Victoria’s Administrative Burden”, A DTF internal working paper, Department of Treasury & Finance, August 2007, p. 4.

<sup>7</sup> Better Regulation Executive (2005), Measuring Administrative Costs: UK Standard Cost Model Manual, Version 1.01.

## **I.2. EU Policies and Programs for reducing the administrative costs**

### **I.2.1. Better Regulation Program**

**Regulation**, a phenomenon happening at local, national or international level, is a mean to answer the challenges triggered by the free movement of goods, services, people and capital, serving several purposes: to protect health by ensuring food safety, to protect the environment by setting air and water quality standards, to set rules for companies competing in the marketplace to create a level playing field.

The European Commission launched a '**Better Regulation**' programme 2002 to simplify and generally improve the regulatory environment. It is designed to cut **red tape**, improve the quality of regulation and design better laws for consumers and business alike.

The **Better Regulation programme** included a mix of different actions:

- introducing a system for assessing the impact and improving the design of major Commission proposals;
- implementing a programme of simplification of existing legislation;
- testing Commission proposals still being looked at by the Council of Ministers and the European Parliament, to see whether they should be withdrawn;
- factoring consultation into all Commission initiatives;
- looking at alternatives to laws and regulations (such as self-regulation, or co-regulation by the legislator and interested parties).

The Commission's ongoing effort - to regulate better - results in examining administrative costs in specific policy areas. The EC set out a method for measuring administrative costs (the EU's net administrative cost model), inspired by best practice in Member States such as the Netherlands and the United Kingdom.

**Alternatives to regulation**, which can be more cost efficient and effective ways to address certain policy objectives than the classic legal tools:

- *Co-regulation* - entrusting the achievement of the goals set out in law, for example to the social partners or to non-governmental organisations;
- *Self-regulation* - voluntary agreements between private bodies to solve problems by taking commitments between themselves.

On **23 March 2005**, the European Council requested "the Commission and the Council to consider a common methodology for measuring administrative burdens with the aim of reaching an agreement by the end of 2005".

On **16 March 2005** the Commission's Communication on Better Regulation for Growth and Jobs in the European Union included, as a companion Staff Working Paper, a detailed outline of a possible "EU Net Administrative Cost Model"<sup>8</sup> based on the Standard Cost Model.<sup>9</sup>

The outline of an EU Net Administrative Cost Model was amended and refined through a pilot phase carried out from April to September 2005 that led the Commission to present a revised methodology, also called the "EU SCM".<sup>10</sup> The Commission listed a number of

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<sup>8</sup> European Commission, Staff Working Paper, Annex to the 2005 Communication on Better Regulation for Growth and Jobs in the European Union, Minimizing Administrative Costs Imposed by Legislation, Detailed Outline of a Possible EU Net Administrative Cost Model - SEC(2005) 175, 16.3.2005.

<sup>9</sup> The use of the SCM has shown significant progress with regulatory reform in several Member States, and this Action Programmes clearly aims at building upon these experiences. The SCM is currently being used by 17 Member States and the OECD. <http://www.administrative-burdens.com/>

<sup>10</sup> See Staff Working Document, *Developing an EU common methodology for assessing administrative costs imposed by EU legislation - Report on the Pilot Phase* (April– September 2005), SEC(2005) 1329, annexed to

possible improvements to the EU SCM, while making clear that such optimisation was no precondition for its application. An operational manual for applying the model was included on **15 March 2006** in the Impact Assessment guidelines<sup>11</sup> and translated in all EU official languages to facilitate methodological convergence. The EU SCM has been applied in a number of published or upcoming Impact Assessments to ensure that any administrative burdens generated by new legislation are justified and minimised<sup>12</sup>.

### **I.2.2. Action Programme to Reduce the Administrative Burden**

In **November 2006**, the Commission proposed launching an ambitious **Action Programme to reduce the administrative burden** of existing regulation in the EU. As part of this, the Commission proposed that the 2007 Spring European Council fix a **reduction target** of 25 %, to be achieved jointly by the EU and Member States by 2012. This underlines the Commission's commitment to Better Regulation as part of the "Growth and Jobs" strategy.

The joint target to reduce administrative burdens by 25 % in 2012 covers Community legislation as well as national regulatory measures. Achieving this objective could lead to an increase in the level of EU GDP of approximately 1.4% or € 150 billion in the medium term.<sup>13</sup>

This **Action Programme** does not refer to deregulation. The Commission aims at suppressing the unnecessary burdens – triggered by the policy objectives' implementation - at all levels, as this is a shared responsibility of the Member States and the European Institutions. The programme aims at identifying, measuring and reducing the information obligations (IOs). It will measure administrative costs, take a judgement on which of these costs constitute unnecessary burdens and reduce unnecessary administrative burdens.

The pilot project and the national measurements carried out to date<sup>14</sup> have confirmed that the reduction of administrative burdens is a joint responsibility of the European Parliament, the Council, the Commission and the Member States.

By 2006, 17 Member States, decided to measure and reduce administrative burdens and other 2 are testing the methodology. The action programme would foresee that by 2009 all Member States would have completed the measurements of IOs in the key national and regional priority areas. Member States and the Commission will also need to agree on the 'across the board' baseline measurement in priority areas and reduction targets, shared between the Community and the Member States in function of the **origins of administrative burdens**. Following discussions and consultation on the Working Document of 14 November<sup>15</sup>, the

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the Communication on a "EU common methodology for assessing administrative costs imposed by legislation" - COM(2005) 518, 21.10.2005.

