THE IMPACT OF FISCAL – BUDGETARY POLICIES ON THE ENTERPRISE INVESTMENT DECISIONS

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Abstract

This paper analyzes the impact of Government decisions on the enterprise investment decision, taking into account the important role of the investments in economic growth. After presenting the fiscal policy instruments used by the EU countries to stimulate investments, we notice that the most widely used instruments are fiscal deductions, fiscal credits and tax rate reduction. On the other hand, in Romania we observe the deductible character of interest expenditures and fixed assets break-even expenditures, and although the 16% rate of income tax. In conclusion, the flat tax offers some advantages, among which we have observed the increase of the investment level, the increase of the budgetary incomes as a result of the increase of the tax basis, the increase of the attractiveness of the economic environment, with a positive impact towards attracting foreign investors, the decreasing of tax evasion.

Key words: fiscal-budgetary policy, investment decisions, flat tax, fiscal deductions.

1 Introduction

Investments play a central, multiplying role in economic growth, which can be explained by the fact that the enterprise carrying out the investment addresses fixed assets suppliers and the investment decision has a series of favourable effects on the economy: the suppliers’ turnover increases, benefits and state taxes increase, production in connected branches increases etc. Consequently, the Government is interested in interfering for investment stimulation and for creating favourable conditions, so that investors can resist in international competition, which is mainly done by the instruments of financial-monetary policy.

2 The coordinates of Romanian fiscal-budgetary policy

According to the Government Programme [Romanian Government, 2005] for the period 2005-2008, the vision of Romanian Government in the field of fiscal policy focuses on ensuring a stimulating and guiding role for taxes, in order to increase economic growth and development, to strengthen the tax system and the middle class, while in the budgetary field it focuses on the efficiency of budgetary allocation according to priorities, on the transparency of public expenditures, on the preservation of the multiplying effect of public expenditures on real economy. The main characteristics of fiscal-budgetary policies between 2005-2008 are subordinated to the objectives of encouraging economic growth and reducing inflation and refer to:

• establishing the deficit of the general consolidated budget at a level correlated to the macroeconomic objectives, as well as diminishing the quasi-fiscal deficits, in

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order to support the efforts of reducing inflation, according to nominal convergence criteria;

- supporting the convergence process of Romanian economy with European economies;
- reform of fiscal administration, in order to improve the collection of budgetary incomes;
- accelerating the fiscal decentralization process in order to actively involve local communities in the process of collecting and allocating public resources;
- decrease in taxes on labour, income and capital;
- decreasing contribution rates to social insurance in order to eliminate the disadvantage of fiscal competitiveness, of reducing subterranean economy;
- increasing the transparency of public expenditures;
- increasing the absorption capacity of pre-accession funds and, after 2007, of structural funds;
- continuing the harmonisation of fiscal-budgetary legislation with EU acquis.

In the market economies, it had been used several instruments of fiscal-budgetary policy of state intervention in the economy [Toma, M., 1998, 73-74], in order to support the enterprise’ investments, such as subsidies, reimbursable subsidies, contributions, fiscal exonerations, warranties etc. Governments benefit from a wide variety of special instruments in order to influence financial decisions of the enterprise, in general, and of investment decisions in particular. The most common are [Mihai, C., 2002, 216]: differentiated tax rates (according to the period, size, location, owner, company’s activity), rapid break-even of capital and credits or facilities for investment and employability. Thus, some firms can benefit from lower tax rates during limited periods or on a permanent basis. Using preferential tax rates influences the decisions of allocating the financial resources of the enterprise, but if lower tax rates already exist, the effect of preferential rates is minimized. An extreme case is the tax deduction for a certain period, which can be done on a discretionary basis, for certain firms, branches and activity sectors or for some areas or regions, such as disadvantaged areas.

3 Fiscal policy instruments of stimulating investments

3.1 EU countries

In the background of Romania integration in EU, a comparison with EU countries in the field of financial-monetary policy instruments used to stimulate investments and development, shows that only 12 of the 26 countries (in the next paragraph we analyze the case of Romania) make use of specific facilities, that is: Austria, Belgium, Denmark, France, Ireland, Latvia, Malta, Holland, Portugal, the United Kingdom, Spain and Hungary.

