NOT ASSIGNING TAXES FOR REINVESTED PROFIT, A POSSIBLE FIRST FISCAL SOLUTION FOR SUPPORTING THE BUSINESS FIELD DURING THE DEEP FINANCIAL CRISIS IN ROMANIA

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Abstract:

Romania has been the sixth among the European Union countries with a high level of commercial deficit of 3.7 billion Euros during the first five months of 2009, according to the data published by Eurostat. The commercial deficit of Romania decreased 2.5 times between January and May, as compared to the same period in 2008, while the imports diminished by 36%, faster than the exports, which decreased by 21% as compared to the first five months of 2008. For the business domain, a decrease from plus 7-8% to minus 7-8% represents a real catastrophe, bankruptcies, relocation of some economic sub-domains. Therefore it is necessary that the Romanian government should take several urgent measures, especially fiscal, which could allow the quick development of the businesses, as the only solution for having a healthy economy in Romania. Even if the representatives of the state could be tempted to take short-term measures, increasing the added value tax – a way to bring money to the budget – we think that the government could find other average and long term economic measures, such as: not assigning taxes for reinvested profit, supporting the export production by warranties and counter-warranties, designing helping solutions for IMMs (small and medium companies), incrementing the trust fund for the rural credits etc.

Keywords: *the economic crisis, the exemption of the invested profit, anti-crisis measure, high economic rise rates*

JEL Codes: *F40; F36; K34; E62*

1. Introduction[1]

The yearly decline of the PIB (GDP - Gross domestic product) was faster and faster in the emergent economies of Europe in the second term as compared to the same period of the

[1] See also the Project of the Law by which the Romanian Government took the responsibility in front of the Parliament in September 2009, regarding the reorganizing of certain public authorities and institutions, the rationalization of public expenses, the support for the businesses and the compliance with the agreement-framework with the European Commission and the International Monetary Fund.

year 2008, the Baltic states having the worst situation: Lithuania -22.4%, Latvia -19%, Estonia -16.6%, while Slovakia had a decrease of 5.3% in the second term, Hungary 7.6% as compared to 6.7% in the first term (see Table 1).

In July, Romania has recorded an annual inflation rate of 5.06% as compared to June 2008 and a decrease of 0.77% beside the previous month, given the fact that the prices of the food decreased by 0.5%, the prices of the non-food goods rose with 0.14% and the fees for services, with 0.32% towards June 2009.

Romania had in July the highest annual inflation in the European Union (according to Eurostat), the average for EU being of 0.2%, while in the Euro area, the deflation was of 0.7%. The average rises of the prices all in all for the last 12 months (August 2008-July 2009) as compared to the previous 12 months (August 2007-July 2008), determined according to the index of the consumption price (IPC), as well as according to the harmonized index of the consumption price (HIPC), is of 6.6%. Although the decrease of inflation is significant during the second term, it was relatively slow, taking into account the vast extension of the contraction of the aggregate demand. The relative persistence of the inflation was fed by structural rigid ness in economy, by the discrepant adjustment of salaries, relative to the evolution of the work productivity in some domains, as well as by the possible effects of an increased incertitude (see Table 2).

In June 2009, compared to the same month of the previous year, the industrial production decreased by 5.9% (as adjusted series, the index has a fall of 8.9%), determined by the decline of the three main industrial domains: extraction (-21.7%), production and delivering of electricity, heat, gas, warm water and air conditioning (-5.2%) and the processing industry (-4.9%).

Relative to June 2008, the exports dropped by 17.5% for the Euro, but the imports had a decline of 38.0%. Compared to May 2009, the exports in June 2009 rose by 11.2% for the Euro, while the imports had a 6.3% rise for the Euro. The commercial deficit FOB-CIF2 in June 2009 was of 668.3 million Euros, 1.42 billion Euros less than in June 2008.