<sup>11</sup> See [http://ec.europa.eu/governance/impact/docs\\_en.htm](http://ec.europa.eu/governance/impact/docs_en.htm).

<sup>12</sup> Though they share a common methodology, the administrative burden reducing exercise is different from normal Impact Assessment practice. This administrative burden exercise aims to provide a comprehensive ex-post measurement of legislation in a policy area for all levels of legislation and then subsequent identification of reduction targets. Impact assessment, on the other hand, measures all the costs and benefits of available policy options, while the administrative burden methodology is only a partial measurement tool which is to be applied proportionately and used only in assessing ex-ante impacts of proposed changes of legislation (marginal approach).

<sup>13</sup> Gelauff, G.M.M. and A.M. Lejour (2005). Five Lisbon highlights: The economic impact of reaching these targets. CPB Document 104. CPB, The Hague.

<sup>14</sup> "Pilot project on administrative burdens", WIFO-CEPS, October 2006.

<sup>15</sup> Commission working document COM(2006) 691: "Measuring administrative costs and reducing administrative burdens in the European Union".

Commission has identified the following priority areas concerning Community legislation which should be addressed:

1. Company law
2. Pharmaceutical legislation
3. Working environment/employment relations
4. Tax law (VAT)
5. Statistics
6. Agriculture and agricultural subsidises
7. Food safety
8. Transport
9. Fisheries
10. Financial services
11. Environment
12. Cohesion policy
13. Public procurement

The mentioned document also assesses the administrative costs of the EU Member States that vary between 6.8% (in GR, HU and RE (Baltic States, Malta and Cyprus)) and 1.5%(UK, FI or SE), the EU average being of 3.5% (the percentages refer to GDP).<sup>16</sup> The prospects of reducing with 25% the administrative costs will lead to a reduction of 1.3% of their weight in GDP, on average for EU.

#### **Common Principles for Reducing Administrative Burdens:<sup>17</sup>**

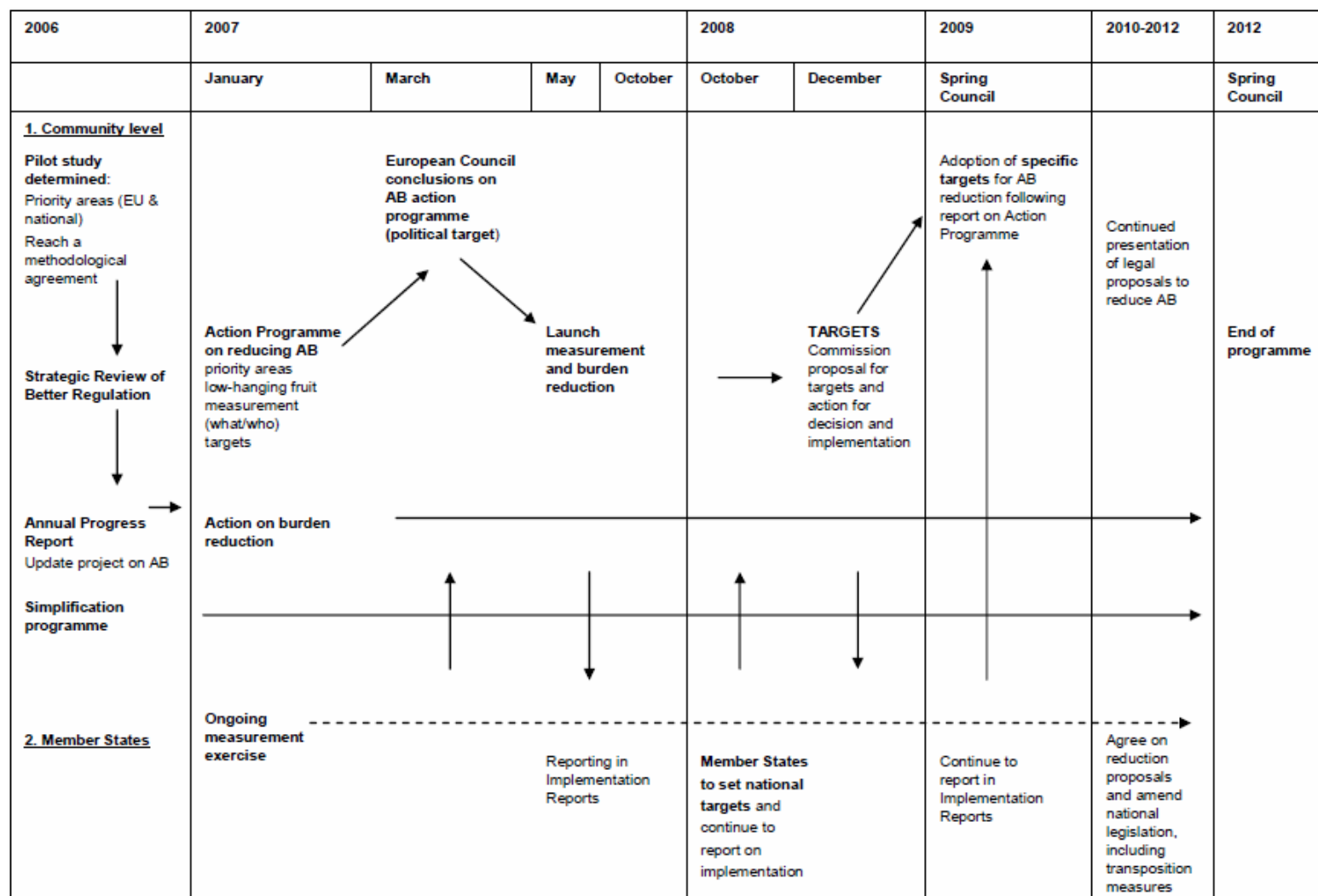
- Reduce the frequency of reporting requirements to the minimum levels necessary to meet the substantive objectives of the legislation and align the frequency of reporting across different related pieces of legislation, where possible;
- Review whether the same information obligation is not requested several times through different channels and eliminate overlaps (e.g. a number of environmental information obligations are presently required by more than one piece of legislation);
- Require electronic and web-based reporting where paper based information gathering is presently required, using intelligent portals where possible;
- Introduce thresholds for information requirements, limiting them for small and medium sized companies wherever possible, or rely on sampling (it is well known that SMEs suffer particularly strongly from administrative burdens – data collection for information purposes should take this into account);
- Consider substituting information requirements on all businesses in a sector by a risk based approach – targeting information requirements on those operators that perform the highest risk activities;
- Reduce or eliminate information requirements where these relate to substantive requirements that have been dropped or modified since the information requirement was adopted (e.g. there are still information obligations in road transport dating back to the time that permits were required to carry out international transport);
- Provide official clarification of complex pieces of legislation that may either slow down business activities, or require acquiring legal expertise.