<table>
<thead>
<tr>
<th>Country</th>
<th>Instruments of stimulating investments and development (I+D)</th>
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<tbody>
<tr>
<td>Austria</td>
<td>Deductions: 25% for I+D expenditures. Up to 35% for expenditures above the arithmetic mean of these expenditures made by the enterprise over the past 3 years. Since 2003, deductions of 15% for some research and investigation expenditures, carried out in the enterprise</td>
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<tr>
<td>Belgium</td>
<td>Deduction: 13.5% for technological innovations to protect the environment and for lower energy investments.</td>
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<tr>
<td>Bulgaria</td>
<td>-</td>
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<tr>
<td>Cyprus</td>
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<td>Czech Republic</td>
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<tr>
<td>Denmark</td>
<td>Deductions: I+D project costs.</td>
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<td>Estonia</td>
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<tr>
<td>Country</td>
<td>Instruments of stimulating investments and development (I+D)</td>
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<tr>
<td>Finland</td>
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<td>France</td>
<td>Deductions: since 31st December 2005, 50% of the difference between (a) I+D expenditures of the current year and (b) the average of the I+D expenditures of the past two years, adjusted with the consumption index. It cannot surpass 6.1 million euros.</td>
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<tr>
<td>Germany</td>
<td>-</td>
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<tr>
<td>Greece</td>
<td>-</td>
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<tr>
<td>Holland</td>
<td>Fiscal wage reductions for the firms having employees involved in an I+D activity. Wage reductions of 40% up to 90,756 euros and 15% for what goes above. Wage reductions cannot surpass 7,941,154 euros per employer. Free break-even for assets protecting the environment and for licenses.</td>
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<tr>
<td>Hungary</td>
<td>Fiscal facilities for enterprises investing at least 100 million HUF in projects aiming at the environment or specific Internet activities, if the results cause considerable changes of the products or in the production process.</td>
</tr>
<tr>
<td>Ireland</td>
<td>Instant break-even. Capital expenditures in scientific research break even in the year when they are incurred.</td>
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<tr>
<td>Italy</td>
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<tr>
<td>Latvia</td>
<td>Deductions: 40% of the total sum of an important investment project. All built or renovated buildings have to preserve their ownership status for at least 10 years after the end of the project and for at least 5 years in the case of technology and equipment.</td>
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<tr>
<td>Lithuania</td>
<td>-</td>
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<tr>
<td>Luxemburg</td>
<td>-</td>
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<tr>
<td>Malta</td>
<td>Differentiated tax rates: a) for new companies, a reduced tax rate of 5% for the first 7 years, of 10% for the next 10 years and of 15% for the next 5 years; b) for the already existing firms 10% for 6 years and 15% for the next 5 years; c) other types of reductions for the reinvested profit. Deductions: for taxes below 65% for SMSE and 50% for other enterprises, whose credits are deducted from taxes.</td>
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<tr>
<td>Poland</td>
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<td>Portugal</td>
<td>Credit for I+D: a basic fiscal credit of 20% of the expenditures of the current fiscal year and an additional credit of up to 50% for the part of the expenditures surpassing the expenditure average of the past 2 years.</td>
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<td>Slovakia</td>
<td>-</td>
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<tr>
<td>Slovenia</td>
<td>-</td>
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<tr>
<td>Spain</td>
<td>Deductions: 30% of the expenditures of the respective fiscal year. If expenditures are above the expenditure average of the past 2 years, 30% is applied to a value equal to the average and 50% for what goes above.</td>
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<tr>
<td>Sweden</td>
<td>-</td>
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<tr>
<td>U.K.</td>
<td>It is allowed to write off a debt, representing I+D expenditures. There are special provisions for SMES.</td>
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The most widely used instruments are fiscal deductions, fiscal credits and tax rates reduction.

3.2 Romania

In Romania in the context of EU integration, fiscal-budgetary policy will have to offer the adequate instruments in order to satisfy three requirements, orienting the activity of enterprises towards investments:

1. *Focusing fiscal instruments on the investment* and thus on saving in order to invest. A differentiated tax system levied on the investment offers the advantage of a rapid and wide impact on the creation of capital.
2. Applying tax deductions to investments in the case of lack of capital, the conjectural deduction technique, with break-even rules, favourable to this technique, offers possibilities of expanding the investment cycle among cash-flows, also increasing the financial possibility to create and support capital markets. The efficiency of the fiscal agent allotted to the additional investment depends on his selectivity in sectors, which levies the introduction of the fiscal deduction instrument in a well-designed strategy. The problem to be solved under such circumstances remains that of the ratio between selectivity and fiscal equity.

