I. Project Context

Country Context

Romania has the second lowest per capita income in the EU. Romania implemented a broad reform agenda over the last decade aimed at improving incomes and living standards and anchored on EU accession. In January 2007 the country joined the European Union (EU). Structural reforms and increased investors’ interest in the country supported acceleration of economic growth and improvements in living standards. Per capita incomes (in terms of purchasing power standards) improved from 26 percent of EU average in 2000 to 46 percent in 2010. Nevertheless, there are still significant challenges in enhancing productivity and thus raising income levels.

The global financial crisis hit the country hard. Convergence slowed and the crisis forced changes to Romania’s growth and reform strategy. Output fell by 6.5 percent per year during 2009-11 after growing at 6.5 percent during 2003-08. Fiscal revenues declined and fiscal deficit widened to 7.3 percent of GDP in 2009. The growth model of the past that relied on consumption proved to be unsustainable. To address the macroeconomic imbalances, restore confidence, and pave the way for economic recovery, the Government of Romania implemented a fiscal consolidation program supported by measures to improve fiscal governance, reform public sector pay, pension systems and financial sector regulation and supervision.

Modernization of revenue administration is an important component of the new Government’s
reform program. Despite nascent economic recovery, the deteriorating external environment in Europe is likely to affect negatively tax revenue collection and thus pose risks to meeting medium-term fiscal targets. Romania has committed to reducing the fiscal deficit to below 3 percent of GDP in 2012 and to exiting the Excessive Deficit Procedure in 2012. The medium-term fiscal framework envisages reducing further reducing the deficit to 1 percent by 2014. To guard against the consequences of macroeconomic instability, the Government has entered into precautionary financial assistance agreements with the IMF and EU for EUR 2.7 billion and it has requested a complementary agreement with the World Bank in the form of a Deferred Drawdown Option (DDO) Development Policy Loan (DPL) worth EUR 1 billion. Modernization of revenue administration is envisioned as an integral component supported by the DPL.

II. Sectoral and Institutional Context
Romania’s tax compliance burden is relatively high. The World Bank/PWC Paying Taxes 2012 report ranks Romania only 154th with regard to the ease of paying taxes out of 183 countries, with the number of tax payments totaling 113 cited as the main reason for the low ranking.

Meanwhile, tax compliance is relatively weak. The overall level of tax filing compliance modestly increased to 86.5 percent in the first semester of 2011, compared to 84.6 percent in 2010 and 77.4 percent in 2009 while payment compliance improved—from 72.8 percent in 2006 to 83.9 percent in 2010. Romania has a large number of small taxpayers with a complex tax regime—their management requires the dedication of NAFA staff resources that are disproportionate to the revenue contribution made by this segment of taxpayers.

Tax and social contribution revenues in Romania remain one of the lowest in the EU. Revenue performance gains during the boom years of 2004–07 were modest with the revenue/GDP ratio rising from 27.2 to 29.0 percent; while revenue losses during the recession were severe with tax/GDP ratio dropping back to 27.2 percent in 2010. Tax arrears are growing rapidly, in particular arrears accumulated by large taxpayers; the total amount of arrears at the end of 2010 is 20.1 percent higher than in 2009 with little improvement in 2011. VAT collection to GDP increased from 6.98 percent in 2009 to 8.75 percent in 2011 but this is largely due to an increase in the VAT rate. While VAT rate has increased by 26.3%, from 19% to 24%, VAT revenue increase by 25.3% over the period. Further improvements in compliance are likely warranted.

EU accession triggered improvements in Romania’s approach to revenue administration. The need to align with EU benchmarks and best practice launched a tax reform in 2004 that included the creation of a unified revenue administration—the National Agency for Fiscal Administration (NAFA)—and the enactment of a new tax procedures code. In 2005, the customs administration and Financial Guard were merged into NAFA and the organization assumed responsibility for the collection of taxes and a major part of social contributions. By 2006, Romania had met all tax-related requirements for EU accession.

Further operational reforms were implemented. NAFA assumed responsibility for collection of social contributions and in 2011, a single declaration and payment for taxes and social contributions was introduced thus reducing reporting requirements. In addition, the base for calculating taxes and social contributions was partially harmonized and single filing was introduced for firms operating in multiple locations. Modern risk management and e-filing tools were introduced, enhancements were brought to VAT refund processing and dispatch of tax documents was centralized in a NAFA fast printing unit. The strategic focus of NAFA was strengthened with strategic plans updated regularly.
NAFA’s organization structure was adjusted in keeping with international practice. NAFA headquarters was reorganized along functional lines and the monitoring of field office operations was strengthened. To support the management of major taxpayers, a special Large Taxpayer Department (LTD) was established with responsibility for close to 2,000 taxpayers. Special arrangements to administer medium-sized businesses are also in place. In 2011, NAFA consolidated the number of Tax Administration Units from 404 to 263 and reduced the number of staff positions by 4,927. Currently NAFA consists of a Head Office, 42 County General Directorates at judet level, 42 Medium-size Taxpayer Units, 221 territorial units, and a Large Taxpayer Directorate. Total staff of NAFA is 26,978.

Despite these and other reforms, much more remains to be done. NAFA has laid solid groundwork for the next generation of revenue administration reforms that will cover the next five years. NAFA has decided that next reforms will focus on: (1) improving voluntary compliance; (2) fighting tax evasion; and (3) increasing collection efficiency.

Further organizational and staff re-alignment is needed. The headquarters functions need to be fully developed and assume responsibility for program design and monitoring of operations. The extensive office network needs further reduction to increase efficiency and effectiveness while reducing costs. Modern tax administrations seek to minimize direct contact with the taxpayer and taxpayer service is provided through use of a robust website, through an accessible call centre and other means available. Reduced physical contact also minimizes opportunities for corrupt behavior. The existing model does not include a dedicated taxpayer services function and this needs to be addressed. Staff is not properly distributed across the organization. Close to half of NAFA staff is in support or clerical roles, less than 15 percent of all staff are assigned to the management of large and medium taxpayers, insufficient staff is assigned to key areas such as audit and debt collection.

Crucial operational reforms are also needed. NAFA itself has identified the need to simplify procedures, to improve service, and to deal with non-compliance in both filing and payment.

III. Project Development Objectives

The development objectives of the project are (i) to increase effectiveness and efficiency in collection of taxes and social contributions; (ii) to increase tax compliance; and (iii) to reduce the burden on taxpayers to comply.

IV. Project Description

Component Name
- Institutional Development
- Increasing Operational Effectiveness
- Taxpayer Services and Corporate Communications
- Project Coordination and Management

V. Financing (in USD Million)

For Loans/Credits/Others | Amount
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Borrower | 0.00
VI. Implementation

VII. Safeguard Policies (including public consultation)

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VIII. Contact point

World Bank
Contact: C. Bernard Myers
Title: Sr Public Sector Mgmt. Spec.
Tel: 458-0995
Email: bmyers@worldbank.org

Borrower/Client/Recipient
Name: Ministry of Public Finance
Contact:
Title:
Tel: (40-21) 410-3400/1189
Email: cabinet.ministru@mfinante.ro

Implementing Agencies
Name: National Agency for Fiscal Administration (NAFA)
Contact: Serban Pop
Title: President of NAFA
Tel: +40-21-314-7535
Email: serban.pop@mfinante.ro
IX. For more information contact:
The InfoShop
The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 458-4500
Fax: (202) 522-1500
Web: http://www.worldbank.org/infoshop