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<sup>16</sup> Idem, pp. 3.

<sup>17</sup> Idem, chapter 5, p. 13-14.

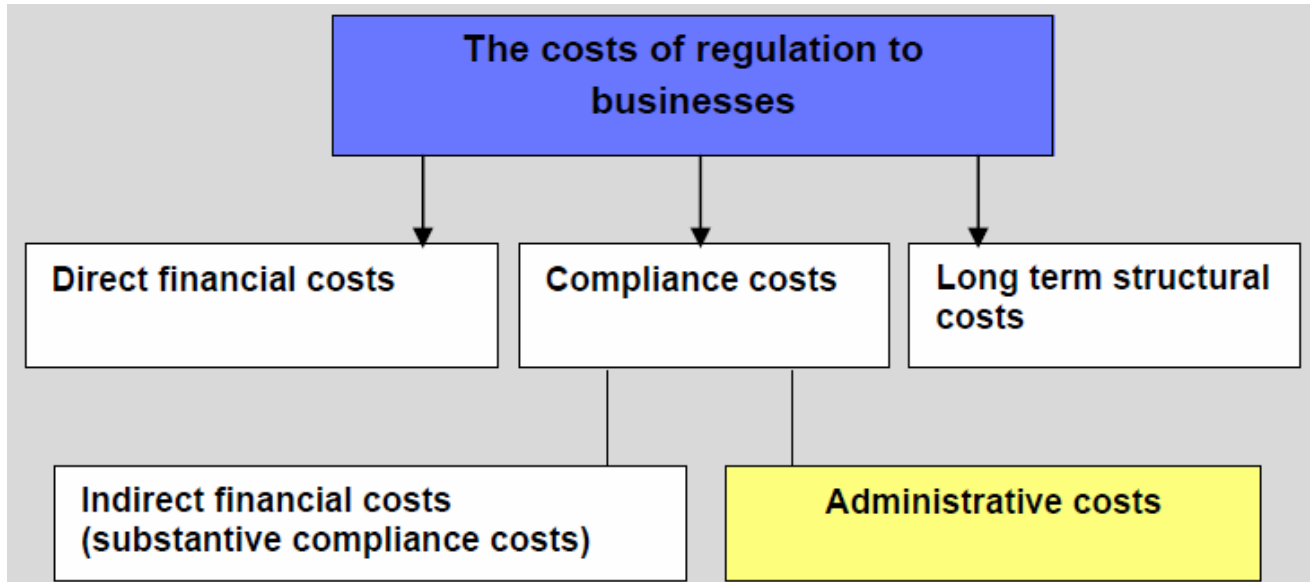
## Programme for reduction of administrative burdens:<sup>18</sup>



<sup>18</sup> Idem, chapter 6, pp. 15-16.

### I.3. OECD. The costs of regulation- financial and administrative<sup>19</sup>

Regulation has a number of consequences for businesses. Administrative costs are only one type of costs that regulation can entail. The figure below illustrates the different types of costs that regulation can impose on businesses.



**Direct financial costs** are the result of a concrete and direct obligation to transfer a sum of money to the Government or the competent authority. These costs are therefore not related to a need for information on the part of the Government. Such costs include administrative charges, taxes, etc. For example, the fees for applying for a permit would be a financial cost of regulation.

**Compliance costs** are all the costs of complying with regulation, with the exception of direct financial costs and long term structural consequences. In the context of the Standard Cost Model, these can be divided into ‘substantive compliance costs’ and ‘administrative costs’.

Examples of **substantive compliance costs** include:

1. filters in accordance with environmental requirements;
2. physical facilities in compliance with working conditions’ regulations.

Examples of **administrative costs** include:

1. documentation of the installation of a filter;
2. an annual report on working conditions.

**Administrative burdens** are the part of administrative costs that businesses sustain simply because it is a regulatory requirement. The administrative burdens are thus a subset of the administrative costs in that the administrative costs also encompass the administrative activities that the businesses will continue to conduct if the regulations were removed.

