

## THE IMPACT OF TOURISM TAXATION: ANALYSIS FOR ROMANIA

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### Abstract

*In modern economies, taxes levied by governments are the most important source of government revenue. Like any other economic sector, tourism is taxed, but it also benefits from financial resources from the government. However, given its specificity, taxation implies a different approach in order to stimulate development, as long as any tax increase can lead to higher prices for tourism products. The paper aims to investigate the tax multipliers of tourism and recreational activities and the propagation effect of taxes, using the data provided by the National Institute of Statistics (NIS), applying Input-Output (IO) methodology for the year 2014.*

**Key words:** *tourism, taxation, input-output, management*

**JEL Classification:** *C67, Z32*

### I. INTRODUCTION

In recent decades, tourism has become one of the rapidly growing sectors, with substantially rising international tourism receipts, while extra revenues, tax revenues, and jobs are generated. Tourist destinations are trying to keep their competitive position in relation to the dozens of holiday locations that appear annually on the tourist map of the world, developing strategic and tactical management and marketing policies.

At the same time, tourism is a source of government revenue from taxation, for example value added tax, airport tax, room or bed tax, environmental tax, property tax, transport tax, profit tax, import duties. Taxes are an important economic tool, providing financial resources for investment in infrastructure and services to support tourism development.

A smart tourism tax is often a prerequisite for sustainable tourism development, especially in developing countries, where there is a 'thin, transparent line' between the authorities' attempt to collect tax revenue and the development of a complex, cumbersome taxing system of the tourism sector. In some cases, taxing the tourism sector and related activities is more effective for collecting government revenue, due to the fact that the demand created by tourists is higher.

Public sector has ignored the impact of tourism on economies and its potential for national and local public funding policies in order to mitigate negative environmental impacts or to support the development of infrastructure and services. The literature provides examples of feasible forms of tourism tax applicable at

national or regional level. The idea of differentiating taxes at an intra-national level was investigated by Archer (1977), and the results indicated that it generates national implications.

Initially, tourism was totally exempt from taxes, either because of its low importance or the decision not to tax international travel or the complexity of the tourism industry. With the expansion of the tourism industry and its economic, social, cultural, political, environmental contribution, national authorities have recognized the need to tax tourism and specific tourism-related activities, and taxes are considered as revenue-generating tools to the central and / or local budget.

Most tourism experts point out that taxes are necessary (Archer, 1977; WTO, 1998; Sinclair and Stabler, 2002; Gooroochurn, 2004; Gago et al, 2006; Durbarray, 2008; Dombrovski and Hodžić, 2010) to bear the share of national, social and infrastructure costs (WTO, 1998), tourism being one of its major users.

Up to a certain limit, tourism taxation is inevitable, as it has an increased share of global economic activity. The income from taxes allows governments to invest in infrastructure and social services without which tourism could not exist (WTO, 1998). The operators' concerns in the tourism industry are directed to the idea that tourism should not be taxed in a disadvantageous way compared to other industries. Moreover, governments need to understand the nature of tourism, especially its relative fragility and sensitivity to high prices.

There are three major categories of interest groups concerned with direct, indirect and induced, positive or negative effects on specific activities,

namely the national / local government / authorities, tourism service providers and tourists. Their interest may be common or divergent, and it is necessary to formulate smart tax policies that apply taxes in a win-win way for all affected parties.

The rest of the paper is structured as follows. Section two analyses tourism taxation and the impact on the competitiveness of destinations. In section three authors describe the methodology used in the paper. Section four presents the results. Section five discusses managerial decisions in order to improve tourism taxation. Last section concludes the paper.

## II. TOURISM TAXATION AND THE IMPACT ON THE COMPETITIVENESS OF DESTINATIONS

According to the World Tourism Organization (1998), taxes have four functions, namely: fiscal or budgetary, economic, social or redistributive, and for investment's increase. Certain tourist activities, by their nature and without additional taxes, already contribute considerably to tax revenues for a particular destination. Expenditures of tourists in shops, restaurants, gas stations, pharmacies, etc. contribute directly to additional revenue from taxes, while income from labour taxes is derived from employing individuals in the tourism sector. Tourism is positively influencing the growth of regional economies, providing a source of income for households and local firms (Carrascal Incera and Fernandez, 2015).

