Weaknesses and Strengths in the Evolution of the Romanian Tax System

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Abstract

The tax system is a product of human thought, decision, and action because of the evolution of human society, created to meet financial objectives, to which are added the objectives of the economic and social system.

The general objective of the research on the evolution of the tax system in Romania is to understand the transformations and changes that have taken place in the country's tax system over time. This research aims to analyze the legislative, economic, and social changes that have affected the tax system and impacted on revenue collection for the state.

The research on the evolution of the tax system in Romania and the identification of strengths and weaknesses has the overall aim of understanding and improving the functioning of the tax system, contributing to a more efficient tax administration, and promoting a healthier economic climate.

Key words: tax system, taxes, inflation rate, budget deficit
J.E.L. classification: H2, H6

1. Introduction

Romania's tax system is not just about taxes; it includes significant elements such as the legal framework, which plays a key role in establishing the legal and regulatory conditions for taxation. This legal framework encompasses both the rights and obligations of the tax authority and taxpayers. In compliance with tax and general legislation, taxation is defined as a set of rules that govern the taxation of taxpayers and serves as the legal basis for taxes and duties, without in any way prejudicing the rights and benefits of taxpayers.

Legislation establishes taxes and duties, which are essential elements in shaping and defining the concepts of taxation. The tax system is not just the result of laws, but a manifestation of human thought, decisions, and actions, evolving in line with changes in human society. This system is designed to meet financial objectives by combining them with those of the economic and social system.

The rationale behind the theme Evolution of the tax system in Romania: Strengths and weaknesses reflects a multi-dimensional interest, including economic, social, and political aspects. From an economic perspective, it explores the development of the key components of the Romanian tax system and how they contribute to the revenues of the general consolidated state budget. From the social perspective, it analyses the legal framework governing the regulatory acts and setting the tax rates applicable to both individuals and legal entities. From the policy perspective, it considers decisions, measures, and possible changes to the legal framework, with the aim of facilitating and bringing a valuable contribution to the general state budget.

2. Literature review

The evolution of the tax system in Romania is a complex and relevant subject, with multiple aspects that can influence both the economy and society. Analysis of the strengths and weaknesses of this system can provide a comprehensive perspective on the efficiency and challenges faced by tax authorities, taxpayers, and business. In the process, the research examines historical development, the legal framework, adaptability to economic change, efficiency in tax collection, tax fairness, anti-avoidance measures and the impact on the business environment (Badea, 2003). Identifying and understanding these issues is essential for designing and implementing more efficient and fair tax policies in Romania.

The literature on the evolution of the tax system in Romania provides a wide range of information and in-depth analysis of its strengths and weaknesses. Relevant issues identified include historical evolution, highlighting legislative changes and major economic events that have shaped the tax system over time. The analyses also focus on the efficiency of tax collection, identifying possible problems and proposing improvements for more efficient collection. The literature also reveals tax equity issues, assessing the distribution of tax burdens and the impact on social inequalities. Studies also extend to the adaptability of the tax system to economic changes and the global context, including how it handles recessions or economic growth (Brezeanu, 2009). Detailed analysis of tax legislation highlights ambiguities and loopholes, while evaluation of anti-avoidance measures focuses on their effectiveness and on improving tax compliance. The impact of the tax system on the business environment, investment and competitiveness is also studied, identifying potential challenges or benefits. Comparison with tax systems in other countries brings into discussion good practices and possible improvements adapted to the specific Romanian context.

According to the normative acts, there are several delimitations within the Romanian tax system to highlight the concepts of taxes and duties owed by individuals and legal entities.

Budgetary income is a monetary obligation regulated by normative acts and is applied to all natural and legal persons who obtain taxable income or own taxable goods. The government budget comprises ordinary revenue, i.e. current receipts, and extraordinary revenue, considered temporary depending on the regularity of receipts. The main recurrent sources of the government budget include taxes, duties, and contributions, providing the liquidity needed to finance public expenditure on a regular basis. Taxes are compulsory and non-refundable contributions paid by individuals and legal entities to the state budget, levied on their income or assets. Contributions are mechanisms for recovering public financial resources and are paid by individuals and legal entities on a compulsory or voluntary basis.