The **categories of administrative activities** that typically arise with any legislation, including tax laws, and that constitute the administrative burden of businesses and citizens, have been defined in the SCM as:

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<sup>19</sup> OECD, Centre for Tax Policy And Administration, Forum on Tax Administration: Taxpayer Services Sub-Group, Information Note, *Programs to Reduce the Administrative Burden of Tax Regulations in Selected Countries*, 22 January 2008, p. 10.

1. **Familiarisation with the information obligation.** The resource consumption of businesses in connection with familiarising themselves with the rules for a given information obligation.
2. **Information retrieval.** Retrieving the relevant figures and information needed to comply with a given information obligation.
3. **Assessment.** Assessing which figures & information are necessary for the authorities to accept a report.
4. **Calculation.** Performing the relevant calculations needed for the public authorities to accept the report.
5. **Presentation of figures.** Presenting the calculated figures in tables or the like.
6. **Checking.** Checking the calculated figures, e.g. by reconciliation with other data.
7. **Correction.** If the business's own checks reveal errors in the calculations, corrections are made afterwards.
8. **Description.** Preparation of description, e.g. the directors' report in the Danish Financial Statements Act.
9. **Settlement/payment.** Payment of tax, charges or the like.
10. **Internal meetings.** Meeting held internally between the various personnel groups involved in complying with the information obligation.
11. **External meetings.** Meetings held in cases where compliance with the information obligation requires meetings with an auditor, lawyer or the like.
12. **Inspection by public authorities.** Businesses must assist external inspectors when they carry out their inspection at the business.
13. **Correction result from inspection by public authorities.** If the external inspection identifies faults/defects, corrections are made afterwards.
14. **Training, updating on statutory requirements.** Relevant employees must be kept up to date with rules that change frequently (at least once a year).
15. **Copying, distribution, filing, etc.** In some cases the report is copied, distributed and/or filed in order to comply with the information obligation. It may also be necessary to store the information obligation with a view to subsequent production in connection with an inspection.
16. **Reporting/submitting information.** In cases where compliance with an information obligation requires the submission of information on the business, the information must be sent to the relevant authority.

The **administrative burden on a business** resulting from the operation of tax regulations will be influenced by a number of factors:

- 1) the number of taxes it has to deal with;
- 2) the administrative design of those taxes;
- 3) the nature and size of its operations (including the size of its workforce);
- 4) the range of administrative activities it must undertake (as described above);
- 5) the degree of support received from the revenue body. It can decide to do all of the required administrative activities internally and/ or use external parties (e.g. payroll agencies and tax accountants) to help meet its tax obligations.

#### **I.4. Standard Cost Model (SCM)**

SCM Network comprises for the time being over 19 states and organisations, and recently also Romania. In fact, for Romania, the "Strategy for better regulation at central government level, 2008 – 2013" comprises as priorities on medium term, "preliminary analysis of the issue of administrative burden, development of a general methodology to assess the

administrative costs and to elaborate a concrete action plan in order to implement the Standard Administrative Cost Model”.<sup>20</sup>

There are measurement/ estimating methodologies for quantifying the administrative burden imposed by tax regulations:

→ standard measurement methodology, such as what has become known as the Standard Cost Model (SCM), which consists of 4 stages:

- **Information obligations (IO)** for each tax are specified (IO are the obligations arising from regulation to provide information and data to the public sector or third parties. An IO does not necessarily mean that information has to be transferred to the public authority or private persons, but may include a duty to have information available for inspection or supply on request. A regulation may contain many IOs);
- The **data requirements** applicable to each information obligation are identified;
- The **administrative requirements** are established;
- **Cost parameters** (i.e. price, time and quantity) for each administrative activity are collected:
  - *Price* consists of a *tariff*, wage costs plus *overhead* for administrative activities done internally or hourly cost for external service providers;
  - *Time*, the amount of time required to complete the administrative activity.;
  - *Quantity* comprises of the size of the *population* of businesses affected and the *frequency* that the activity must be completed each year;

**SCM formula:**

*Cost per administrative activity (or per data requirement) = Price x Time x Quantity (population x frequency).*

→ tailor-made approach, such as those as employed by the New Zealand and Swedish revenue authorities when quantifying the administrative burden of their respective VAT systems.<sup>4</sup>

Taxes that contribute most to overall administrative burdens:

- Personal income;
- Social contributions - received largely from employers in the form of withholdings from employees’ wages - is administered by separate social security agencies (in some countries, multiple agencies), while in other countries (e.g. Finland, Ireland, Netherlands, Norway, Sweden, and UK) it has been integrated with the collection of personal income tax administered by the main revenue body;
- Corporate;
- Value Added Tax (VAT) - imposes the most significant level of burden (in absolute terms) of any tax in most countries;
- Excise.

Integrating the collection of social contributions and personal tax collections should trigger a reduction in the administrative burden of businesses, “placing responsibility for collection (of social contributions) with the tax administration can also significantly reduce compliance

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<sup>20</sup> Government of Romania – “Strategy for better regulation at central government level”, 2008 – 2013, pp. 13, [www.sgg.gov.ro](http://www.sgg.gov.ro).

costs for employers, with less paperwork as a result of common forms and book-keeping systems, and a common audit program covering income, VAT and payroll taxes, and social contributions based on income and payrolls. The increasing use of Internet-based electronic filing and payment systems with the tax administration also lowers taxpayers' and contributors' compliance costs. This simplification can also improve the accuracy of calculations made by employers and therefore compliance levels".<sup>21</sup>

## **I.5. World Bank. Economic Benefits for Administrative Reform<sup>22</sup>**

The World Bank has developed a series of administrative reform projects that aimed at reducing the administrative costs.

