

## TAX AND BUDGETARY SUSTAINABILITY – CURRENT AND FUTURE PERSPECTIVES

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***Abstract:** The crisis caused by the pandemic context we have been facing for over 2 years represents a threat not only for the population's health, but also for the national economy, respectively for the citizens' living standard. From one industrial sector to another and from one enterprise to another, the adverse effects were felt against the background of the restrictions imposed to limit the impact caused by the coronavirus. In this context, it is obvious that the public finances, which are closely interdependent with the branches of the private sector, have also been subject to various influences. a situation characterized by the unsustainability of public finances greatly complicates the conduct of fiscal, budgetary and monetary policy and requires decision-makers to implement a tax-monetary strategy which, even if in the first phase, generates negative reactions, shall be effective on medium and long term.*

***Keywords:** budgetary sustainability, tax, public finances.*

***JEL Classification:** H21, E62, H32.*

### 1. Introduction

The sustainability of public finances is the ability of a government to cover its current expenditure and to support its public policies without jeopardizing its solvency or risking not being able to repay part of its debts or making part of its pledged expenditure.

In the context of the pandemic crisis generated by COVID-19, the situation of public finances has become sensitive, from at least two points of view: on the one hand, the recorded economic contraction has generated the reduction of the tax basis, the main source of public funds, and on the other hand, the support measures related to COVID-19 have generated high costs supported from the public budget.

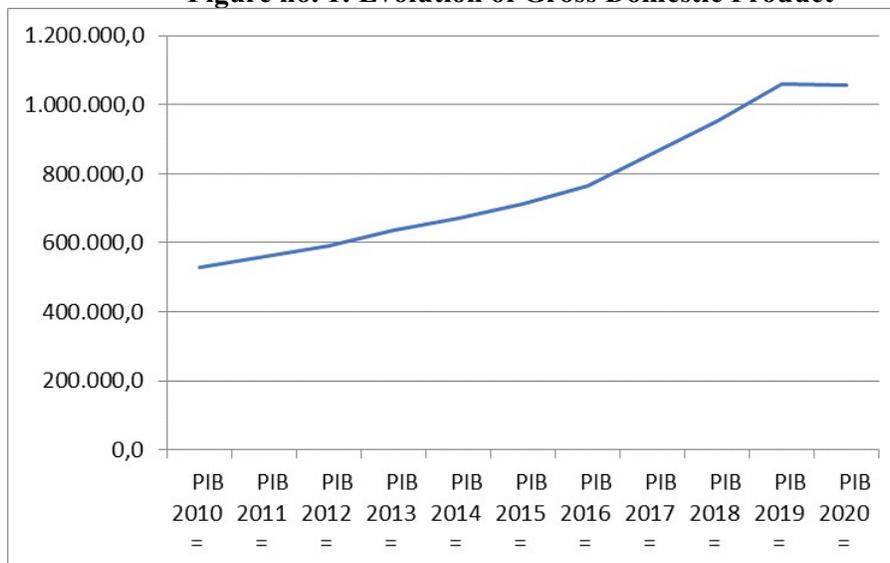
### 2. Factors determining tax and budgetary sustainability

The crisis caused by the pandemic context we have been facing for over 2 years represents a threat not only for the population's health, but also for the national economy, respectively for the citizens' living standard. From one industrial sector to another and from one enterprise to another, the adverse effects were felt against the background of the restrictions imposed to limit the impact caused by the coronavirus. In this context, it is obvious that the public finances, which are closely interdependent with the branches of the private sector, have also been subject to various influences.

We are talking, on the one hand, about the measures taken by the Government to counteract the effects of the health crisis, measures with a significant impact on the increase of budgetary expenses, and, on the other hand, about the contraction of the tax basis, with an effect on the sources of public revenues.

Considering the evolution of the main macroeconomic variables, according to the data provided by the Ministry of Public Finance, the Gross Domestic Product has experienced a continuous growth. The data published for the period 2010-2020 highlights this trend:

**Figure no. 1: Evolution of Gross Domestic Product**



Source: Made by the author based on the data taken from [https://insse.ro/cms/sites/default/files/com\\_presa/com\\_pdf/pib\\_tr1r2022.pdf](https://insse.ro/cms/sites/default/files/com_presa/com_pdf/pib_tr1r2022.pdf)

For a correct assessment of the evolution of the macroeconomic indicator, it should be noted that even if in nominal values it recorded an approximately 6% increase in the last year, in real terms the evolution is not confirmed.

Another indicator highlighting the fragility of the public finances' position is the budgetary deficit. Its evolution in recent years indicates a deepening of the gap between budgetary revenues and expenditures.

