

Executive summary

Hungarian Competition Authority's accelerated sector inquiry aims to

Likewise, all around Europe, an outstanding price increase happened in 2022, in Hungary. This significant price increase happened due to several factors, including restrictions on competition and competition law issues - although the reality of these are limited, given the very fast growing, significant and cross-sectoral inflation problem. However, the Hungarian Competition Authority (GVH) has done its utmost to analyse the reasons for the increase in food prices and to identify the possible competition law reasons behind the surge in inflation.

An accelerated sector inquiry was opened on 20 January 2023, due to the potential distortions of competition in the market of milk and dairy products. Consumer prices for milk and dairy products increased sharply. At the same time, the signals received by the GVH showed a weakening trend in the supplier positions of domestic operators producing and processing in the dairy sector.

The investigation was initiated, in the light of the significant share of milk and various dairy products in the domestic consumer basket. Demand for these products in Hungary are met by domestic dairy operators on the one hand and by importers on the other. The most important participants in the domestic dairy sector are dairy farmers supplying raw milk, dairy processing plants, dairy wholesalers and retailers, food retail chains, which ultimately serve consumers at the end of the value chain. However, the GVH also considers that it is appropriate to examine to what extent the evolution of concentration within the product category, including changes in the share of private label products, practices that hinder competition on the free market and other circumstances, may have contributed to the developments in the sector (high price increases).

Conducting the accelerated sector inquiry

The GVH's experts carried out a number of on-site inspections at dairy processors and food retail chains during the accelerated sector inquiry. In parallel, the Authority carried out extensive data collection at all levels of the dairy value chain in Hungary, including dairy farmers, dairy processors, cooperative retailers, and professional associations, even to the Milk Interprofessional Organization and Product Board Institute of Agricultural Economics Nonprofit Llc.

According to this, the GVH would like to thank all the contacted businesses for their cooperation - according to the pace of the accelerated sector inquiry – helping with detailed answers in a very short time to reveal all the relevant facts. Contributing with their cooperation to the GVH's work of exploration and evaluation of the milk and dairy products competitions relationships in the national market.

Main results of the sector inquiry

The data summaries and descriptions in the report are based on information gathered during the on-site investigations carried out during the procedure, as well as on more than 140 submissions from market participants, and on the evaluation of contracts and other documents relating to business relationships, commercial practices and other documents in the sector. The findings and recommendations resulting from the sector inquiry are therefore not based on individual opinions, indicators of selected market players or scattered information - the relevant legislation

provides the GVH with a broad fact-finding toolbox precisely to enable the competition authority to draw on comprehensive factual information when formulating the results of the sector inquiry.

The statutory task of the national competition authority in sector inquiries is mapping the structure of competition in a given sector, the competitive conditions prevailing there, and if it detects distortions, reporting them and defend competition with the available tools. The GVH's aim is to protect domestic consumers, therefore considers it important to use all the reliable help curb food inflation. However, free market competition is not only beneficial for consumers, it can also guarantee the international competitiveness of domestic industries in the longer term.

In the light of the above, the GVH makes the following suggestions and recommendations based on the results of the accelerated sector inquiry into the domestic market for milk and dairy products presented in this report.

Competition advocacy proposals to reduce inflation:

1. Review of the prognosis for raw milk base price

The GVH proposes to revise the methodology used by the Milk Interprofessional Organisation and Product Board for the prognosis for raw milk base price. The methodology that significantly determines the price of raw milk is currently based on a price formula, some elements of which could further increase the price of dairy products in 2023, and thereby contributing to high inflation. The GVH is therefore proposing to the Product Board to review the price formula, to which the national competition authority is offering its professional support. The Authority's proposal will protect both Hungarian consumers and Hungarian producers, as the revision could not only help to reduce inflation but also strengthen the competitiveness of the Hungarian dairy producers.

This conclusion of the GVH is supported by a review of certain elements of the price formula and its practical operation, as well as by market developments confirmed by the calculations and analyses carried out in the sector inquiry, which show that the transfer price of raw milk in Hungary has become disconnected from production costs from the second half of 2021, has increased more steeply than production costs and has also increased significantly in an international comparison. Given that the cost of raw milk used accounts for approximately 70% of the production costs of dairy product manufacturers (i.e. processors), this price increase is also reflected in the transfer prices charged by processors. These higher transfer prices have in turn led to higher consumer prices, as the price analyses carried out in the sector inquiry generally show that consumer prices at retail level have closely followed the evolution of purchase prices.

2. Professional advice on the food price cap

Based on the data received by the GVH, it can be seen that in 2019, 2020 and 2021, companies in the retail sector achieved profits of nearly HUF 100 billion in the food and daily consumer goods market, which corresponds to only 1.3% of turnover. In 2022, the profitability of the sector decreased significantly, turning negative, mainly due to the market distorting effect of price freezes and significant cost increases. Despite the fact, evidence in the GVH's possession and the price analyses carried out show that retailers

were able to realise higher margins in HUF for some free-price dairy products in 2022 in order to reduce their losses from price freezes. Evidence seized during the on-site inspections reveals a business practice whereby some retailers sought to compensate for their losses by increasing margins on products not affected by the official price.