These projects benefit society if they reduce administrative and compliance costs.

*Macroeconomic benefits* - Trade liberalization will entail a loss in trade tax revenue that can be covered by an increase in the domestic tax revenues.

*Reduction in administrative costs of collecting the taxes* - The modernization of tax administration should lead to lower costs per amount of revenue raised as:

- (i) the tax administration is streamlined,
- (ii) tax officials are better trained,
- (iii) taxpayers become more compliant as a result of enhanced tax payer education, and the establishment of taxpayer support centres, process simplification, and improved automation,
- (iv) a simpler tax policy results.

*Reduction in compliance cost for the taxpayer* - These costs, which tend to be higher than the cost of administering the tax itself, include the cost individuals and enterprises incur in preparing their tax declaration, and dealing with tax audits<sup>23</sup> (in-house costs, bribes).

*Support trade liberalization* - These benefits have been estimated for 1997–2015 at \$500 billion (1997 dollars), three-quarters of which would result from the dismantling trade barriers in low- and middle- income countries<sup>24</sup>

*Reduction in distortions of the present tax regime* - strengthening the capacity of the tax administration.

## **I.6. National Experiences**

Matei (2008) presents a series of comparative approaches with reference to the reduction of the administrative burden.<sup>25</sup> Australia's experience is also relevant. Summing up the concerns of the Australian authorities, we mention:

**Key measures** implemented or planned to **reduce administrative burdens**:

*Whole of Government' approaches affecting tax policy/administration*

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<sup>21</sup> See 'IMF Working Paper: Integrating Tax and Social Security Contributions Collection within a Unified Administration' (December 2004), prepared by officials from the Fiscal Affairs Department of the IMF.

<sup>22</sup> World Bank, (2007), "Estimating Economic Benefits for Revenue Administration Reform Projects", Tuan Minh Le (Senior Economist, PRMPS), Duc Minh Pham (Senior Economist, EASPR), and Luc De Wulf (Consultant, PRMTR), PREM Note, Public Sector Governance, March, no. 112.

<sup>23</sup> Evans, Chris, (2003), "Studying the Studies: An Overview of Recent Research into Taxation Operating Cost." eJournal of Tax Research 1 (1): 64–92. Atax, University of New South Wales.

<sup>24</sup> World Bank, (2002), "Global Economic Prospects and the Developing Countries." World Bank, Washington, DC.

<sup>25</sup> Matei, A., (2008), "Performance of the Public Expenditure Management at Local Level in Romania", Transylvania Review of Administrative Sciences, no. 23E/ Journal, chapter II, pp. 63-68.

- a) Reporting on a ‘whole of government’ basis— ‘Standardised Business Reporting’ arrangements - identical information is requested from businesses separately by different agencies:<sup>26</sup>
  - a. “A number of agencies at all levels of government require businesses to report activity. While the information sought is often much the same, the purposes of reporting are seemingly different- to monitor financial trends, calculate tax liability, track employment trends.....and monitor non-compliance. Sometimes the same data (probably known by a different name) is collected by more than one agency, and sometimes data are collected that can be derived from information another agency already has”;
  - b. “Many participants at the small business roundtable convened by the Taskforce, together with those making submissions, indicated their frustration at having to report the same information to multiple government departments and agencies, and that agencies do not use information from existing sources”;
  - c. “The key to reducing the record-keeping and reporting burden lies both within and across agencies and will depend on collaboration to rationalise the reporting and data requirements”.
- b) Rationalising the administration of social contributions - efforts to improve operational efficiency and effectiveness and to reduce the burden of compliance on business:
  - a. shifting responsibility for the collection (but not payment) of social contributions to the main revenue body and integrating its administration with other taxes;
  - b. harmonising the tax base for income tax, payroll taxes and social contributions.

#### Tax policy-related measures

- b) *The use of thresholds to reduce administrative burdens* - a variety of thresholds to:
  - a. relieve taxpayers of the burden of complying with a particular requirement in the law,
  - b. reduce the frequency of compliance,
  - c. simplify the act of compliance,
  - d. reduce the workload of the revenue body;
  - e. identify which taxpayers need to register for VAT purposes,
  - f. determine the frequency of reporting and payment obligations for most of the taxes administered,
  - g. identify which taxpayers may be able to use a simplified approach for determining a tax liability (e.g. use of the cash accounting basis for determining VAT liabilities).
- c) The adoption of simplified approaches for determining tax liabilities - measures taken include:
  - a. Allowing more SMEs to use the cash accounting method for VAT (e.g. Australia and UK);
  - b. Enabling advance payments of income tax to be based on reported VAT turnover (NZ);

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<sup>26</sup> See ‘RETHINKING REGULATION, AUSTRALIAN GOVERNMENT’S RESPONSE’ (August 2006)

- c. A simplified regime for businesses with annual turnover up to €763,000 (goods) and €230,000 (services) enabling simplified accounting and business tax return, with VAT quarterly instalments and an annual return (France);
  - d. Enabling assets of minor value (up to €1,000) to be assigned to a pool of goods that can be depreciated using the straight line method over 5 years (Germany);
  - e. Packages of simplification measures for SMEs (e.g. Australia, Chile and Korea).
- d) Personal tax simplification:
- a. *Deduction simplification* – using a standard deduction reduces the record-keeping burden on taxpayers, simplifies administration by the revenue body (also see the use of pre-filled tax returns) and reduces the need for selective verification action by the revenue body.
  - b. *Using third party information sources to verify deduction entitlements* - transferring most of the data to the revenue body electronically from the relevant organizations. Afterwards, employees can get their integrated data by accessing a website where these data are stored. As a result, employees save time and money in gathering the documents while employers save resources on checking and storing the documents. Data-producing organizations also save on the costs of mailing and stationery previously incurred.