Government policy has a significant impact on price efficiency through tax policy, which, *ceteris paribus*, requires price increases at destination levels compared to its competitors (Durberry, 2008). In the long run, international competitiveness of destinations and sector sustainability may be affected by an unfair taxation policy (Gooroochurn, 2004).

The World Tourism Organization and HOTREC underline that governments need to build and implement a tax policy to encourage and motivate taxpayers to pay taxes and tourism businesses to be financially sustainable. At the same time, the tax burden should be structured so as to ensure the financial viability of the tax, so that the tourism project to be not endangered by the tax incidence (World Tourism Organization, 1998).

Gooroochurn (2004) emphasizes that tourism taxation has important economic effects such as changes in GDP, investments, prices, consumption, balance of payments but not always favourable, and governments have to take these effects into account. In turn, tourism is very sensitive to taxes and, in particular, to taxes that influence price formation (Dombrovski and Hodžić, 2010).

The importance of tax policies is related to its capacity to act as a substitute for the price of some goods or services consumed by tourists (Gago et al,

2006). Revenue growth can be achieved by increasing the tax rate and / or increasing the number of tourism taxes.

Tourism taxation generates both positive and negative effects.

Positive effects of tourism taxation include the following:

- Tourism is a relatively easy target for the government to identify additional sources of tax revenues, and some of these can be used to finance the development of infrastructure and other facilities on which tourism depends (Durberry, 2008).

- A tax is the most *important tool to achieve an improvement in the economic environment*. For this, it is necessary to set a certain level of tax that takes into account the social costs generated and not just the private costs of the activity (Sinclair and Stabler, 2002).

- Tourism taxation generates positive effects on equity. In the intensive tourism sector, tourism taxation can have negative effects on equity (Gooroochurn, 2004).

- Income from taxes can be used to develop social programs for citizens, develop local environment to make it more attractive for tourists or build buildings, and infrastructure (Ryan, 2003).

- Landowners in the region will be subject to lower property taxes, *ceteris paribus*, with the development of holiday homes in their community, and the quality of local public goods and services will be improved without an increase in property taxes paid by local landowners (Fritz, 1982).

- The level of taxation may influence tourist flows and spending.

- Taxation in tourism also has a corrective role (Gago et al, 2006). Thus, aspects of land use sustainability can be addressed by imposing a Pigouvian tax. The tax induces a private monopoly over the developed land (used to build hotel capacity), less rapidly than a public monopoly. From this point of view, taxes can be complementary to other forms of public intervention related to the planning of the territory (Piga, 1999).

- Taxes can be used as a time-domain variable to avoid traffic congestion peaks and reduce seasonality of tourist activity (Gago et al, 2006)

- Certain taxes may hinder tourism development in order not to harm the environment.

Negative effects of tourism taxation include the following:

- *Inflation costs induced by rising prices for tourism products and services*. Another tax-induced effect is the increase in the prices of goods and services that do not guarantee an increase in total revenues. From an economic point of view, taxes and subsidies should be regarded as a transfer payment which should normally be excluded in the assessment of project costs (Vanhove, 2005).

- Taxes can have a *distorting effect on the economy*, and may result in a lower level of revenue than expected. High rates of taxes are *unfavourable to preserve the competitive advantage of destinations* and to obtain the desired income in tourism (Dombrovski and Hodžić, 2010). Although tourism tax seems attractive, the tax on tourism, assimilated to tourism exports, erodes the competitiveness of a destination (Corthay and Loeprick, 2010).

- *Effect of distortion of demand from the taxed destination*; this occurs when demand is relatively elastic, price differences caused by taxation determine important changes in the consumption behaviour of tourists.

- *Cost of collecting taxes*. The collection of certain taxes costs as much as the revenues generated by the state budget. The benefit of these taxes is reduced - the main effect is to distort demand from the destination to less taxed destinations (WTO, 1998).

