

INCREASE OF CONSUMER PRICES IN ROMANIA IN THE FIRST YEAR AS A MEMBER STATE OF THE EUROPEAN UNION

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This analysis deals with several theoretical aspects about how prices' inflation is measured in Romania, the role of national and harmonized indices of consumer prices as well as the main conceptual differences between such indices. The analysis of harmonized ICP in Romania in the 11 years since it has been calculated, as well as of the differences between EU states during the first year after Romania's accession to EU is based on data published by the official statistics of each member state, as published by Eurostat. Even if the inflation has significantly decreased during the last years in Romania, it is still 2.8 percentage points above the EU average, which places it in the higher quartile interval.

Key words: National Index of Consumer Prices, Harmonized Index of Consumer Prices, annual average inflation rate

Since January 1997, based on a harmonized methodology devised by European statisticians, under the guidance of Eurostat (The Statistical Office of the European Communities based in Luxemburg), each member state calculates and publishes, on a monthly basis, a Harmonized ICP. Financial markets equally place a high importance on the harmonized ICP, as it provides indices comparable among EU member states. HICP is used for several purposes: for indexing social benefits and contracts, as input for other economic analyses and as the main tool to assess price stability in the Euro-zone. The Harmonized ICP was established to measure and compare the national inflation in the countries of the Euro-zone and of the European Union. Initially, HICP was used to evaluate the prices' stability and convergence - criteria to be met when joining the Economic and Monetary Union. More recently, the focus has been placed on the aggregated HICP for a group of countries, especially for the Euro-zone, as it is a central indicator of the single monetary policy of the European System of Central Bank and of the European Central Bank in the Euro region, being the basis for the calculation of the Monetary Union Index of Consumer Prices (MUICP). This focus shift reflects the objective of stability aimed at by the European Central Bank, which defines price stability as the year-on-year MUICP level that is less than, but close to 2%.

The harmonized indices of consumer prices are a set of indices of consumer prices calculated in a harmonized approach, based on common definitions and methodologies. The main objective was to provide a comparable measure of the consumer price inflation in the European Union. It is the only official assessment of this inflation in the euro-zone that is used within the monetary policy. All of European Central Bank's objectives regarding inflation is based on the HICP calculated for the Euro-zone.

The HICP represents the best possible statistical basis for international comparisons with respect to consumer prices evolution.

HICP is calculated based on a harmonized methodology for all member states and includes all categories of the household final monetary consumption expenditures. To note that the relative importance of consumers expenditures for individual products vary from one country to another and, as a consequence, there is no common "uniform basket" for all member states, as consumption habits of one household vary from one country to another. Each country uses a representative "basket", which should reflect the final household consumption. This "basket" corresponds to the official classification of goods and services, also known as COICOP/HICP. The index covers all final household monetary consumption expenditures.

The geographical and demographical coverage has been harmonized in all member states. All sectors of population are covered with respect to their plan of expenditures, irrespective of whether they are wealthy or poor households, whether they are in the urban or rural area, whether they belong to the private or the institutional sector. The expenditures of foreign visitors, including tourists and cross-border clients, have been integrated in the HICP of the member states where purchases were made, according to the concept of

final household monetary consumption expenditures in force on the economic territory of that member state. Business expenditures have been excluded by definition. Such a harmonization guarantees that foreign tourists expenses that have not been covered so far by all member states, are taken into account only in the country where purchases have been made. The demographic and geographic coverage of the Harmonized ICP is full, with no omissions or overlaps. Apart the national ICP, the harmonized ICP is published currently on a monthly basis. While the national ICP has been calculated since 1960, the HICP has been calculated since the beginning of the 90's for the old member states. Data concerning the new member states are comparable only after 2000.

The National Institute for Statistics calculated a HICP for Romania from the very beginning, in 1997, but it became mandatory once Romania joined the European Union in January 2007. The two indices are used for **specific purposes**:

- a. ICP is used to substantiate the monetary policies (especially by the National Bank of Romania), the social policies (to set the minimum wage, the indexations, the social benefits, the pensions, etc.) and the economic, budgetary and fiscal policies on a national level;
- b. HICP is exclusively used to compare, at an international level, the level of inflation among member states and to establish the monetary policy at the EU level.