#### Other tax administration-related measures

- a) Institutionalising simplification through formal burden reduction processes and programs:
  - a. Establishment of a corporate body, possibly supported by an advisory board with external representatives, to guide and manage the simplification efforts;
  - b. Introduction of formal consultative processes or feedback mechanisms with key stakeholders (e.g. representatives of small business) to learn of their key “burden” issues and possible responses;
  - c. The development and publication of a formal plan of measures to address the key concerns identified, including the testing of ideas with key stakeholders;
  - d. Allocating resources to enable development of agreed measures;
  - e. Evaluating the impact and effectiveness of the measures implemented.
- b) *Implementing citizen-and business-centric approaches to tax administration*
  - a. **Dedicated organisational units** to manage aspects of specific customer segments
  - b. **‘Key account managers’** for the largest taxpayers.
  - c. **Internet-based services presented** around different segments of taxpayers and intermediaries
  - d. **A single taxpayer register** covering all taxes
  - e. **A single taxpayer tax account** that integrates all of a taxpayer’s tax accounting
  - f. **Integrated reporting and payment** of taxpayers’ periodic tax liabilities
  - g. **Integrated case management system** covering the major types of taxpayer interventions
  - h. Client-focused **consultative bodies**
- c) *Expanding electronic services* — providing more and better targeted quality services on-line and providing incentives for their use
- d) *Interfacing taxpayers’ computer accounting system and revenue bodies’ computer systems* - ‘machine to machine communication’— where a taxpayer’s own accounting software system is interfaced directly and automatically with the revenue body’s

computer system via its website in order to effect the transmittal of requisite information (e.g. a monthly or quarterly tax return).

- e) *Integrated return filing and payment regimes* - tax return and payment obligations under the law are brought into alignment and businesses are required to determine and account for all their liabilities as part of a single process (typically conducted when they do their own internal business accounting) and make a single payment to the revenue body. One of the most complete examples of this development is the 'business activity statement' (BAS) designed and implemented by the Australian Taxation Office as part of a major business tax reform effort in 2000.
- f) *Improved telephone contact centre operations*
  - a. providing phone contact staff with on-line access to details of taxpayers' prior history, correspondence etc to help resolution of inquiries at the point of initial contact;
  - b. provision of self-service telephone system to order forms and publications on a 24/7 basis;
  - c. improved management/ routing of incoming calls to achieve acceptable phone contact objectives;
  - d. linking of service channels (e.g. Internet and phone).
- g) *Education and assistance programs targeted at new small businesses* - provision of simple record-keeping tools, specialised explanatory materials/ guides, dedicated seminars for people just starting business, central help desks for inquiries, use of community helpers, and special electronic products.
- h) *Making direct payments/ providing tax credits to offset taxpayers' administrative burden*
- i) *Introduction of pre-filled tax returns for personal taxpayers*
- j) *Eliminating unnecessary/ unjustified reporting requirements*
- k) *Reducing audit cycle times and the incidence of unnecessary/ non-productive audit inquiries*

## **Chapter II. The Administrative Costs in the Public Sector**

### **II.1. An extension of the conceptual framework**

The terminology and contents of administrative costs can differ depending on the analyzed situations and contexts. In general, the administrative costs refer to expenditure for achieving the obligations for disclosing information. According to the International Standard Cost Model Manual, the administrative burden refers to „expenditure generated by companies, when, based on legislation, they meet the information obligations required by public administration based on the legislative rules”.<sup>27</sup>

The extension of this issue towards the public sector will lead to an extension of the content of the administrative burden to include „compliance costs for enterprises, services and citizens, including administrative and bureaucratic (operational) costs as well as capital costs”.<sup>28</sup>

Consequently, the administrative costs in the public sector comprise, mainly, the costs for purchasing goods and support services for bureaucracy, as well as payments of some charges etc. The model that will be presented follows the ideas from Matei (2008), and it was used for

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<sup>27</sup> International Standard Cost Model Manual, “Measuring and reducing administrative burdens for business”, SCM Network, Oct., 2005, [www.administrative-burdens.com](http://www.administrative-burdens.com).