- Most tourism operators consider taxation as an *important barrier to business and investment*. Efforts to rationalize the tax regime can help boost tourism growth by reducing the cost of business start-up and operation in the sector (Corthay and Loeprick, 2010).

- Existing differences between property tax rates are a source of inefficiency and inequality (Fritz, 1982). Under certain circumstances, this increase in the land area allocated to holiday homes (condominium, complex structures, individual dwellings) was associated with an *increase in fiscal pressure on residential property*.

- Accommodation taxes are not fair, as it penalizes tourists (HOTREC, 2012).

- *System revenue leakage*. By raising taxes, the authorities withdraw part of the money from the economic system and thus reduce demand levels. Only through government spending this money re-enter the economy (Ryan, 2003).

In conclusion, decisions on the level of tax rates should be the result of a study of their impact on tourism and the state budget. Once an optimal solution has been identified, no frequent changes should be made because even the smallest tax rate correction generates a decrease in the demand for tourism services (Dombrovski and Hodžić, 2010).

### III. METHODOLOGY DESCRIPTION

The Input-Output (IO) analysis provides useful information to justify the allocation of tax revenues (for the financing of tourism-related infrastructure projects) and certain funds to local, regional and national governmental offices (Ryan, 2003).

The IO analysis underlines that a change in total production within sector  $j$  causes the total supply of sector  $j$  to be changed for the rest of the sectors of

activity using sector  $j$  products / services as inputs in their own production process (Bonfiglio et al, 2006). This type of backward link is used to indicate the types of cross-sectoral transactions.

The IO equilibrium equation it is displayed as follows:

$$X = (I-A)^{-1} * Y \quad (1)$$

Where  $I$  - the unit matrix;  $A$  - technical coefficients matrix;  $X$  - the output's vector;  $Y$  - the final demand vector;  $(I-A)^{-1}$  - total requirements matrix (Leontief inverse matrix); in the paper is considered as being  $L$ .

The *output multipliers* ( $L_j$ ) are calculated as the sum of each column:

$$L_j = \sum_{i=1}^n l_{ij} \quad (2)$$

Tax multipliers are obtained using the Leontief inverse matrix and the matrix of tax direct coefficients, as follows:

$$Tx = T * L \quad (3)$$

Where  $Tx$  - the tax multipliers matrix;  $T$  is the tax coefficients matrix (on the main diagonal the tax coefficients and zero for the rest); Tax Coefficients = Taxes / Output.

It is important to determine the volume of total taxes, in order to establish budget deficit targets. According to Zaman et al (2010), taxation implies a volume of taxes equal to  $T_{tx}$  in the interdependent sectors of the national economy, backward and forward.

In order to estimate the volume of total taxes, the following formula is used:

$$T_{tx} = (I-A^T)^{-1} * T_d \quad (3)$$

$T_{tx}$  - total taxes;  $T_d$  - direct taxes;  $A^T$  - transposed matrix of  $A$ .

The difference between total taxes and direct taxes (the total propagation effect) is a useful tool in investigating the fiscal burden for each sector of the economy. The difference between total taxes and direct taxes shows the effect totally propagated in other sectors by the taxes of a particular sector.

$$\Delta T = T_{tx} - T_d \quad (4)$$

Taxation is more productive or beneficial for production in sectors with higher coefficients of multiplication rate. Previous researches underline that some sectors generate a higher propagation effect, even if the tax revenues are low (Zaman et al., 2010).

### IV. TOURISM MULTIPLIERS AND SECTOR CLUSTERIZATION

The analysis of the impact of tourism taxation in the economy is important in order to support the decision makers to improve their decisions regarding taxes imposed to economic agents operating in the sector. For this reason, the IO analysis was used in

order to investigate tax multipliers and total propagation effect of taxes.

The output multiplier for tourism and recreational activities is 1.386, ranking the sector on the 13th out of 19th sectors. A change in tourist demand in the sense of an increase / decrease by 1 leu leads to a change of the total production by 1.386 lei.