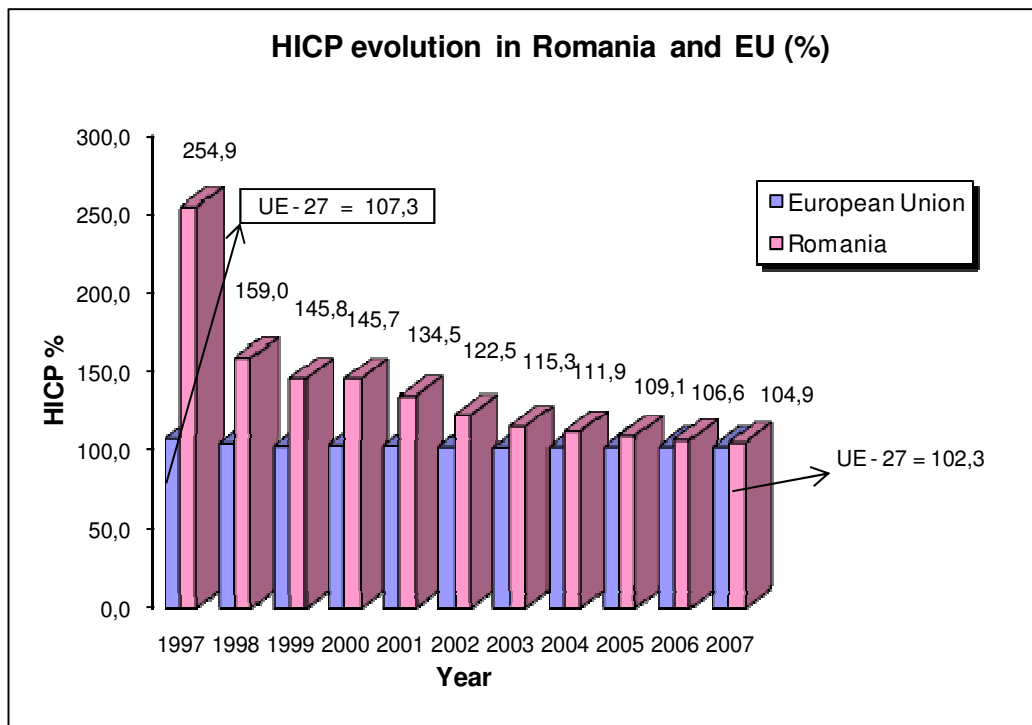
The main differences between the national ICP and the harmonized ICP are.

- 1) the classification used in aggregating the expenditures on groups and sub-groups of goods and services:
 - In the national system a list of goods and services is used for the calculation of ICP, that is structured on 54 entries of food products with 369 varieties, 112 entries of non-food products with 921 varieties and 50 entries of services with 445 varieties, significant for Romanian population's consumption.
 - In the European system a classification of expenditures is used based on the purpose of the consumption (COICOP - Classification of Individual Consumption According to Purpose), which regroupes the entries in the national system, according to this classification. For instance: within "transportation" group, HICP includes purchases of new vehicles and passenger cars, transportation services, fuels and lubricants, repairing services, while the similar group within ICP includes only transport services, the rest falling under the "non-food goods" group.
- 2) reference populations
 - ICP covers the effective consumer expenditures of Romanian population, namely the prices and tariffs paid by Romanian residents for the purchase of products and services in Romania;
 - HICP also takes into account the expenditures made by foreign tourists on the Romanian territory, based on data estimated from the balance of payments – separately for transportation, accommodation, food, leisure activities.
- 3) other differences:
 - for insurance, the HICP quantifies the balance between the premium and the damages paid while ICP includes the premium paid on mandatory insurance policies;
 - for medicines, HICP takes into account only the actual household expenditures, while ICP takes into account gratuities, apart net expenditures;
- 4) indices' reference period
 - for **HICP**: the index is calculated and published as compared to the previous year's average and, again for comparability reasons, the weights used by each country in the HICP calculation are expressed in prices for December of the previous year.
 - for **ICP**: the index is calculated both as compared to the previous month of the same year (it highlights the month-to-month price evolution), as well as compared to December of the previous year (it reflects the evolution of prices since the beginning of the year);

It should be noted that, irrespective of the basis for the calculation of ICP or HICP, based on the relations between 2 indices calculated with the same fixed basis, similar indices can be obtained in any other reference basis. In other words, from the ratio of two HICP for two different months in one year (calculated

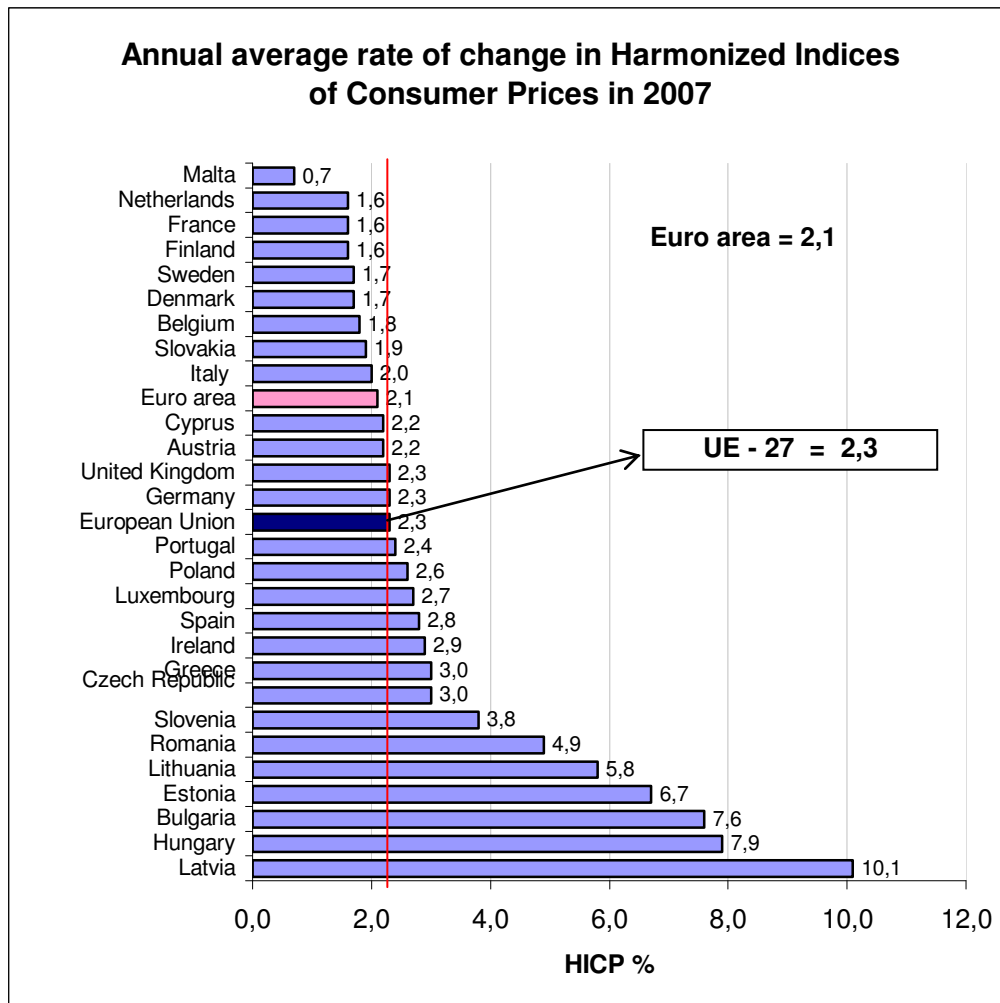
based on the previous year's average) we can calculate the HICP of one month as compared to the previous month of the same year and to compare it with the national ICP of that period. We could notice then that between HICP and ICP for the same calculation period there is no difference in value or there is a marginal difference, of around 0.1 percentage points. For instance, HICP at the end of 2007 (December 2007 as compared to December 2006) was 106.7% and ICP was 106.57% for the same period (that is a difference of 0.03 percentage points).

In Romania, HICP has witnessed a constant decrease since 1998. In 1997 the average level of consumer prices increased 2.5 times as compared to 1996, while the increase was only 7.3% at the level of the European Union, and it reached 4.9% at the end of the period. However, HICP in Romania is still two times higher than the European average.



Comparing HICP of EU member states

In order to assess Romania's position in terms of inflation when it joined the European Union, we compared HICP for all member states in December 2006.



The difference between the minimum HICP (Malta) and the maximum HICP (Latvia) was of 9.4 percentage points in the analyzed period, Romania ranking sixth with a HICP of 104.9%. The accession of the two states on January 1, 2007 contributed to a slight increase of HICP.

To note that there are old EU member states, with a developed economy, whose HICP is higher than the European average. Spain belongs to this group, with 102.8% (+0.5 percentage points above the EU-27 average) and even Luxembourg, with a HICP of 102.7% (+0.4 percentage points above the EU-27 average).

For the end of 2008, the National Forecast Commission estimates an inflation rate of 5.4%, while the National Bank of Romania estimates an inflation rate of 5.9% and an annual average of 7%. The European Commission estimates for 2008 a HICP for Romania of 105.6%, forecasting a decrease to 104.5% in 2009. According to the estimations of the European executive body, it is expected that inflation in Romania be influenced mainly by the agricultural deficit of 2007 and also by the potential increase in international prices for fuels and goods. EC estimates that Romania's budgetary deficit will be around 3.2% of GDP in 2008, higher than the deficit in 2007.

As a conclusion, even though the prices increase has been tempered in Romania during the last years, it remains above the European average, decreasing populations' purchase power. Only a real and sustainable economic increase can limit the consumer prices increase, with a long term impact.

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