<sup>28</sup> “Good Practice Guidelines for the Management of the Evaluation Function”, <http://europa.eu.int/comm/dg19/evaluation/en/goodpracticien.htm>.

assessing the public sector performance<sup>29</sup> or substantiating the marketing strategies under the reduction of the administrative costs.<sup>30</sup>

The weight of public expenditure is different and depends on the development level of the public or of the private sector. Reported to the latter, the administrative burden of the public sector has a non linear evolution. From this perspective it is worth mentioning the models formulated by Musgrave (1974) and Rostow (1960), stating that in the earlier stages of growth and economic development, investments in the public sector are high, providing the core social infrastructure. The purpose of these investments is to help economy to reach higher development stages, where, although the state will continue investments, their role will be to complete the private investments. The conclusions of the two economists are relevant also for the evolution of the administrative costs, both in the public and private sector:

- While total investments increase as proportion from GDP growth, the relative share of the public sector decreases.<sup>31</sup>
- When economy reaches the maturity stage, the mix of public expenditure will be oriented from the expenditure for infrastructure to expenditure for education, health and welfare services.<sup>32</sup>

Therefore, if we take into calculation, the total administrative costs (AC) obtained by summing up those from public and private sector:

$$AC_{tot} = AC_{public} + AC_{private} \quad (II.1)$$

it will have the following characteristics:

- $AC_{tot}$  can be considered constant, for certain periods of economic development;
- $AC_{public}$  and  $AC_{private}$  vary in time;
- between  $AC_{public}$  and  $AC_{private}$  there is bidirectional transfer due to effects of dislocation between public and private expenditure, specific for different periods of economic and social development.

The above assertions are based on Peacock-Wiseman analyses, stating that „Governments have the trend to spend more money and the citizens do not wish to pay many taxes. Consequently, the Governments should take into consideration the wishes of their citizens”.<sup>33</sup> In this context, it occurs the so called *effect of dislocation*, namely the public expenditure dislocates the private expenditure in certain periods, such as crises periods.

By using (I.1) and (II.1) we obtain:

$$BAU_{public} + BAU_{privat} = const. - (AB_{public} + AB_{privat}) \quad (II.2)$$

Which lead us to the idea that, at least on a macroeconomic level, the customary costs of the public and private affairs depend directly on the administrative burden.

<sup>29</sup> Matei, A., (2008), Op.cit., pp. 69-73

<sup>30</sup> Matei, A., Matei, L., Dinu, T., (2009), “Marketing of Local Public Services under the Reduction of Administrative Expenditures”, Theoretical and Applied Economics, no. 3 (532), March, pp. 17-27.

<sup>31</sup> Musgrave R.A., (1974), “Expenditure Policy for Development”, University of Florida Press, U.S.A., pp. 35.

<sup>32</sup> Rostow W., W., (1960), “The Stages of Economic Growth: A Non – Communist Manifesto”, Cambridge University Press, U.K., pp. 9 – 10.

<sup>33</sup> See Payne, J., E., Ewing, B., T., Mohammadi, H., (2006), “Wagner’s hypothesis: new evidence from the U.S. using the bounds testing approach” in Ott, F., A., Cebula, R., J., (2006), “Empirical Public Economics”, p. 37.

## II.2. The impact of administrative costs reduction upon public services financing

The following example that we shall describe is based on a classical approach for production process of an enterprise, using the function of production, Cobb-Douglas.

$$Y = AK^\alpha L^\beta \quad (II.3)$$

where:

Y – output resulted from the production process;

K – fix capital of the enterprise used in the production process;

L – labor force involved in the production process;

A,  $\alpha$ ,  $\beta$  are constants with economic significance, well established, namely:

A – coefficient of dimension,  $\alpha$  - elasticity of production related to capital, and

$\beta$  - elasticity of production related to labour force.

From (II.3), we define a series of performance indicators, mentioning the average productivity (average output), as well as the marginal productivity (marginal output). The average productivity can be determined depending on capital ( $R_K$ ) or based on labour force ( $R_L$ ) as follows:

$$R_K = AK^{\alpha-1} L^\beta, \text{ respectively,} \quad (II.4)$$

$$R_L = AK^\alpha L^{\beta-1} \quad (II.5)$$

Similar expressions are also used by Mourre (2008) to assess “sources of the productivity gap between the EU and the US”.<sup>34</sup> The function used in this case has the following expression:

$$Y = A(EHQ_L)^\alpha K^{1-\alpha} \quad (II.6)$$

Where Y stands for GDP, E is employment in persons, H is average hours worked,  $Q_L$  is the indicator of the quality of the labour input, K is capital input, A is Total Factor Productivity (TFP), and  $\alpha$  and  $1-\alpha$  is the production elasticity of labour and capital.

Going back to (II.3), in agreement with (I.1), the former becomes:

$$Y_{AU} = A K_{AU}^\alpha L_{AU}^\beta \quad (II.7)$$

Where we used a decomposition of K, in a value expression,

$$K = K_{AU} + K_B \text{ respectively, } L = L_{AU} + L_B \quad (II.8)$$

Where the AU indices express the “customary costs” and B the administrative burden, both related to capital and labour.

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<sup>34</sup> Mourre, G. (2008), “What Drives Income Differentials, Underutilisation of Labour and Economic Growth in Europe? A Detailed GDP Accounting Exercise”, Manuscript, Free University of Brussels, taken from COM(2008) 774 final, pp. 22.

## II.2.1 The formal Model

The model describing the influence of reducing the administrative burden on the economic productivity is based on the following important hypotheses:

- in enterprises there is a policy for reducing the administrative burden, determined both by own internal measures, and external measures;
- the administrative burden is within a relation of proportionality with the total capital, K, and with the total labour force, L.

In a simplified expression, this second hypothesis is translated through the existence of positive, proper (sub-unitary) constants  $\lambda$ ,  $\mu$ , so that the administrative burden AB is as follows:

$$AB = \lambda K + \mu L \quad (II.9)$$

- under the situation of reducing the administrative burden, the flows of money are used exclusively in production, assuming that they will determine its increase.

