

Unclassified

English - Or. English

10 November 2022

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

Competition and Inflation – Note by Hungary

30 November 2022

This document reproduces a written contribution from Hungary submitted for Item 12 of the 139th OECD Competition Committee meeting on 29-30 November 2022.

More documents related to this discussion can be found at
www.oecd.org/competition/competition-and-inflation.htm

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1. Introduction

1. This contribution summarises recent experience of the Hungarian Competition Authority (Gazdasági Versenyhivatal – GVH) concerning substantial inflation and price rises. Section 2 briefly describes the historical link between competition policy and price regulations in Hungary, before Section 3 turns to the period characterised by the economic consequences of Covid19 and the war in Ukraine. Section 4 elaborates on the methods, findings, and conclusions of the so-called accelerated sectoral inquiries which tool was applied by the GVH to investigate surging prices in recent years. Section 5 presents a few technical issues.

2. Historical background

2. Various inflationary pressures and the notion that, when price regulation is absent, the GVH has to deal with prices have influenced competition law and its application, especially in the first decades of the operation of the GVH.

3. This dates back to the beginnings of modern Hungarian competition law in the late 1980s, when competition – or in the presence of dominant market participants competition law enforcement – was expected to keep prices at reasonable level, as they were gradually liberalised from price control of the planned economy. Indeed, the first fully fledged Hungarian competition law¹ was designed by an expert group in the price office and beyond the classical competition law toolkit, it included a preliminary notification system for price rises concerning certain products and their superdominant producers. It also prohibited “withholding products” (i.e., creating shortages) to raise prices by dominant firms. More or less the same group of experts was working in parallel on the new Price Act,² and the two laws were adopted and published at the same time. The GVH then was established by reallocating a part of the facilities, personnel, and management of the former price office.

4. The same period was characterised by high and lasting inflation in Hungary, and the GVH received a relatively high number of (exploitative) excessive pricing complaints in the 1990s. Even later, excessive pricing cases represented a significant share of enforcement, although they involved mostly a limited number of areas, such as local cable TV services. In most of the 2000s and 2010s inflation remained low, and the discretion of the GVH to select cases gradually broadened. Nevertheless, in the event of significant price rise, many expected the GVH to investigate excessive pricing allegations.

5. The latest significant excessive pricing case was launched ten years ago.³ It involved the price setting practices of MOL, the dominant fuel producer, wholesaler, and retailer in Hungary. This investigation tested not only excessive pricing allegations but also a price squeeze theory of harm and the suspicion of asymmetric price transmission. It ended with a commitment by MOL, making sure that its fuel would follow the movements of the

¹ Act LXXXVI of 1990 on the Prohibition of Unfair Market Practices.

² Act LXXXVII of 1990 on Price Setting.

³ MOL fuel prices (VJ/50/2010, closed in 2014).

international price benchmark with the same speed either when it increases or decreases in the next five years.

6. The GVH engaged into competition advocacy in occasions when taxi drivers demanded regulated minimum or fixed prices (which emerged typically in periods of high petrol prices) in Budapest, the capital, where taxi regulation included maximum prices. The GVH advocated against the demand of taxi drivers in 2005 (successfully), and also argued for eliminating price regulation in the telephone booking and the hotel contract segment (unsuccessfully).

7. While usually the GVH advocated for deregulation, sometimes it proposed price regulation or to make existing price regulations stricter for statutory monopolies (or, in certain cases, to open up the market, as the first best solution). The GVH also raised the possibility of regulating cable TV prices in the mid-2000s, as it was overwhelmed by excessive pricing complaints and investigations, characterised at the time with local natural monopolies. Most of these initiatives, including concerning local cable TVs, failed to realise.