From the point of view of the structural deficit, it is as follows:

**Table no. 1: Evolution of Romania's budgetary deficit**

	<i>Budgetary deficit – million lei</i>	Budgetary deficit - % of GDP
2010	-33,607.8	-6.4
2011	-23,898.6	-4.3
2012	-14,773.9	-2.5
2013	-15,794.0	-2.5
2014	-11,493.2	-1.7
2015	-9,630.7	-1.4
2016	-18,304.3	-2.4
2017	-24,294.7	-2.8
2018	-26,850.3	-2.8
2019	-48,554.3	-4.6
2020	-101,798.7	-9.6

Source: Made by the author based on the data taken from <https://mfinante.gov.ro/domenii/bugetul-de-stat/istoric-deficit-bugetar>

Even before the COVID-19 pandemic, in 2019, it had reached 48,554.3 million lei, an increase of approximately 85% compared to the previous year; in 2020, the structural deficit advanced, reaching 9.6% of GDP. An important factor that determined the

evolution of the structural deficit was the pronounced trend of growth of staff expenditure, as well as of those incurred with social assistance during the last years. Thus, in 2020, these categories of expenditure accounted for 94.3% of tax revenues (including insurance contributions), respectively 23.9% of GDP.

This situation is not sustainable given the two categories of expenditure are located at the level of current expenditure, which implies a final consumption of Gross Domestic Product.

The level of the budgetary deficit target for 2021 was 80,020.3 million lei, corresponding to a weight of 6.72% of GDP, with a decrease of the budgetary deficit in 2021 compared to the previous year.

The decrease in the budgetary deficit was supported by structural adjustment measures, namely the amounts collected in 2021 from the budgetary obligations related to 2020, whose payment was postponed by economic agents. In the Tax-Budgetary Strategy, the Ministry of Public Finance aimed for 2021 an adjustment of the weight in GDP of staff expenditure (by 1.9 pp), expenditure incurred with goods and services (by 0.8 pp) and with social assistance (by 1.3 pp). In fact, consumption expenditure continues to grow from one period to the next, in line with the growth of beneficiaries of the public wage system, as well as their remuneration.

It is difficult to envisage a tax consolidation in the period 2021-2024 in the absence of a significant increase in budgetary revenues. This could come from: improving the efficiency of collection, increasing the tax basis, narrowing the exceptions and loopholes that deviate negatively from the standard tax rates paid by some taxpayers, resolutely combating tax evasion and unfair tax competition, and optimizing tax rates.

Another aspect that could significantly contribute to increasing the sustainability of public finances is the possibility of accessing European funds, both in terms of the allocations related to the EU Multiannual Financial Framework for the period 2021-2027, and through the facility of the Recovery and Resilience Facility (RRF).

The temporary recovery instrument "Next Generation EU, with a financial capacity of EUR 750 billion, implemented at European Union level, can also be a solution for financing the recovery measures proposed at national level. It is based on three pillars: instruments to support the efforts made by Member States to recover, to remedy the consequences of the crisis and to emerge stronger therefrom; measures to stimulate private investment and support businesses in difficulty; strengthening the main EU programmes to capitalize on the lessons learnt from the crisis, to increase the robustness and resilience of the Single Market and to accelerate the green and digital double transition, and making use of it will be of real benefit to Member States, including Romania.

In this sense, beyond the manifestation of the interests of the various political groups, Romania's chance lies in a success of attracting as much as possible of these funds, leading to the implementation of structural reforms, directly and indirectly supporting the process of tax consolidation.

In assessing tax sustainability, due consideration should be given to the current and potential level of public debt. A high level of public debt may jeopardize tax sustainability, irrespective of the long-term expenditure related to population ageing.

**Table no. 2: Evolution of Romania's public debt**

Public administration debt	2018	2019	2020	2021	Martie 2022**)
total – million Ron	330,518.7	373,496.9	499,868.5	577,142.6	593,971.5
% GDP	34.7%	35.3%	47.2%	48.8%	50.3%

Source: Made by the author based on the data taken from <https://mfinante.gov.ro/ro/web/trezor/datorie-guvernamentala>

In recent years, the growth rate of the public debt has increased, so that, for the first time in February and March 2022, the weight of the public debt in the Gross Domestic Product recorded values of over 50%. It is foreseeable that, against the backdrop of current public policies, public debt will continue to grow, which will have a considerable impact on economic activity and inflation.

### 3. Conclusions

The impact of the budgetary-tax policy – and therefore of the evolution of the Gross Domestic Product, of the budgetary deficit, of the public debt – on growth and other micro and macroeconomic variables has been approached both in theory and in practice.

The deterioration of the public finances situation is perceived as worrying, the influence of the increase of the budgetary deficit and of the public debt on the economic activity being an unfavorable one and generating negative effects on the economy: the decrease of the purchasing power, inflation, fluctuations of interest rates, the reduction of investments, the slowdown of capital buildup, etc.

We are also identifying the negative effects of budgetary deficits and of rising public debt on long term basis. Firstly, the increase in public debt leads to a reduction in the related percentage of national income that is saved. Secondly, the increase in debt also determines the increase in budgetary expenditure with the payment of annuities. These payments must be made at the expense of productive expenditure – for example, public investment in infrastructure – or must be covered by increased taxes. Also, the increase of the debt increases the country risk and thus the risk premiums, which increases the costs of state funding and may endanger its solvency.

In conclusion, a situation characterized by the unsustainability of public finances greatly complicates the conduct of fiscal, budgetary and monetary policy and requires decision-makers to implement a tax-monetary strategy which, even if in the first phase, generates negative reactions, shall be effective on medium and long term.

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