Considering (II.7) and (II.8) we obtain:

$$\frac{Y_{AU}}{(1-\lambda)^\alpha (1-\mu)^\beta} = AK^\alpha L^\beta \quad (II.10)$$

$$Or, Y = Y_{AU} / (1-\lambda)^\alpha (1-\mu)^\beta \quad (II.11)$$

Y will have the significance of a total production that will be obtained using the entire capital and labour force.

The expression:

$$k = (1-\lambda)^\alpha (1-\mu)^\beta \quad (II.12)$$

will be defined as a *factor of influence for the administrative burden on production*.

- In the case of a policy for reducing the administrative burden spread out on several years ,n, we obtain a succession of effects overlapped, due to annual factors of influence,  $k_1, k_2, \dots, k_n$  and consequently:

$$Y = Y_{AU} / \prod_{i=1}^n k_i \quad (II.13)$$

$$k_i = (1-\lambda_i)^\alpha (1-\mu_i)^\beta \quad (II.13bis)$$

represents the factor of influence of the administrative burden on production in the year i.

Through a similar judgment we obtain factors of influence on average productivity depending on capital,  $k_K$ , or depending on labour,  $k_L$ , namely:

$$k_K = (1-\lambda)^{\alpha-1} (1-\mu)^\beta \quad (II.14)$$

$$k_L = (1-\lambda)^\alpha (1-\mu)^{\beta-1} \quad (II.15)$$

## II.2.2. Influence of the administrative burden on the economic performance in a public utility service

In order to provide an example on the above mentioned issues, we turn into consideration the autonomous public company R.A. „Apa”, Braila, Romania (R.A. “Water), whose general objective is to develop the system of water and the sewage at local level through modernisation and its enlargement to the peripheral areas of Braila Municipality.

Analyzing the statistic data between 2000 and 2005<sup>35</sup> we obtained:

<b>Year</b>	<b>Production (Y)</b>	<b>Capital (K)</b>	<b>Wage expenses (L)</b>
2000	12,510,578	24,253,760	4,821,499
2001	11,430,219	18,552,430	5,675,151
2002	12,490,810	20,537,752	5,122,277
2003	13,821,040	25,003,426	6,069,335
2004	15,733,981	25,683,846	6,841,239
2005	18,844,835	31,368,067	7,813,556

Tab. 1. Empirical data on the variables of function Cobb – Douglas

The determination of constants for the function of production (II.3) imposes, first of all, its logarithmic process. Consequently we obtain:<sup>36</sup>

$$\ln Y = \ln A + \alpha \ln K + \beta \ln L \quad (II.16)$$

From Table 1, in the same manner, through approximation:

<b>Year</b>	<b>ln Y</b>	<b>ln K</b>	<b>ln L</b>
2000	30.3	30.8	19.5
2001	29.7	30.5	20.2
2002	28.7	30.7	19.8
2003	30.2	30.8	20.2
2004	30.3	30.9	20.3
2005	30.8	31.3	20.6

Tab. 2. Empirical logarithmic data of the function of production Cobb-Douglas

From calculation reasons, in order to determine in a unique manner, the constants A,  $\alpha$ ,  $\beta$ , we will divide the analyzed period in two sub periods, 2000 – 2002, respectively, 2003 – 2005. We will obtain for the first period:

$$\alpha = \frac{3}{2}, \beta = -\frac{1}{4} \quad (II.17)$$

In order to ensure that these constants are unique we shall repeat the procedure for the second period of time. After checking, the results are compatible.

<sup>35</sup> Data from the Bulletins of the National Institute of Statistics during 2000 - 2005, as well as from the reports and financial statements, transmitted by R.A. „Water” to local authorities.

<sup>36</sup> Matei, A., Matei, L., (2007), “Systemic Models of Local Development”, in Theoretical and Applied Economics, no. 1(506), pp. 11-24, Bucharest, Romania.

Formulating a hypothetic situation for reducing the administrative burden at the level  $\lambda=5\%$  and  $\mu=10\%$  we obtain, using (II.12) that the value of the factor of influence on production is:

$$k=0,951 \quad (II.18)$$

Consequently the limitation of the administrative burden at the level above described will involve an increase of production with  $l/k=1.051$  namely 5.1%.

Calculating the average productivity depending on capital or labour we shall discover that the reduction of administrative burden does not lead necessarily, at least for the present example to the increase.

In fact, using (II.14), respectively (II.15) we get:

$$k_K = 1.0006, k_L = 1.056 \quad (II.19)$$

leading to the following finding: an insignificant reduction of the average productivity depending on capital and a reduction with 5.6% of productivity depending on labour force.

Therefore, the conclusion is as follows: while reducing the administrative burden there are necessary measures to change the structure of production so that the average productivity increases, in the same time with the increase of the total production.

## Conclusions

The paper achieved a brief review of some topics, results and practices, relevant for increasing the economic performance through reduction of the administrative costs. The vision proposed by the present paper integrates the concerns and the efforts to determine the so-called administrative burden both for the public and the private sector. In fact, in the development of local communities, the public and the private actors are often acting in joint economic structures, usually in partnerships. Even though the development of the public services and public goods become attractive for the private actors, for the public and the private sector, the reduction of the bureaucratic burden, no matter the terminology, has however different conceptual, social and economic determinations.

Therefore, we preferred to present instead of a synthesis on the performance of the public expenditure management in the local administration in Romania, a theoretical model for estimating the influence of reducing the administrative burden on production and the economic performance. In our opinion, a new direction of research has opened, facilitating the theoretical and practical assessment of the effects of reducing the administrative burden.

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