According to the estimations of the National Institute for Statistics of Romania, the GDP decreased by 8.8% in the 2nd term of 2009, relative to the same period of 2008, and if compared with the 1st term of 2009, by 1.2%.

[2] Also see INCOTERMS 2000

During the first semester of 2009, the execution of the general consolidated budget had a deficit of 14.38 billion lei, representing 2.7% from the gross domestic product. Following the budget rectification in August 2009, the budget deficit for 2009 was settled to 7.3% from the gross domestic product.

These financial data, as well as the forecasts made by the competent authorities, draw the picture of a deep economic crisis which can jeopardize the economic stability of Romania.

2. Forecast changes

The economic crisis, global phenomenon affecting structurally the Romanian economy enforces the adoption of exceptional measures which, being efficiently and promptly applied, should lead to reducing its effects and to create the basis of the development of the national economy. At the same time, these measures must include the carrying out of the obligations running from the Agreement Memorandum, concluded between the Romanian Government and the European Commission and from the Stand-by Agreement between the Romanian Government and the International Monetary Fund (IMF)3.

According to public governmental sources, it is necessary, first of all, to reduce the budgetary expenses by reorganizing the public authorities and institutions, by reducing the staff expenses of the public authorities and institutions, by strengthening the financial discipline of the autonomous administration, national companies and commercial companies with integral or majority state capital, by limiting the possibility of cumulating the retirement payment and the salary.

Another exceptional measure, suggested by the companies this time, and referring to the support of the businesses for the consolidation of their capacity to go beyond the financial difficulties generated by the present economic context, and for the development of the commercial circuit. This includes the exemption of the invested profit, the stimulation of the renewal of the national vehicle park, including the one for the agricultural works, facilitating the access to the financing of the beneficiaries in the agricultural and food domain.

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[3] The financing agreement with IMF is valid for a period of 24 months, the Fund being about to transfer a total of 12.95 billion Euros to Romania, in eight installments from a backup loan of 19.95 billion Euros, of which 5 billion Euros come from the European Commission, 1 billion Euros from the World Bank and 1 billion Euros from the European Bank from Reconstruction and Development and the European Bank for Investments. Romania has received up to now a total amount of 6.57 billion Euros from the IMF, the 2nd instilment being of 1.85 billion Euros.

It can be inferred that these two types of solutions cumulatively and simultaneously applied, can create the premises of the Romanian economy acceding to a developing trend and can reduce the budgetary deficit.

The government considers an economic contraction of 8.5% for this year and the value for the GDP of 497.3 billion lei. Last year, the value of Romania's GDP was of 504 billion lei (136.8 billion Euros).

The IMF also forecasts for this year a reduction of the Romanian economy with 8.5%and anticipates a rise in 2010 with 0.5%.

On the other hand, the National Forecasting Commission (NFC) estimates, in its preliminary autumn report, that the Romanian economy will decrease by 7.7% this year, followed by a rise in the second term of 2010, with 1% as compared to the first three months of the next year.

For the whole year 2010, NFC considers a real increase of 0.5% of the gross domestic product of Romania.

Romania will have an economic fall of 5.7 percent in 2009, but it will avoid a collapse similar to the Baltic countries, due to a low debt in the private sector and to the reduced dependence from the external trade, as Moody's predict.

The rating agency added that the economy will start to rise in 2010, having an increase of 0.2 percent.

The Moody's analysts consider that the situation of liquidity on the local market improved starting with February, due to the external financing of 20 billion Euros, which came by the agreement with IMF.

"As the financial system gets stable, the funds will allow the central bank to reduce, little by little, the interest rates in order to back up the recovery of the economy. However, as difficult as the recession will be, Moody's believes that the economy will avoid a major collapse of the kind experienced by the Baltic states, due to the relatively low debt in the private domain and the more reduced dependency from the international trade".

Moody's added that the inflation rate will go to 4.9% from GDP in 2009, above the target established by the National Bank of Romania, but will get diminished to 3.7% next year.