Within the state budget revenues, taxes are the second category next to duties. They are issued by public authorities and represent state budget revenue. The characteristics of taxes include the paying party determined precisely at the request of an act, service, or work by the state authority (Vintilă,*et al*, 2002). Payment of taxes is unequivocal, determined at the level of the state authority, anticipated and one-off. These features distinguish taxes specifically within the tax system.

Public financial resources come, for the most part, from the collection of taxes, duties and contributions from legal entities and individuals. Taxes, related to the earliest forms of state organization, evolved in close connection with the functions and responsibilities of the state. Defined as compulsory contributions for natural and legal persons, taxes are payments to the state imposed at national level on specific income or property.

In the past, payments were designed and made in kind or in labor, but nowadays they are denominated in the currency of the country concerned. For the most part, taxes are directed towards covering public expenditure, financing essential activities for society. Contrary to payments, taxpayers do not receive direct compensation from the competent authorities (Ciucur *et al*., 2004).

An essential aspect of taxes is recognized by their reversibility, where the amount collected can be transferred into acts and services that benefit taxpayers in the form of social and cultural facilities provided by the state. The tax is therefore seen as a compulsory contribution with no immediate equivalent, but taxpayers become direct beneficiaries of activities organized by the state, without being obliged to pay the consideration.

The literature also focuses on the analysis of compulsory social contributions within contributions, which are paid for social pension insurance, social health insurance and unemployment protection (Minea *et al*., 2006). Although there are clear demarcations between contributions, taxes, and duties in the functions they perform, common aspects have been identified that apply to all the categories analyzed. In addition to their main functions of mobilizing financial resources and financing public expenditure, contributions become an important economic and social policy instrument to influence the development and redistribution of income and wealth in society.

Taxation was established as a financial instrument to mobilize resources to meet public needs. Compulsory levies in the form of taxes are influenced by the objectives and actions planned in the state budget for a given period. In addition to taxes, there are other sources of financing public expenditure. The size of taxes, as an expression of the financing function of public expenditure, depends on the scale and complexity of public sector actions (Minea *et al*., 2006). This function is achieved by the State taking a share of the financial results of the subjects of law (in the case of taxes, levies, contributions, or payments) or by establishing a partial participation of the subjects of law in covering the expenditure incurred by the State in organizing public services (in the case of taxes).

The normative nature of the tax requires a rigorous regulatory process based on imperative benchmarks. Theorists have debated since the dawn of capitalism the rules that tax regulators should follow. During the rise of capitalism, the economist Adam Smith formulated four fundamental principles for state tax policy: the justice of taxation (tax fairness), the certainty of taxation, the convenience of taxation and the yield of taxation (Pilat, 2006).

The elasticity of taxation indicates the ability to constantly adapt the volume of tax revenue to the state's need for financial resources. Thus, when budget expenditure increases, it is essential that tax revenues increase, and conversely, a decrease in budget expenditure should lead to a decrease in tax revenues (Tofan *et al*, 2019). Today, with countries facing increasing public expenditure, all countries are facing an increase in the need for public revenue, which is directly reflected in higher tax revenues. Thus, taxes need to be flexible to adapt to cyclical factors, and if the tax base is sensitive to changes in economic activity, taxes can become an instrument of economic stabilization.