However, there are significant differences between the individual retail businesses, and some smaller franchised retailers were able to increase their profits despite the price caps. Considering the price caps are meant to be temporary government measures for social policy purposes, it is not the national competition authority responsibility to evaluate them beyond their effects on competition. As regards the effect of price caps on competition, GVH offers professional consultation assistance for future legislative considerations related to price caps.

The GVH's investigation confirmed, that retailers sought to reduce their losses due to the temporary introduction of price caps on the consumer prices of certain food products, which were introduced for the purpose of social, and therefore their margins in HUF increased for certain products not affected by the price caps. However, the GVH's investigation only looked at the price margins of seven specific products, while the retail sector operates with tens of thousands of items and aggregated financial statements show a significant reduction in profits for most retailers in 2022.

In the light of the distortive effect of price caps on economic competition for social policy purposes, the GVH offers technical advice to assist future legislative considerations on price caps.

3. Development and operation of an online price monitoring system

Based on the findings of the accelerated sector inquiry and the experience of some EU Member States, the President of the GVH has proposed to the Government the creation of an online price monitoring database and application to monitor consumer prices of food products, which is currently being implemented.

In the GVH's view, this type of development could increase competition through transparency and better comparability of retail prices, which could have a long-term moderating effect on prices and increase (consumer) awareness. International experience gathered during the study confirms this expectation. The design of the price monitoring system is based on the results of consumer research and the analysis of domestic and foreign examples to ensure that the system is able to meet the needs of a wide range of potential users.

4. Pricing and promotion of plant-based drinks

The GVH proposes to improve the position of consumers of plant-based drinks and soy yoghurts through trade policy instruments.

Lactose intolerance and milk allergy are very common food allergies, affecting up to 35% of the Hungarian population. The GVH's experts therefore reviewed the price trends of plant-based drinks (almond drinks, rice drinks, oat drinks) and soy yoghurts, as well as the pricing practices of some actors in the distribution chain. The results of the analysis show that the import price of these products barely increased between 2019 and 2022, but the sales prices of domestic distributors, and thus their margins, started to rise from autumn 2022. This is presumably linked to the increase in the price of dairy products as close substitutes, which in turn is a negative

inflationary trend. Another important finding that concerns many is that the retail margins and VAT levels for plant-based drinks and soy yoghurts are higher than for related dairy products, which represents a significant additional burden for consumers with various food sensitivities who are vulnerable to these issues and environmentally conscious consumers.

5. Promoting sustainable packaging

The GVH proposes to encourage operators at the processing level of the domestic dairy value chain, as far as practicable, to sell dairy products (mainly milk, sour cream and yoghurt) in returnable packaging.

Based on the cost analyses carried out in the accelerated sector inquiry and the statements of several market players (processors), it can be concluded that packaging materials have become significantly more expensive in the recent period. In view of this and from a sustainability point of view, it would be beneficial to encourage the sale of suitable dairy products in returnable packaging.

6. Continuous actions by the national competition authority

The national competition authority will continue to pay particular attention to the commercial sector in order to increase competition and reduce prices.

For several of the products under review, the increase in retail gross margin in HUF was higher than the increase in costs per product, so the average profit realised by retailers on the product increased significantly by 2022 compared to 2019, 2020 and 2021. However, this was not the reason for the very significant price increase of the product in question, as the profit level of the retailers constitute only a small fraction of the gross consumer price, for example, in the case of Trappista cheese, the average profit of retailers was only 6.3% of the gross consumer price in 2022, while the consumer price of the product increased by 161% from 2021 to 2022.

The same can be said of taxes. Taxes built into the gross margin have contributed only marginally to the very significant increase in consumer prices for the products under review. For example, of the average consumer price of a kg of Trappista cheese, the average tax paid by retailers (excluding VAT) amounted to HUF 12.4, which is only 0.42% of the average consumer price. However, there are significant differences between retailers.

However, encouraging retail competition is of paramount importance as it can have a positive impact on the whole supply chain. Retailers can also influence the lower levels of the supply chain through their purchasing negotiations, as confirmed by the GVH's price transmission analysis. Increased competition also increases business efficiency and helps to contain higher prices.

The competition authority's aim is to ensure that as many of these benefits as possible are passed on to Hungarian consumers and will therefore continue to pay particular attention to the retail sector and the analysis of consumer prices. The justification for this is further strengthened by the fact that the significant price reductions observed during the period of the accelerated sector inquiry (especially for milk and dairy products covered by the analysis) - among many other external factors - also suggest that the targeted investigation and official procedures of the GVH may have contributed to the reduction of inflationary pressures and the decline in consumer prices.