Romania's weaknesses are the control of the budgetary deficit, the risks for the macroeconomic stability, but also the belated plan for structural reforms4.

3. Measures for the budgetary-financial discipline of economic operators

The Government's project mentioned above proposes the achievement of complete legal frame to regulate the management and the functioning of the autonomous companies, of the national companies and of the companies with integral or major state capital in order to enhance the financial discipline and to reduce the expenses, especially for the staff. For this, the following is provided:

- The achievement of the salary politics for the above mentioned economic operators as a law, the nomination of state representatives, of administrative territorial authorities respectively, at the level of the leading bodies to promote this politics;
- The establishment of a unitary practice for all the economic operators with integral/major state capital or patrimony, regarding the negotiation term of the collective work contract, correlated with the approval term of the income-expenses budget;
- Terms for the economic operators to present the income-expenses budgets to the ministries, specialized bodies of the public administration and the central or local public authorities, to which they are subordinated, by which they are coordinated or under whose authority they function, as well as of the deadlines for the necessary documentation in the approval of the budgets and the sanctions provided for non-complying with them.

Some measures are also necessary in order to support the businesses in their endeavors to surpass the financial difficulties and to improve the commercial circuit5.

Adopting certain legislative solutions can stimulate competition and innovation can attract investments, develop the job market and improve the work conditions6.

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[4] Also see the Deloitte Report entitled Romania, the economy at a crossroad: strategies to overcome the critical position. The first analysis from the CEO point of view of the local businesses, Bucureşti 2009, referring directly to the Efforts of Businesses to minimize the operational risks requires macroeconomic stability.

[5] See also Review of the EU Sustainable Development Strategy (EU SDS) − Renewed Strategy Council of the EU, Brussels, 9 June 2006, 10117/06, p.24

[6] Gregoire Brouhns, Introduction au droit public belge et europeen de l'economie, Larcier, 2003, Bruxelles, p.33

In order to generate and maintain the high rates of economic rise on long term, it is necessary to make steady efforts for developing competitive economy able to develop technological performances, according to the competition conditions in Europe and in the world.

In this context, but also for creating additional financing sources for the economic agents, it is necessary to adopt some fiscal measures, such as the exemption for the profit invested in technology (machines, equipment, installations) to be used for the fundamental activity, and the amount for which the facility was applied will not be redeemed financially.

Nowadays, the investments in such equipment are financially redeemed by deducting them from the calculation of the profit to be taxed as redemption expenses. As a fiscal stimulation, made to have the respective investments come back faster, the tax payers can opt for the accelerated redemption, which involves having no more than 50% reduced during the first year of functioning from the input value of the respective equipment.

Also, for the small and medium companies, a new mechanism is to be applied involving the reimbursement of the sums paid as tax on profit for the investments in technological equipment (machines, tools, installations), as well as in computers and their additional facilities, a mechanism managed by the Ministry for Small and Medium Companies, Trade and Businesses.

In order to indemnify the significant rise of investments for the companies, other European countries (Italy, Estonia, Austria, Holland, Luxemburg, Poland) take similar fiscal measures to encourage the investments.

Introducing this fiscal facility will produce new work places and will lead at the same time to direct effects in the improvement of the investments motivation, in the orientation of the economic agents to high technology domains for obtaining a high added value with an increased impact on production and exports.

4. Conclusions

Not assigning taxes for the reinvested profit is a measure longly expected by the employers. They expressed their wish for this measure to be applied ever since the beginning of the crisis this year, appreciating that such a fiscal solution beginning with the 1st of January 2010 is useless for companies, as many will not be able to benefit from this facility.

We believe that this measure being applied this year could save a part of the small venture capitalists because most of the companies from Romania will be profitable only in 2009. In 2010, the companies will not be able to invest any longer, because, on the one hand, some will not resist on the Romanian market, and the remaining ones for the next year will not have any profit, most of them registering losses. Not assigning taxes for the reinvested profit has also the effect of reducing the tax paid, brings new jobs or helps maintain the existing ones and also push the Romanian economy up.