The backward tax multiplier for tourism and recreational activities is 0.066, ranking the sector on the 13th out of 19th positions. A change in tourist demand by 1000 lei leads to a change of 66 lei in the revenues collected from taxes at national level, indicating a low potential to generate tax revenues due to the increase of the final demand in the sector.

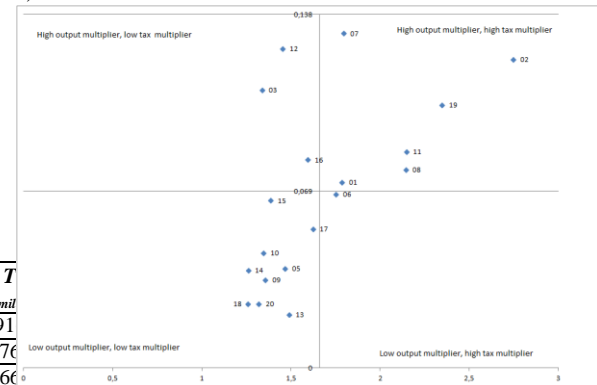
The total tax revenues generated by tourism and recreation activities amount to 4246 million lei, representing 2.7% of the total revenues collected from taxes at national level.

**Table 1. The estimated multiplier, 2014**

Sectors	Output multiplier	Tax multiplier	Taxes (mil. lei)
01	1.784	0.073	91
02	2.747	0.121	176
03	1.337	0.109	166
05	1.467	0.039	36
06	1.751	0.068	5144
07	1.794	0.131	2518
08	2.143	0.078	914
09	1.356	0.035	348
10	1.345	0.045	756
11	2.146	0.085	93
12	1.453	0.125	147
13	1.488	0.021	218
14	1.260	0.038	343
15	1.386	0.066	42
16	1.594	0.081	7313
17	1.622	0.054	8247
18	1.259	0.025	2642
19	2.347	0.103	7829
20	1.319	0.025	1484

Sources: authors' estimations

multiplier and high tax multiplier (extractive industry; HR services, administration, education, secretary; public utilities; metallurgical industry; agriculture, fishing, forestry; chemical industry) and sectors with low output multiplier and low tax multiplier (tourism and recreational activities; financial, insurance, real estate, accountancy, consultancy services; car industry; transportation and courier; textile industry; computers and electronics; research, development, advertising, health; commerce and repairs; other services) (see Fig. 1).



**Figure 1 – Clusterization of economic sectors based on output multiplier and tax multiplier**  
 Note: 01- Agriculture, fishing, forestry; 02 – Extractive industry; 03 – Food, beverage and tobacco; 05 – Textile industry; 06 – Wood and furniture; 07 – Chemical industry; 08 – Metallurgical industry; 09 – Computers and electronics; 10 – Car industry; 11 – Public utilities; 12 – Construction; 13 – Commerce and repairs; 14 – Transportation and courier; 15 – Tourism and recreational activities; 16 – Media industry, telecommunication, TIC; 17 – Financial, insurance, real estate, accountancy, consultancy services; 18 – Research, development, advertising, health; 19 – HR services, administration, education, secretary; 20 – Other services.

**Figure 1 – Clusterization of economic sectors based on output multiplier and tax multiplier**

**MANAGERIAL IMPLICATIONS FOR IMPROVEMENT OF TOURISM TAXATION**

Total propagation effect in other sectors by the taxes from tourism and recreational activities ( $\Delta T$ ) is 1825 million lei, placing tourism in the second half of the sectors ranking from the economy.

The values of the propagation effect indicator record relatively low values in tourism and recreational activities compared to other sectors of activity, indicating that the production of the respective sector may increase, as this does not induce strong backward or forward propagation effect as a result of taxation.

The weight of the propagation effect in the total tax revenue collected at the tourism and recreational activities is 2.3% - much lower compared to that recorded in other sectors of activity (e.g. extractive industry, metallurgical industry, constructions, agriculture, fishing, forestry, public utilities).