3. Recent experiences apart from the accelerated sectoral inquiries

8. Several – sometimes interlinked and overlapping – developments triggered waves of excessive pricing complaints (as well as complaints concerning related issues, such as shortages) in recent years in Hungary:

1. the extreme price rises and shortages in the first half of 2020, caused by the Covid19 related demand shocks as an immediate response to the pandemic, involving mainly face masks, cleaners, sanitisers, and disinfectants;
2. the significant price rises of Covid19 PCR tests (lab services) in the second half of 2020 and later of Covid19 rapid tests (self-check products) in late 2021;
3. the soaring prices and shortages in 2020, caused and/or strengthened by the mismatch between supply and demand due to the Covid19 related supply chain disruptions and later by the “post-Covid19” economic rebound, involving various products, and attracting the most public attention in the case of construction materials and energy;
4. the most recent, and sometimes extreme surge of prices, and actual or potential shortages, mainly caused and/or strengthened by the economic and political consequences of the war in Ukraine (and even its prospect before), worsened by significant devaluation of the Hungarian currency against euro and US dollar, involving many products, but mainly food and energy.

9. Those waves of complaints are not surprising, given the historical relationship between competition law and price regulations in Hungary, as explained in Section 2. However, most of them were not well founded, and in our experience excessive pricing cases are inherently difficult as well as they are far from clear cut both in terms of standards and remedies. Therefore, these complaints have not induced the GVH to launch cases.

10. In fact, the number of these complaints was not as high as one would expect based on the magnitude of the problems they concern. Media or political pressure on the GVH to take part or even to play a major role in treating the price surges in question also remained unnoticeable.

11. On the contrary, in recent years these types of issues have increasingly been seen by the public, the media, and the government alike as belonging to the domain of

government responsibilities, rather than those of the GVH. Indeed, the government, acting in a protective spirit, applied price caps in several areas in recent years, such as the price-cap for fuel and certain food products as well as the freezing of certain mortgage interest rates. Also, Covid19 PCR test prices were lowered by regulation. Furthermore, the government did not allow the increase of regulated prices of electricity and natural gas for residential consumers either, despite of the soaring prices of imports. Most recently, the scope of some of these measures was reduced.

12. The GVH did not advocate against these measures. Moreover, in the case of the short-term price shock and shortages involving face masks, cleaners, sanitisers, and disinfectants in early 2020, the GVH advised the government – capable to apply a more adequate and broader set of measures than the GVH, e.g., rationing – to consider regulatory intervention.⁴

13. Beyond excessive pricing allegations, inflation, in theory, may strengthen the motivation to collude and to demand regulations protecting certain businesses from (allegedly excessive) competition. Parties may refer to inflation as an excuse for restrictive co-operations, especially to pass through cost inflation collectively to their customers; they may refer to it as a rationale to merge or to apply a particular business practice.

14. In the experience of the GVH such references of parties were rare in recent years, and tended to be rather vague empty talk about various business difficulties and uncertainties in order to get a more lenient treatment either in terms of legal evaluation or in terms of remedies and fines (including a reduction of fines or allowing payment in instalments due to financial difficulties). While the GVH had a cartel case where parties colluded to pass-through certain costs in a uniform manner,⁵ it was not done in an inflationary context, and inflation was not raised as a defence. (In fact, the case and the cartel in question preceded the current inflationary period.)

15. The latest development concerning the intersection of competition law and inflation in Hungary is the new GVH initiative of a forthcoming series of hearings and consultations with those businesses and their associations that are presumably the most affected by inflation and energy shortages. The main objective is to raise the awareness of those businesses, especially, to educate them about what to do when they suspect the cartelisation of their suppliers, and to discourage them from trying to mitigate their difficulties with their own cartelisation. This may strengthen both compliance and cartel detection, possibly weakening or even halting “spill-over inflation” in those areas. Another objective is to get more familiar with the relevant circumstances and considerations of the businesses in question. This may help the GVH to be better prepared to deal with crisis cartels (or rather “crisis co-operations” between firms), should they emerge.

4. Accelerated sectoral inquiries

16. Accelerated sectoral inquiry is a relatively new tool of the GVH, introduced in 2021.⁶ From a legal perspective they differ from “regular” sectoral inquiries in their time

⁴ The government did not intervene this way, nevertheless retailers, including pharmacies, employed rationing.