The gains of the venture capitalists wouldn't be very high, but at least they represent a step forward. Moreover, we believe that applying this measure to all types of investments in the production field is imperiously necessary. We think that not assigning taxes for the reinvested profit could also represent the first anti-crisis measure to be taken in 2010, even in the context in which the budgetary impact of tax exemption for reinvested profits will rise to 3.44 billion lei, 0.59% of GDP respectively, because it will create added value, will generate and maintain high economic rise rates. It will also represent the basis for the development of a competitive economy able to compete in Europe and in the world from the technological point of view.

Table 1 - Balance of payments euro-indicators for EU27 and the euro area (EA16)

(in bn euro)

(in bn euro)	**Q2/2008**	**Q3/2008**	**Q4/2008**	**Q1/2009**	**Q2/2009**
EU27 current account balance	-76.3	-72.6	-61.0	-54.6	**-49.2**
EU27 balance of trade in services	22.6	20.1	21.4	13.1	**17.5**
EU27 current account balance as % of GDP	-2.4%	-2.3%	-1.9%	-1.9%	**-1.7%**
EA16 current account balance	-31.1	-23.1	-29.5	-40.7	**-25.4**
EA16 balance of trade in services	13.1	13.4	6.2	0.5	**7.4**
EA16 current account balance as % of GDP	-1.3%	-1.0%	-1.2%	-1.9%	**-1.1%**

Source: Eurostat for EU27 data, ECB for euro area (Eurostat-Newsrealease euroindicators 144/2009 - 7 October 2009)