3. Fiscal regulation of the investment is levied as an efficient means to stimulate the investment process based on capitalizing through sponsorship. Two fiscal strategies should be conceived: differentiated taxes and investment detaxations; drafting an adequate system of “reserves for investments” at the enterprise level, non-taxable, providing that a fraction of these funds be deposited in a bank, in an account with a known destination, with special rules for usage.

The three ways of implementing a selective fiscal policy oriented to capitalization require for the previous existence of two essential conditions: the possibility of establishing the exchange rate at a level that ensures the real power of the national currency and maintaining the interest rate within the limits of interest rates of international capital markets.

Thus, in the decision-making process, the enterprise is influenced by a series of factors, among which the fiscal-budgetary policy promoted by authorities, especially the tax system, by the level of corporate income tax or by the different fiscal facilities granted by the state to economic agents. Approaching investment decisions has to be connected to fiscal-budgetary policy, taking into account the effects of the higher or lower taxation on investments.

In the investment decision making process, the enterprises take into consideration the deductible character of an array of expenditures and their value constitutes important variables for the implementation of those particular decisions. It is mostly the case of interest expenditures and fixed assets break-even expenditures, respectively.

Break-even expenditures generate a fiscal economy through taxation and also influence the autofinancing capacity of the company, which may lead to superior economic and financial results. A high autofinancing capacity can also lead to less borrowing (because the company pays fewer taxes on accomplished fiscal economy), having a direct effect on the debt level and on interest expenditures, the result of this effect being the decrease of taxes and of the borrowed capital cost.

With regard to the means of establishing the deductibility of expenditures with report to interests and their impact upon capital costs, the legal provisions referring to corporate tax can either diminish borrowed capital costs or increase it, according to the specific context. In the long run, if the company reaches a subunitary debt level or the debt expenditure diminishes reported to the company’s income, on a global level this will lead to a decrease in the global borrowed capital costs given by the tax saving.

In this context, we can say that the tax regulations need to be analysed carefully not just strictly from the accountant’s point of view, but also from the perspective of the implications the latter generate and impose upon the fundamental financial performance indicators characteristic of the company itself and upon the investment decisions in general. In this way, the manager will be able to identify the most effective ways of raising the value of the company he leads by identifying a fiscal optimum.

The optimization of tax cost can lead to an increase of its competitiveness as a result of the decrease of tax costs. The enterprises can elaborate fiscal strategies that help them keep control of their tax costs by means of tax planning. The optimization of tax cost is a responsibility of tax management and has become a necessity as a result of the increase of the impact of tax systems upon enterprises. One first step towards the optimization of tax costs is represented by the possibility that the enterprise benefits from certain tax deductions.
or tax facilities in the establishment of current taxes. For this, the company has to be acquainted with the provisions of the Tax Code, so as to model the tax basis in its favour.

Tax cost diminishes as a result of the decrease of tax basis when the Government grants tax deductions or other facilities aimed to encourage the development of certain activities or branches of the economy. The influence of tax deductions on tax costs can be rendered starting from the relation that helps determine income tax. The succession of the dependencies established in view of the determination of tax costs is as follows:

\[
\text{Tax cost} = \text{income tax expenditure} + \text{the sum of all other expenses (taxes, contributions, special funds)} \tag{1}
\]

\[
\text{Income tax expenditure} = 16\% \times \text{Taxable results (fiscal)} \tag{2}
\]

\[
\text{Fiscal result} = \text{accounting result} - \text{tax deductions} + \text{undeductible incomes} \tag{3}
\]

\[
\text{Accounting result} = \text{Total income} - \text{Total expenditure} \tag{4}
\]

The enterprise diminishes its tax cost by benefiting from legal deductions granted by the current fiscal law.