3. Research methodology

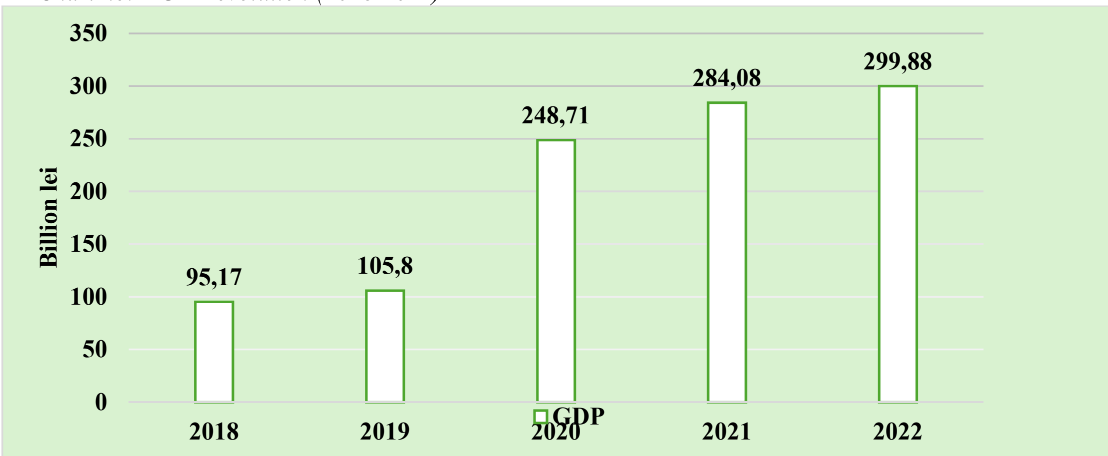
The research method for the analysis Evolution of the Tax System in Romania: Strengths and Weaknesses adopts a mixed approach, combining qualitative and quantitative methods for a comprehensive understanding. The various methods included in the research include documentary analysis, which explores official documents and tax legislation from a historical and legal perspective. Case studies provide detail on specific periods or aspects of the tax system. Interviews with experts, government representatives and other stakeholders provide practical insights and relevant information. Direct research and field observations provide a detailed understanding of how the tax system works in practice. The use of official statistical data provides quantitative assessments of tax trends. Comparative analysis with other countries brings in cross-national perspectives and focus groups with taxpayers and experts gather relevant opinions and perceptions. It is essential that the research is accurate and objective, interpreting the results in the specific context of the Romanian tax and economic environment.

4. Findings

4.1. Strengths of the Romanian tax system

As strengths of the Romanian tax system, we find the growth of the Gross Domestic Product, but also the contribution of the factors during the period analyzed.

Chart no. 1 GDP evolution (2018-2022)

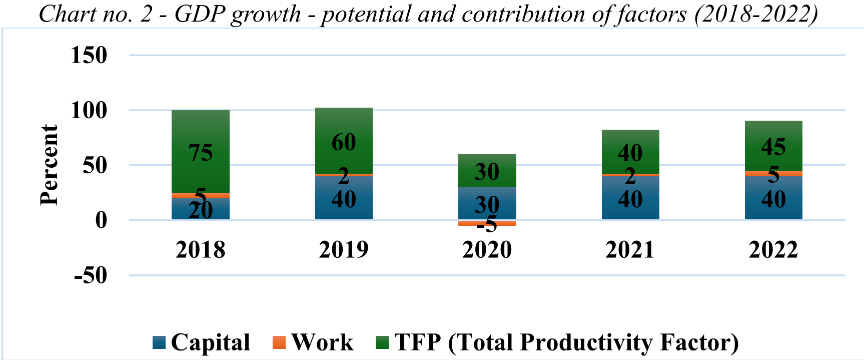


Source: Budget Report 2018-2022, Ministry of Finance, available at https://mfinante.gov.ro/static/10/Mfp/buget2022/proiectbuget2022/Raportbuget2022.pdf

In Romania, the Gross Domestic Product has fluctuated significantly in recent years. In 2018, it was 95.17 billion lei, down from the previous year, when it reached 105.80 billion lei in 2019. A notable increase was recorded in 2020, reaching 142.92 billion lei. The upward trend continued in 2021, when GDP reached a total of 284.08 billion lei. The highest point was reached in 2022, with a peak of 299.88 billion lei.

With the growth of the Gross Domestic Product, it becomes important to break it down by the various areas of activity, analyze the main expenditures and assess the contribution made by the main contributors to the annual state budget.