Table 2 - Growth rates of GDP in volume

Growth rates of GDP in volume (based on seasonally adjusted data)										
	Percentage change compared with the previous quarter					**Percentage change compared with the same quarter of the previous year**				
	2008		**2009**		*Previously released value**	**2008**		**2009**		*Previously released value**
	Q3	**Q4**	**Q1**	**Q2**	*2009 Q2*	**Q3**	**Q4**	**Q1**	**Q2**	*2009 Q2*
EA16	-0.4	-1.8	-2.5	**-0.2**	*(-0.1)*	0.4	-1.8	-4.9	**-4.8**	*(-4.7)*
EU27	-0.4	-1.9	-2.4	**-0.3**	*(-0.2)*	0.6	-1.7	-4.8	**-4.9**	*(-4.8)*
EU Member States										
Belgium	0.0	-1.7	-1.7	**-0.3**	*(-0.4)*	1.1	-1.0	-3.1	**-3.7**	*(-3.8)*
Bulgaria**	:	:	:	**:**	*:*	6.8	3.5	-3.5	**-4.9**	*:*
Czech Republic	0.5	-1.3	-4.8	**0.1**	*:*	2.9	0.5	-4.5	**-5.5**	*:*
Denmark	-1.4	-2.0	-1.3	**-2.6**	*:*	-1.7	-3.7	-3.6	**-7.0**	*:*
Germany	-0.3	-2.4	-3.5	**0.3**	*(0.3)*	0.8	-1.8	-6.7	**-5.9**	*(-5.9)*
Estonia**	-3.0	-4.5	-6.0	**-3.4**	*(-3.7)*	-3.2	-9.2	-15.0	**-16.1**	*(-16.6)*
Ireland	0.5	-5.6	-2.3	**0.0**	*:*	-1.2	-8.0	-9.3	**-7.3**	*:*
Greece	0.4	0.3	-1.2	**0.2**	*(0.3)*	2.7	2.4	0.3	**-0.3**	*(-0.2)*
Spain	-0.6	-1.1	-1.6	**-1.1**	*(-1.1)*	0.5	-1.2	-3.2	**-4.2**	*(-4.2)*
France	-0.3	-1.4	-1.4	**0.3**	*(0.3)*	0.1	-1.7	-3.5	**-2.8**	*(-2.6)*
Italy	-0.8	-2.1	-2.7	**-0.5**	*(-0.5)*	-1.3	-2.9	-6.0	**-6.0**	*(-6.0)*
Cyprus	0.1	0.2	-0.6	**-0.4**	*(-0.5)*	3.3	2.5	0.8	**-0.7**	*(-0.7)*
Latvia	-1.8	-4.7	-11.0	**-0.8**	*(-1.6)*	-5.8	-10.7	-18.5	**-17.3**	*(-18.2)*
Lithuania	-0.3	-1.4	-10.2	**-9.8**	*(-9.8)*	2.0	-1.3	-11.6	**-20.4**	*(-20.4)*
Luxembourg	-0.4	-2.9	-1.7	**-0.3**	*:*	-0.7	-3.9	-5.9	**-5.3**	*:*
Hungary	-1.0	-1.9	-2.6	**-2.0**	*(-2.1)*	0.3	-2.2	-5.6	**-7.3**	*(-7.4)*
Malta	0.0	-1.1	-1.2	**-0.9**	*:*	2.1	0.5	-1.7	**-3.0**	*:*
Netherlands**	-0.4	-1.1	-2.7	**-1.1**	*(-0.9)*	1.9	-0.7	-4.5	**-5.4**	*(-5.1)*
Austria	-0.4	-1.0	-2.7	**-0.5**	*(-0.4)*	2.0	-0.1	-3.8	**-4.5**	*(-4.4)*
Poland	0.6	-0.1	0.3	**0.5**	*(0.5)*	4.9	2.6	1.7	**1.4**	*(1.4)*
Portugal	-0.5	-1.8	-1.8	**0.3**	*(0.3)*	0.3	-2.0	-4.0	**-3.7**	*(-3.7)*
Romania**	-0.1	-2.8	-4.6	**-1.1**	*(-1.2)*	9.2	2.9	-6.2	**-8.7**	*(-8.8)*
Slovenia	0.7	-4.1	-6.4	**0.7**	*(0.7)*	3.7	-0.9	-8.9	**-9.0**	*(-9.0)*
Slovakia**	1.8	2.1	-11.0	**2.2**	*(2.2)*	6.6	2.5	-5.6	**-5.3**	*(-5.3)*
Finland	-1.1	-2.5	-3.0	**-2.6**	*:*	0.9	-3.0	-6.5	**-8.9**	*:*
Sweden	-0.5	-4.9	-0.9	**0.2**	*(0.0)*	0.2	-5.1	-6.5	**-6.1**	*(-6.3)*
United Kingdom	-0.7	-1.8	-2.5	**-0.6**	*(-0.7)*	0.3	-2.0	-5.0	**-5.5**	*(-5.5)*
EFTA Countries										
Iceland	1.8	3.2	-5.9	**-2.0**	*:*	-3.4	1.6	-7.1	**-3.1**	*:*
Norway	-0.9	0.4	-0.8	**-1.3**	*(-1.3)*	1.2	0.5	-0.7	**-2.5**	*(-2.5)*
Switzerland	-0.4	-0.6	-0.9	**-0.3**	*(-0.3)*	1.3	-0.2	-1.6	**-2.1**	*(-2.1)*
Main economic partners										
United States	-0.7	-1.4	-1.6	**-0.2**	*(-0.3)*	0.0	-1.9	-3.3	**-3.8**	*(-3.9)*
Japan	-1.3	-3.4	-3.3	**0.6**	*(0.9)*	-0.3	-4.5	-8.4	**-7.2**	*(-6.5)*

Source: http://ec.europa.eu/eurostat (Eurostat-Newsrealease euroindicators 150/2009 - 22 October 2009)

: Data not available.
* See News Release 125/2009 of 2 September 2009.
** Percentage change compared with the same quarter of the previous year: non-seasonally adjusted.

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