⁵ Collective passing through of battery treatment fee (VJ/43/2015, closed in 2019).

⁶ The 2021 amendments of the Hungarian Competition Act, temporarily by Government Decree 406/2021 of 8 July 2021, effective immediately; those new provisions, with some improvements, were made permanent by Act CXXX of 2021, entered into force on 1 June 2022. (Amending the

frame and their more streamlined procedural framework, as they must be completed in a month after their launch (this deadline can be extended by no more than two months).

17. Given this minimalist time frame the GVH employed simplified information gathering and analysis (compared to “regular” sectoral inquiries). It collected data on prices, sales volumes and other relevant information (such as product types, number and names of trading partners, description of the supply chain, substitution patterns as well as market trends and shocks) from market participants of several levels of the supply chain of the industry in question. However, only a selected set of products and a selected set of market participants from each level of the supply chain were chosen to provide data and other information. These data were complemented with information from other sources when it was appropriate and possible, and they were analysed with relatively simple methods, focusing on price transmission. This approach produced insight of reasonable accuracy.

18. Up to date, the GVH performed five accelerated sectoral inquiries, four of which were launched to understand the reasons of significant price rises in certain areas, and to determine whether they required enforcement and/or advocacy. Three of those four concerned various construction materials, while the fourth one concerned Covid19 antigen rapid tests. The fifth accelerated sectoral inquiry concerned Covid19 antibody rapid tests.⁷ However, this inquiry was launched to investigate the communication practices of the suppliers that could mislead consumers and could ultimately distort competition.

19. The launching of these inquiries – similarly to other activities mentioned in the previous section – was a proactive step from the GVH and their findings did not lead to any enforcement action but several advocacy proposals were generated based on the knowledge gained.

4.1. Ceramic masonry products⁸

20. In case of ceramic masonry products (mainly bricks) the most important raw material primarily comes from Hungary and the final product is produced in domestic factories. The Hungarian market for ceramic masonry products is concentrated: apart from the two producers with a significant market share, there are only a few fringe competitors.

21. Regarding producers, it was found that some companies reduced their production volume and capacity due to the uncertainty caused by the pandemic, which led to temporary shortages due to the suddenly increased demand after the second half of 2020. At the same time, this was quickly corrected (smaller producers and imported bricks were also able to fill the gap), so basically there was no long-term shortage of ceramic masonry products in Hungary. The domestic raw material is available in large quantities, but increasing output requires significant investment with slow return. Hence, well-designed public policy could

Act by a government decree was possible in the period of the so-called state of danger due to the Covid19 pandemic, but the effect of those decrees was limited to that period.)

“Regular” sectoral inquiries were introduced in 2000 (by the 2000 amendment of the Hungarian Competition Act, by Act CXXXVIII of 2000, entered into force on 1 February 2001).

⁷ Accelerated sectoral inquiry concerning Covid19 antibody rapid tests (AL/128/2022), closed in April 2022.

⁸ Accelerated sectoral inquiry concerning ceramic masonry products (AL/478/2021), closed in September 2021.

provide incentives to improve production technology and product development as well as to increase production capacities.

22. Furthermore, the investigation ascertained that, in fact, there was no significant producer price increase of ceramic masonry products in 2021. The price increase that consumers encountered was caused by the increasing costs of transportation, packaging, and logistics. Finally, different construction material dealers applied substantially different prices, therefore the GVH recommended to facilitate the provision of trustworthy information by construction material dealers to consumers.

4.2. Wooden construction materials⁹

23. Regarding wooden construction materials, the inquiry ascertained that Hungary's import dependence is high, most of the wooden construction materials are imported. In the preceding few years, the demand for European wood increased from America and China, who have offered higher prices for lumber, thus exports have increased in their direction. Furthermore, fuel and energy prices rose, and there was also a labour shortage. Therefore, the price increase was primarily driven by global developments. Domestic demand also expanded due to state subsidies and investments and by the Covid19 pandemic (which seemed to draw the attention of locked down population to the state of their apartment).

