

STUDY. Price increases are felt more sharply by low-income Romanians

In 2023, the number of people at risk of poverty will increase if the authorities do not use all monetary and non-monetary instruments at their disposal to reduce inflation as soon as possible

Inflation affects everyone, but not in the same way. The poorest Romanians ended up experiencing an average inflation rate 1.4% higher than that calculated for the entire population of Romania, is the conclusion reached by a group of researchers from the Institute for Economic Studies - Europe (Christian Năsulea, Radu Nechita and Diana Năsulea). They analysed the statistical data collected by the INS between October 2021 and October 2022 and concluded that reducing inflation is essential to protect the savings and the well-being of the population. Along with monetary policy measures, all non-monetary instruments at our disposal must be used as soon as possible so as not to jeopardise the standard of living. The study "The Rising Cost of Living: Recommendations for Reducing Inflation" can be downloaded here: <https://ies-europe.ro/studii/cresterea-costului-vietii>.

The prices of most categories of food products recorded higher increases than inflation in October 2022, compared to the prices of October last year. The biggest price increases are for cooking oil (+41.9%), milk and dairy products (+26.3%), milling and bakery products (26%), vegetables and canned vegetables (+24.7%), eggs (+24.7%) or sugar (+22.9%). In total, food products have a weight of 33.02% of the consumption basket, and the fact that their price increased by 20.58% decisively influenced the general inflation in Romania.

The price increases recorded in two other important product categories, energy (+32.4%) and fuels (+19.7%), also contributed to the inflation that Romania's economy is facing today, 15.3% inflation for October, which low-income Romanians felt as 16.7%.

"To understand why inflation affects poorer people more, one must consider that wages tend to adjust more difficultly to market conditions. In an inflationary situation, low incomes grow slower, leading to a decline in purchasing power for the poorest families. Inflation makes the poor even poorer," said Diana Năsulea, PhD Candidate with the Bucharest University of Economic Studies, one of the authors of the study.

A better understanding of the phenomenon emerges from the analysis of how Romanians prioritise their expenses. Thus, the poorest 10% of Romanians allocate 48.5% of consumption expenses to the purchase of food products and non-alcoholic beverages, while the richest 10% of Romanians allocate only 24.2% of their consumption expenses for the same products. At the same time, the poorest allocate up to 15.2% of their income for home maintenance, energy, and fuels, while rich Romanians allocate 13.2% of their consumption expenses for the same products.

The impact of inflation is also overwhelming on retirees, who have difficulties in achieving a decent standard of living. In this case, the policies of post-December 1989 governments have led to a situation

within the pension system of a "severity everyone instinctively guesses, but which is underestimated by the public and ignored by the actions of the politicians", say the researchers from IES-Europe.

"This situation is a direct consequence of the structure of the state pension system, which provides pensioners with relatively small sums compared to the value of contributions paid during their working lives. If they were invested in a capitalised pension system, the resulting pensions would be much higher", says Radu Nechita, associate professor at Babeş-Bolyai University.

We smoke excise duties with VAT

Another category of products that burn Romanians' pockets is that of alcohol and tobacco, for which the state imposes excise duties with the stated aim of encouraging responsible behaviour in the consumption of these products.

"Excise duties contribute to the increase in prices of these product categories. In other words, the state takes care of us by increasing the price of some products that we like, and the impact of excise duties on the final price is not at all negligible", notices Christian Năsulea, lecturer at the University of Bucharest, who adds that, for example, the application of excise duties and VAT can lead to a two-thirds increase in the shelf price of spirits.

It is almost the same with tobacco products: the excise duty and VAT applicable to the excise duty represent 64% of the shelf price of a pack of cigarettes, which means that the application of the excise duty almost triples the selling price of a pack of cigarettes. For cigars, the excise duty and VAT applied to the excise duty account for over 53% of the shelf price. "In short, we smoke excises," say the authors of the study.

Starting from January 1, 2023, the pockets of Romanians will also be affected by the increase in the price of sugar-based soft drinks, as a result of the increase in VAT for these drinks, from 9 to 19%. This charge falls under the category of regressive taxation, which tends to affect lower-income consumers more, i.e. those who already spend a higher proportion of their income on food and drinks.

"Increasing the level of taxation on sugar-based soft drinks could translate to fewer resources for the purchase of healthier foods. It remains to be seen if their declared goal, namely reducing sugar consumption to prevent certain diseases, will be achieved", says Diana Năsulea. She draws attention to the fact that, when the price of a product increases considerably, consumers will turn to substitutes on the market, which, however, can be more harmful than the original product, a fact that compromises the declared objective, that of encouraging the population not to consume harmful products.

In conclusion, the authors of the study say that many taxes are introduced with the motivation of public utility, public health, the interest of the citizen or the fulfilment of other important objectives of a social nature, but often the main objective, and sometimes the only one, is that of collecting revenue for the state budget.

"Even if we accept the objectives of taxation as legitimate and identify situations where these objectives would be fully met by taxation, ultimately the reality is that taxation reduces the purchasing power of citizens. Moreover, taxation is supplemented by non-fiscal regulation, which make the activity of economic agents difficult or create barriers to the entry of new operators into the market. This leads to higher prices and less competitiveness on the international market," says Christian Năsulea.