Chart no. 2 - GDP growth - potential and contribution of factors (2018-2022)



Source: Romanian Government, Convergence Program 2018-2022 and National Strategy and Forecast Commission

In the analysis of Graph 2, we examined the evolution of capital, labor, and total labor productivity factor, all of which contributed to the growth of Gross Domestic Product in Romania. The productivity factor accounts for about 30-75% of this growth, reflecting the potential of the productive resources involved in the economic circuit, including material resources such as construction and machinery, but also service resources. The high percentage in the period under analysis is due to the prevalence of economic agents providing services in Romania.

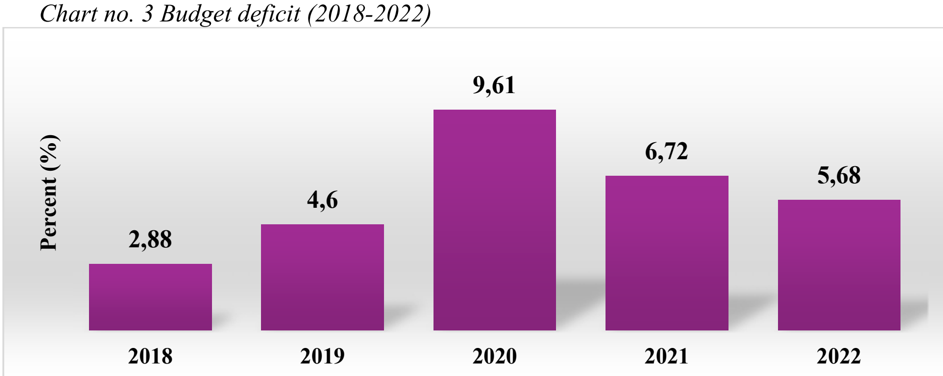
The year 2020 was significantly affected, with a major drop in total labor productivity to 30%, with capital and labor both at 30% and -5% respectively. The COVID-19 pandemic has had a direct impact through shutdowns, massive unemployment and even redundancies in companies. In 2021, there is a significant rebound, with a 10-percentage point increase in the total productivity factor, an increase in labor to 2%, and an increase in capital to 40%.

The year 2022 brings no significant difference, but the total productivity factor reaches 45%, capital remains at 40%, and labor increases to 5%. Further developments in Romania will depend on factors directly affecting the state budget, and particularly the Gross Domestic Product, generating lags and increases depending on these factors.

4.2. Weaknesses of the Romanian tax system

In the context of Romania's fiscal system, weaknesses such as the budget deficit, unemployment, consumer prices, inflation and government debt are highlighted. These indicators are influenced by various aspects of the economic environment, such as the size of the population, labor productivity, the evolution of Gross Domestic Product, the level of income and expenditure and other relevant factors.

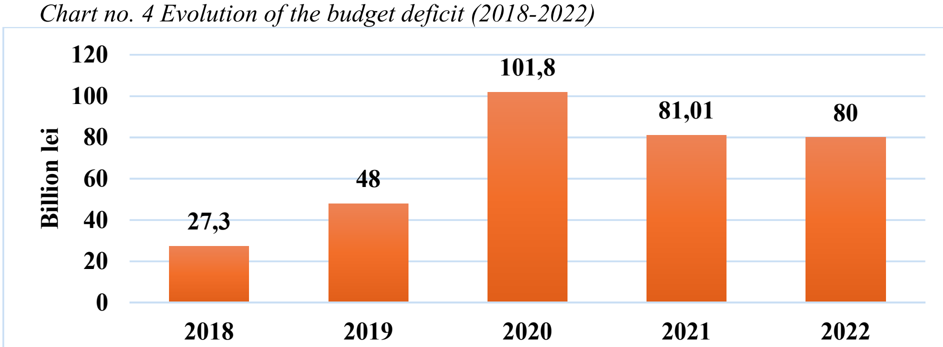
Chart no. 3 Budget deficit (2018-2022)



Source: Ministry of Finance, Budget 2018-2022, available at https://mfinante.gov.ro/ro/web/site

According to Graph 3, the budget deficit has shown a significantly high evolution especially in the year of the pandemic implementation. Thus, in 2018 the deficit was 2.88%, in 2019 it increased to 4.6% and in 2020 it reached 9.61%. With an increase of 5.01 percentage points compared to 2019 and a decrease of 2.89 percentage points compared to 2021, which recorded a deficit of only 6.72%. In 2022, the budget deficit reaches 5.68%, which means that from an economic point of view, Romania is going for a recovery of the general consolidated budget, but also for reducing the deficit below a certain ceiling.