Regarding the multipliers effect, in the analysis of disparities between sectors, both output multiplier and tax multiplier indicates two main clusters of sectors, respectively: sectors with high output

Gooroochurn (2004) considers that increased efficiency of tourism taxation may be helpful in formulating tax policies, especially in developing countries facing a complex tax structure and over-reliance on trade taxes. Also, underlines that is more efficient to raise an additional dollar of tax revenue by taxing the hotel, restaurant, transport and communication sectors than other non-tourism sectors, meaning that the government should increase taxes in tourism-related sectors and reduce them in non-related sectors, in order to increase tax revenues and prevent welfare decline.

Tourism is sensitive to taxes, but cannot be exempt from it, since it is an important source of revenue for the budget (Dombrowski and Hodžić, 2010). Corthay and Loeprick (2010) consider that in many countries the tax system for the tourism sector is characterized by exemption schemes and tools that generate low revenues and burden to businesses.

Travel businesses may be vulnerable to

distortions in the tax regime, due to low profit margins and strong competition from both domestic and foreign firms. Some countries refer to these aspects and other business climate constraints by introducing special tax incentives for tourism, such as holiday tax, customs duty exemptions, accelerated depreciation of buildings, and so on. Incentives are often managed on a discretionary basis and may generate a number of well-known problems (Corthay and Loeprick, 2010).

Tax incentives are typically added to the mix of investment promotion policies, sometimes affecting the competitiveness of the sector. When considering the value of incentives, it is important to distinguish the different forms of tourism.

Tourism promotion by public sector bodies and tax subsidies and / or incentives had an impact on production. While taxes increase tourism costs, subsidies and grants can be used to stimulate supply (Sinclair and Stabler, 2002).

The tax regime should treat large firms differently than small ones. Most tourist activity is generated by hotels and small operators that are cost-sensitive (Corthay and Loeprick, 2010).

Tourism industry cannot be shielded from indirect taxation (Popescu et al, 2015). Indirect taxes paid by foreigners are a net benefit for the country. A higher tax adopted for a budgetary reason is not related to the desire to pay for a product or service, for example, a higher fuel tax leading to higher transport costs, having a purely transferring effect and not contributing to welfare increases (Vanhove, 2005).

Planners and managers in tourism should raise awareness of the causes / reasons behind certain taxes levied on tourism activities. Therefore, tourism can become an interface between tax collectors and visitors; appropriate marketing and the use of effective communication tools inform the public on the reasons why they should pay a specific tourist tax, making them realize that they are involved in the development process.

## **VI. CONCLUSIONS**

Tax policies have a special role in the economy, influencing tourism industry activity due to the magnitude of the potential revenue for the tax system and the high degree of social acceptance (Gago et al, 2006). In modern economies, taxes levied by governments are the most important source of government revenue. These are mandatory, levied on a regular basis, and are not directed to a particular purpose.

Economists consider taxes as being paid to discourage specific activities or the consumption of products that harm the environment, or to bear the full costs of production and / or services and facilities. Taxes are designed to meet different levels of consumption or production, particularly in order to maximize net social benefits (minimize net social costs), thereby achieving a certain economic optimum (Sinclair and Stabler, 2002). One concern related to tourism taxation is about the negative impact of consumption taxes on tourism competitiveness, because the purchase of goods and services by overseas visitors are not exempted from such taxes, and the lack of a reduced rate, or the existence of a higher reduced rate for tourism-related activities (e.g. hotels and restaurants), than in competitor destinations (OECD, 2014).

Tourism taxation is not simple and governments have developed more approaches to collect revenue from the sector. Such policy differences are evident when comparing marginal rates of actual taxes with tourism investments, which are substantial even among neighbouring economies.

Understanding the size and the economic value of the tourism industry supports the development of specific activities or corrects them in order to minimize costs and negative impacts. Moreover, the economic and social explanations of impact studies can be considered a rational justification given to national and local authorities to support the tourism industry or, on the contrary, to limit its development or to take adaptive measures.

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