Energy. Price controls produce negative effects felt over time

"If in the case of products such as tobacco, alcoholic beverages or sugar-based soft drinks we can identify public health issues that could be used as justification for introducing additional consumption taxation, these interventions are much more difficult to argue for in the field of energy, especially at a time when Romanians are struggling with the shortcomings caused by the galloping increase in prices. Of course, reducing pollution can be and is used as an argument to justify excise duties on energy products, but the priority should be to increase the availability of energy of any kind in a country where a large percentage of the population lives in a state of energy poverty", declares Radu Nechita.

The discussion is important because energy products have an important weight in household expenses (8.3% in Electricity, gas and central heating, respectively 8% in Fuels). The current situation of prices in the field of energy is influenced by several factors that act on demand and supply, on the expectations of producers and consumers. Some of them have been operating for a long time, others have recently joined. It is about the regulatory "chasing" of energy sources considered non-green, such as coal, shale gas, diesel and, in the near future, gasoline; fiscal "persecution" - through explicit (excise) or implicit (carbon taxes) overtaxation; respectively the consequences of the Russian invasion in Ukraine, with the uncertainties, disruptions and destruction inherent in a war, combined with the political decisions to sanction the aggressor state (embargo).

However, the interventions of the authorities in the monetary field and the regulation of the energy sector have a particular impact on the evolution of prices in the field of energy. Price controls produce negative effects felt over time by a large number of people, including those who initially enjoy this "gift". The authors of the IES-Europe study "The Rising Cost of Living: Recommendations for Reducing Inflation" give the example of the capping, at a price slightly above half of the market price, of products such as firewood, briquettes and pellets, a measure that led to the disappearance from the official market of these products and the emergence of a parallel market.

"This situation has benefited illegal deforestation networks and increased the vulnerability of the poorest inhabitants of the country", says Radu Nechita, who recommends abandoning price capping strategies (because they demotivate both saving and resource production) and mitigating the social impact by other compensation mechanisms, subject to income.

During this period, the state increases the level of regulation and the level of taxation, which will lead to an increase in costs. Capping keeps prices artificially low, which is happening now, but those costs are passed on to the future, either directly, through compensation, or indirectly, through the aforementioned loss of competitiveness.

"In the short term, a mechanism must be found to stimulate economising resources, also by the beneficiaries of the aid, and the future adoption of measures that include price controls must be avoided, even the evocation of this kind of ineffective and counterproductive measures must be abandoned", says Radu Nechita.

In the medium term, electricity and gas interconnection efforts need to be accelerated so that consumers win through increased competition and security of supply. The extraction of gas from already identified gas perimeters should be intensified, such as the 42-84 billion cubic meters from the Neptun Deep area (Black Sea) or the 30 billion cubic meters from Caragele (Buzau county) and prospections must be

continued, including for shale gas. An important contribution of the state would also consist in ensuring legislative stability, explicitly and publicly requested by Romanian and foreign investors.

In the long term, Romania has the interest to position itself explicitly and pro-actively in favour of nuclear energy, alongside France, in all EU courts. Increasing the production of nuclear power, even critically revising norms that prove to be excessive, then stabilising them in order to be able to move to standardisation, "series" production are also measures recommended by the authors of the study so that the costs of building a nuclear power plant are significantly reduced, without quality reduction.

The field of telecommunications is the outlier

The report of the Institute for Economic Studies - Europe highlights another interesting thing: there is an atypical field for the Romanian economy, that of telecommunications. It is the only area in which there was a decrease in prices between October 2021 and October 2022, with the price of telephone services falling by 0.76%. Although Internet access services saw a 3.33% price increase between 2015 and 2022, this was well below the cumulative inflation rate for the same period (33.72%).

The quality of services is also very high, fixed internet speed in Romania being in the top 10 worldwide. In Romania, the average download speed through fixed connections was, in October 2022, the second highest among EU countries, after France, Romania being surpassed at the European level only by Switzerland and Monaco. The explanation lies in the fact that, although regulation in the telecommunications sector exists, it does not restrict competition. Consumers benefit because the level of regulation is lower, barriers to market entry were very few before ANCOM was established, and products and services are not overtaxed.

"As a recommendation, further opportunities should be found for de-bureaucratisation and for simplifying market access for potential investors. From the point of view of taxation, no special measures need to be taken. The authorities must resist the temptation manifested in other fields, to oscillate unpredictably between subsidising and overtaxing", Christian Năsulea also declared.

The study "The Rising Cost of Living: Recommendations for Reducing Inflation", carried out by Christian Năsulea, Radu Nechita and Diana Năsulea within the Institute for Economic Studies - Europe (ies-europe.ro), based on the qualitative analysis of some public information, from databases of Eurostat, OECD, World Bank, WHO and INS is part of a pan-European research project coordinated by Epicenter Network (epicenternetwork.eu). The first study in this series was published by the authors in June 2022. IES-Europe is a non-governmental organisation founded in 1989, whose main activities are related to economic education and the promotion of the principles of classical liberalism in public policy and society in general. Epicenter is an independent network of non-governmental organisations that aims to inform public debate on the public policies of the European Union and to promote the principles of a free society based on the economic expertise of its members.