Chart no. 4 Evolution of the budget deficit (2018-2022)



Source: Ministry of Finance, Budget 2018-2022, available at https://mfinante.gov.ro/ro/web/site

The budget deficit in Romania varied significantly over the period under review, reaching 27.3 billion lei in 2018, 48 billion lei in 2019, and 101.8 billion lei in 2020. In 2021, there was a deficit of 81.01 billion lei, and in 2022 it was 80 billion lei.

After the end of the state of emergency in 2020, economic agents resumed their activities, showing improvements, especially in digitization. In 2021-2022, many taxpayers adapted to work more efficiently, avoiding staff shortages or shutdowns.

The reorganization of economic activities in Romania has had an impact on the general state budget, generating an increase in productivity. However, the legislative changes implemented from the following year onwards affected mainly companies, imposing new legal provisions through percentage rates. Taxpayers are obliged to comply with these legislative changes, under penalty of fines and penalties in case of non-compliance according to governmental ordinances published in the Official Journal of Romania.

One of the aspects contributing to the fragility of the Romanian tax system is the unemployment rate, which is on an upward trend in the period 2018-2022. In 2018, the unemployment rate was 1.3%, dropping to 1.1% in 2019 and reaching 0.5% in 2020. However, from 2021 onwards, the unemployment rate increased to 1%, indicating an increase in the number of unemployed compared to the active population.

Another factor with a negative impact on the tax system is the emigration of the Romanian population to other countries. For financial reasons, many choose to move to countries such as Germany, Italy, Spain, the UK or even outside the European Union to ensure a more decent living for their families back home. The permanent emigration of families to other countries can negatively affect the state budget, as they no longer contribute financially to Romania.

According to data, more than 1 000 people migrate from Romania every year, and more than 4 million Romanians already live in other countries. The main emigration destinations include the United States, Germany, Saudi Arabia, and the Russian Federation, while Romania is among the countries with the most emigrants, along with Bosnia and Herzegovina, Serbia, and Bulgaria.

The World Banks indicate that Romania ranks seventh in the top 20 European countries as a destination and source of international remittances, with about $8 billion in and $1 billion out in 2019-2020, representing 3.5% of total remittances.

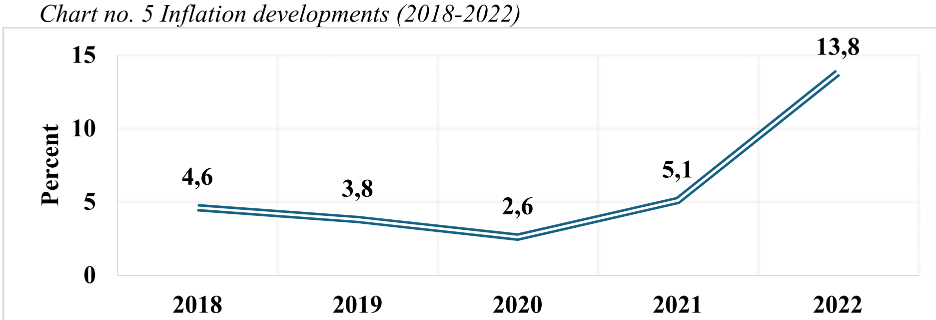
In the sphere of weaknesses, there is also the consumer price index, an important aspect influencing fiscal stability in Romania.

The evolution of the consumer price index in Romania shows an upward trend, with significant changes starting in 2020. In 2018, the index was 104.63%, while in 2019 it recorded a slight decrease to 103.83%. The year 2020 marked a significant decrease, with a reduction of 1.2 percentage points, reaching 102.63%, the major effect of this decrease being the implementation of the SARS-CoV-2 virus pandemic.