24. As a result of the short-term supply difficulties and significant price increases, the dispersion of consumer prices and the price differences across individual sales locations increased significantly. In this context, the GVH found that the transparency of retail prices was insufficient, which made it substantially more difficult for consumers to find the most favourable offer for them.

25. The GVH recommended to require retailers of wooden construction materials to publish their current prices both on their website and at their physical points of sale, as well as the use of electronic business administration systems (such as SAP).

4.3. Thermal insulation materials¹⁰

26. In case of thermal insulation materials, price increase can be traced back to three reasons. First, energy prices soared and fuel products are required for production; second, the price of imported raw materials used for production increased due to the devaluation of the Hungarian Forint; third, the sharp increase in demand. Based on the analysis of the GVH, the market for extruded polystyrene (XPS) and mineral wool (rock or glass wool) is concentrated and import of the final product is also significant for these product categories. However, no evidence was found for abuse of dominance.

27. To mitigate the soaring raw material prices, the GVH recommended the expansion of the technology to recycle styrofoam and use it as a raw material for XPS and expanded polystyrene (EPS) production. For residential builders the GVH recommended the involvement of the thermal insulation contractor in the early stage of planning, so that they can select the thermal insulation materials to be used, considering the current prices and procurement possibilities. A recommendation for the government was to design a

⁹ Accelerated sectoral inquiry concerning wooden construction materials (AL/641/2021), closed in January 2022.

¹⁰ Accelerated sectoral inquiry concerning thermal insulation materials (AL/327/2022), closed in August 2022.

permanent scheme for house renovation and insulation subsidies to moderate demand fluctuations.

4.4. Covid19 antigen rapid tests¹¹

28. Consumer prices of Covid19 antigen rapid tests in Hungary were higher than in the majority of European and neighbouring countries, so it was reasonable to assess the market characteristics and developments, the range of market players at different levels of the supply chain and the prices they applied. The GVH also contacted the ECN competition authorities to learn and utilise their experiences.

29. The inquiry revealed that the Hungarian supply chain of self-checking antigen tests is particularly long in some cases. The products arrive from producers to consumers through several market participants, and additional margins are built into the product prices at all levels of the supply chain. This ultimately leads to higher retail prices. This supply chain is one of the reasons why the prices of antigen rapid tests are higher than in neighbouring countries.

30. Therefore, the GVH recommended reducing the length of the supply chain by allowing drugstores, retail chains, and petrol stations to sell these products as these retail formats often procure the products directly from the producers or Hungarian importers, hence, can shorten the supply chain.

31. An almost immediate legislative change allowed the sale of Covid19 antigen rapid tests at retail chains, drugstores, and petrol stations. The government's action¹² following the GVH's proposal led to a sharp increase in the number of outlets and a reduction of the retail price of antigen rapid tests.

5. Technical issues

32. Substantive GVH fines are based on the turnover affected by the conduct in question, therefore they automatically adjust to inflation.¹³ (Of course, inflation technically still moderates the impact of fine, since the relevant turnover is always an amount of "past money", to be paid in "new money" which is worth less due to inflation. The same effect is at play when the calculated fine is reduced by the statutory limit of 10% of the annual turnover of the previous financial year of the fined entity.)

33. Merger notification thresholds in Hungary are not automatically adjusted to inflation, however, they are usually reviewed for update when the Competition Act¹⁴ is amended by the Parliament. Those reviews take several factors, including inflation, into account. There have been two such updates since 1997 when the current Competition Act entered into force, and one additional update is proposed currently. Some of these updates have involved the increase of procedural fees as well.

¹¹ Accelerated sectoral inquiry concerning Covid19 antigen rapid tests (AL/782/2021), closed in February 2022.

¹² Government Decree 34/2022 of 8 February 2021.

¹³ Notice No 1/2020 of the President of the Hungarian Competition Authority and the Chair of the Competition Council of the Hungarian Competition Authority on the method of setting fines for infringements of antitrust type of prohibitions, para 8.

¹⁴ Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices.