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How Romanian bread may affect distilled spirits market

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Report Highlights:

The Romanian Government recently adopted fiscal measures aimed at reducing tax evasion. Romania's general Value Added Tax (VAT) rate is 24 percent, including on food and beverages, whereas most EU member states apply a different tax regime for food products. Under pressure by the local food-industry, the Government reduced the VAT rate for bread and bakery products to 9 percent and offset the projected initial revenue loss by raising the excise tax on distilled spirits by 33 percent.

General Information:

Currently the general Value Added Tax (VAT) rate in Romania is 24 percent, including on food and beverages, which is one of highest among the European Union member states. Over the past three years, the food-industry has worked to persuade the Romanian Government to reduce the VAT level for food products, claiming high taxes provide strong incentives for companies to hide their business activity which erodes fair competition among players in the economy.

For more than a year the government's goal has been to decrease the VAT on bread and bakery products alike. Industry estimates fiscal evasion associated with the VAT in the milling and baking sectors alone has reached very high levels, currently estimated at about 70 percent (USD 300 million) of the total milling and bakery market. If other taxes are taken into account in addition to VAT, the value of non-collected state revenue rises to USD 430 million. Despite this justification to encourage VAT payment, the International Monetary Fund (IMF), with which Romania has a signed agreement, has not approved the strategy in absence of identified income sources to replace the projected lost revenue generating from a lower VAT in the milling sector.

Effects on the milling and bakery sector

At the end of July, following another round of discussions with the IMF, the Romanian Government adopted fiscal measures aimed to reduce fiscal evasion. According to provisions of Government Ordinance 16/2013, the VAT level for bread and several bakery products will be reduced from 24 percent to 9 percent, as a mean to fight fiscal evasion and to ensure a fair playing field for milling companies. The new VAT rate is scheduled to be implemented effective September 1, 2013.

In addition to this change, the Prime Minister appealed to Romanian consumers to support Government efforts in fighting fiscal evasion by asking for a receipt with each purchase regardless the amount of money spent. Tax analysts believe that in order to be successful, fiscal control should be intensified, while penalties for fiscal evasion should become more severe. The impact of this measure in the bakery sector is to be re-assessed after several months after implementation. Dependent on the outcome of the review the VAT rate may remain at the lower level or may be reassessed upwards.

As a result of the measure, bread prices are expected to decline 12 percent, from one RON/loaf (0.29 USD/loaf) to 0.88 RON/loaf (0.25 USD/loaf), assuming producers/retailers decide to transfer the savings to the consumer. However, in some cases, producers might decide to maintain the current price level and retain the difference in VAT rates to re-investment in operations, or to pay down debt, which both actions should improve the overall business environment.

Apart from the milling and baking sector that will directly benefit by the VAT change, the measure is welcomed by other agricultural and food-industry sub-sectors, such as meat-processing and dairy. Assuming the measure will generate positive revenue flow for the state and will lead to contraction of the grey market, the Romanian Government has already indicated it intends to explore widening application of this model to other food sectors in the future.

Effects on the distilled spirits market

Unlike other sectors, the distilled spirits industry is not enamored with the government's action as once again the sector is being targeted to bear the burden of governmental shortcomings. Since higher state revenue is not expected instantly, the Romanian Government decided it would offset the expected revenue shortfall of the reduced VAT (on paper) by increasing the excise tax on distilled spirits by 33 percent, from 750 EURO/hectoliter to 1,000 EURO/hectoliter.

The Alcohol Producers' Association notes that tax evasion among its sector will likely increase once the excise level is amended, from the current 70-80 percent level to 90 percent. The Association believes this measure will translate to price increases for alcoholic drinks of about 25-40 percent, depending on the alcoholic content. The distilled spirits market is estimated at about 90-100 million bottles currently, a third of what existed 10 years ago (300-350 million bottles in 2002). Given the significant contraction of this market already, producers have strong motivation for not supporting the government's notion that the sector should shoulder the state revenue loss burden generated by tax irresponsible behavior of other sectors.

According to 2012 official trade data, U.S. spirits export to Romania (volume) resumed the upward trend after three years of decline (please see table below). Whiskies represented almost 100 percent of the spirits the U.S. exported to Romania.

Romanian spirits imports, 2009-2012

Spirits imports to Romania	Unit of measure	2009	2010	2011	2012
Total spirits Quantity	**LPA**	3,230,656	3,209,270	3,282,589	3,787,527
• **Out of which from United States**	**LPA**	369,819	341,242	324,073	330,650
US Share in total imports (volume)	**%**	11.45	10.63	9.87	8.73
Total Value	**USD**	61,226,782	59,396,708	67,110,415	67,149,882
• **Out of which from United States**	**USD**	9,989,155	8,338,752	8,637,455	8,547,451
US Share in total imports (value)	**%**	16.32	14.04	12.87	23.73

Source: Global Trade Atlas; LPA – Liquid of Pure Alcohol