From the beginning of 2021, a sustained increase in the consumer price index is observed, recording a value of 105.05% at the end of that year, and in 2022, it reaches 113.8%, reflecting a significant increase of 8.75 percentage points.

Another crucial factor with a direct impact on the general consolidated state budget is inflation. This is generated by the generalized increase in the prices of goods and services in an economic society, substantially influencing the state's financial balance.

Chart no. 5 Inflation developments (2018-2022)



Source: National Institute of Statistics, CPI- annual data series, available at https://insse.ro/cms/ro/content/ipc%E2%80%93serie-de-date-anuala

Over the period under review, inflation in Romania increased by up to 9.2 percentage points, which is a considerable percentage, especially in the context of a country undergoing economic development.

In 2018, the inflation rate was 4.6%, with a decrease to 3.8% in 2019. In 2020, it reached 2.6%, and in 2021, there was an increase of 2.5 percentage points to 5.1%. A significant moment was in 2021, when the inflation rate reached 13.8%. The main causes of this include imports of goods from the European Union and other countries, involving customs duties, taxes, and specific duties, generating an increase in the prices of goods, and affecting taxpayers.

In parallel with these price increases, there has been an increase in the gross minimum wage in the country, leading to an increase in taxes paid to the state by economic agents and other public institutions at central and local level. Economic developments in Romania are characterized by increases in taxes, legislative changes and, in general, in the prices of goods and services.

Another aspect in the category of weaknesses of the Romanian tax system is the government debt, which is expanding during the period under review.

During 2018-2022, the government debt did not exceed RON 50 billion, accumulated both at central and local government levels.

In central government, government debt recorded values of RON 47.4 billion in 2018, RON 48.1 billion in 2019 and RON 48.5 billion in 2020, and then slightly decreased to RON 48.3 billion in 2021 and RON 47.9 billion in 2022.

Regarding the government debt of local governments, it was 1.4 billion lei in 2018, 1.3 billion lei in 2019, decreasing to 1.2 billion lei in 2020, 1.1 billion lei in 2021 and 1 billion lei in 2022.

Although there is a downward trend in government debt, it is still a weak point in the Romanian tax system, generating annual expenditure of over 40 billion lei. In the context of other competitive factors, it contributes to the economic downturn, reinforcing the fragility of the tax system.

Within the Romanian economic system, the paper mainly deals with the tax level, accounting for about 23% of the whole topic. Other significant issues include corruption, which according to statistics accounts for 18%, tax regulations for 15%, and access to finance for 14%. Political instability takes up 10%, while the remaining factors, such as inflation, labor, and innovation capacity, are below 10%.

We see that Romania's tax system has both strengths and weaknesses over the period under review. Among the positives are the growth of Gross Domestic Product and the factors that contribute to it, such as capital, labor, and the total productivity factor. In contrast, there are also critical issues such as the deficit, unemployment, the consumption index, inflation, and government debt. All of these interact within the economic system, and government decisions and regulations can bring about significant changes in the financial plan.

5. Conclusions

The research analyzed the evolution of the tax system over a five-year period, focusing on revenue and expenditure. Revenue increased from 141.35 billion lei in 2018 to 216.44 billion lei in 2022, while expenditure doubled to 497.71 billion lei in 2022. This analysis reveals the strengths and weaknesses of the Romanian tax system between 2018-2022.

Among the strengths, the Gross Domestic Product (GDP) has grown steadily from 95.17 billion lei in 2018 to 299.88 billion lei in 2022. Substantial capital shares (20-40%), a labor force with a notable return in 2022 (5%), and a total productivity factor between 30-75% demonstrate significant growth and recovery potential for the Romanian tax system.

On the weak points, the budget deficit is highlighted, reaching 80 billion lei in 2022, an unemployment rate increasing by 1%, the consumer price index rising to 113.80%, and inflation at a level of 13.8%. Government debt at central and local level totals 50 billion lei annually.

The findings suggest that the evolution of the Romanian tax system over the period under review reflects both growth and significant challenges. Proposed solutions include effective legislative regulation, accessibility to external funds, attracting labor and managing price increases for products and services.

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