The enterprises can chose between two accounting treatments stipulated by the accounting standards as regards tax expenditures. According to the basic accounting treatment, tax expenditures are regarded as expenditures of the current period, whereas the alternative treatment admits the capitalization of these costs, as they can be attributed to the construction of the asset in question. The basic accounting treatment leads to the acknowledgement of large amount expenditures within the financial year, which diminishes the income tax basis and implicitly the income tax, when interest expenses can be entirely deducted in the course of the current interval, since it is widely known that the deductibility of interest taxes depends upon the degree of capital indebtedness.

The alternative accounting treatment allows for the capitalisation of indebtedness costs, which accounts for the fact that these costs do not appear as registered in the expense accounts within the fiscal year, and they are capitalised within the asset accounts. But this treatment allows for the expenses to be avoided only during the current fiscal year, as these capitalised costs will subsequently appear in the expenses of the future fiscal years by means of the break-even of the assets in question. In this case, we are dealing with the allocation of indebtedness costs along multiple fiscal years, the former being deduced gradually from the taxable result. Another ways of diminishing tax cost is the reorientation of the enterprise in tax free areas or in disadvantaged areas, for whose economic development, enterprises benefit from tax deductions or considerable tax diminutions.

A company can decide to pursue its activity in such an area precisely in order to avoid elevated tax costs. It is necessary that fiscal authorities ensure an efficient system of taxes by ensuring the long term stability of the Tax Code stipulations regarding these facilities. Thus, certain fiscal decisions considered as beneficial as some point may prove to be no longer effective for the enterprise in the case of subsequent law modifications. For this reason, the company has to analyse a multitude of factors when it decides to invest, since the latter could have a substantial influence upon the company’s future situation.

In these circumstances, tax decrease for disadvantaged areas or the granting of certain fiscal facilities should not represent a sufficient reason for the company to decide to direct its interests towards that particular area. It takes a comparative analysis of deducted tax costs by reporting them to the disadvantaged area and to the possible supplementary costs that the company would incur as a result of basing its activities in the respective area. These supplementary costs may be related to transport, materials supply, etc., which could exceed the value of tax cost reductions.

At the beginning of 2005, Romania adopted the reduced flat tax level for personal income and for corporate income, which is 16%. Still, Romania is not the only European country which adopted such tax policy measures. The other European countries which made the same option are Estonia (26% - 1994), Georgia (12% - 2005), Latvia (25% - 1995),
Lithuania (33% - 1994), Russia (13% - 2001), Serbia (14% - 2003), Slovakia (19% - 2004) and Ukraine (13% - 2004). This orientation towards a flat tax is determined by the advantages it offers for the development of the business environment, among which we can notice that it encourages work and investments; it can contribute to the increase of the budgetary incomes by the increase of the tax basis (according to the Laffer curve); it lowers tax evasion by the decrease of this activity’s opportunity costs; it contributes to the increase of the attractiveness of the economic environment, with a positive impact towards attracting foreign investors.

The flat tax has its advantages in the area of investments, especially with regard to their amount. Before January 1st 2005, the income tax rate was still proportional, but its level was of 25%. Thus, under the influence of introducing the flat tax on the 1st of January 2005, it can be noticed that in 2005, in the field of investments, their level increased to 37,392.9 mil. RON from 30,935.62 mil. RON in 2004, which corresponds to a relative real increase of 13.4% [Lazar, S., Annals of Oradea University, Tom XV, 2006, 768]. This evolution has continued in 2006 when the investments had an increase of 16.1% in comparison with 2005, according to the Annual Statistic Reports.

4 Conclusions

In the context of European integration, Romania had to remove some of the fiscal facilities, according to the stipulations of the Code of Conduct for Business Taxation in EU which tries to avoid or eliminate those “harmful” measures that exist at the European level and that have an incidence over the localization of the investments.

It is important to assess the impact of reducing the level of corporate income tax and of the fiscal facilities on the enterprise’s investment decisions. In this context, although the enterprise has autonomy in taking the investment decisions, can not leave the fiscal-budgetary policies aside.

We consider that the fiscal factor plays an important role in the investment decision making process of an enterprise, but it must take into consideration also other aspects, as the infrastructure, the available labour, the legislation, the quality of the local services, etc. If the enterprise decides to establish its activities where the fiscal charge is more reduced and not where the production costs are smaller, the production will be less efficient.

References


