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## **Global Forum on Competition**

### **DOES COMPETITION KILL OR CREATE JOBS?**

#### **Contribution from Hungary**

-- Session I --

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## **DOES COMPETITION KILL OR CREATE JOBS – LINKS AND DRIVERS BETWEEN COMPETITION AND EMPLOYMENT**

-- Hungary --

### **1. Introduction<sup>1</sup>**

1. As regards the connection between competition and employment, it is often said that when competition is improved in a sector of a country or region then this has a positive effect on employment. Naturally it is true that only competitive undertakings are able to create permanent employment because if the turnover of an undertaking decreases or it loses its markets, it is not able to create employment. That being said, the reverse is also true.

2. In order for an undertaking to become competitive and for it to remain competitive, it must first engage in a process of continuous improvement as regards to its level of productivity. Once this has been achieved and the undertaking is operating more efficiently, this brings about a decrease in the employment level. In this manner, improved competition may have a negative effect on the increment of employment.

3. The above-mentioned connection between improved competition and the level of employment was also evidenced in the last 21 years of the Hungarian economy on a macroeconomic level. In the '90s, huge changes took place to the structure of the processing industry. Modern technologies from the processing industry reached Hungary partly as a result of the privatisation of formerly state owned undertakings, and partly due to the existence of new undertakings. Competition in the industry improved significantly, which was shown, inter alia, in the rate of growth of production and in the increase of the productivity index.

4. The export structure of the processing industry changed significantly in a short period of time; the importance of the markets of former socialist countries decreased, and the number of sales aimed at Western-European countries increased. Improved competition in the processing industry and the huge decrease in the level of employment went hand in hand despite the fact that government policy at the time was aimed at trying to stop and balance this transition. There was no realistic prospect that the technical modernisation would not have an effect on the employment situation.

5. In the '90s this transition was especially spectacular in the sector of large enterprises and the nature of the problem did not change in the '00s either; if industrial production increases more than GDP, then in reality this does not result in an increase in the level of employment at big companies. The relatively low level of employment which results from improvements to the efficiency and effectiveness of undertakings' operations is not only to be found in the processing industry; it also appears in commerce, services and agriculture, but not to the same extent as in the processing industry.

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<sup>1</sup> Based on the study by Mr. László Kállay: KKV-szektor: versenyképesség, munkahelyteremtés, szerkezetátalakítás (SME sector: competitiveness, job creation, restructuring), study prepared by the workshop on "Competitiveness and Economic Policy" Budapest, 2011

6. In the sector of small and medium-sized undertakings an inverse progress took place in Hungary. In the '90s, the number of employees in small and medium-sized undertakings increased continuously and dynamically but in the '00s, the increase slowed down, before completely stopping. In 1992, almost half of the employees of the non-state sector worked at large enterprises, by 1995 this number changed to one third<sup>2</sup>. The number of employees in medium-sized undertakings also decreased slightly. The level of employment only increased at micro and small undertakings, which resulted in a rapid increase in the level of employment at such undertakings at the same time as a decrease was taking place in the total level of employment.

7. The rapid increase in the level of employment at small and medium-sized undertakings in the '90s was mainly the result of a radical restructure in the economy that took place due to the change in the structure of the company size, an explanation of which is provided below.

8. For example: the establishment of undertakings and the fast and radical liberalisation of the private sector, the latter of which began before the change in the political regime took place. The formerly restricted, and partly prohibited, private undertakings were presented with opportunities to enter the market. More than ten thousand undertakings were established, without having the establishers and directors any management experience.

9. While the liberalisation of the regulation of export trade happened really fast, in one part of the market the concurrence of competition in the import sector and the existence of foreign-owned undertakings occurred at a later date and more slowly. For a short period of time this enabled newly established undertakings to take advantage of the less intensive competition.

10. The structural reorganisation of the state and of the co-operative sector that began in the '80s resulted in the establishment of small organisational units, which were easier to be transferred to the private sector. A consequence of the structural change was the informal privatisation that took place, in the scope of which the economic capacity of the state and of the co-operative sector became a part of the private sector not through the sale of undertakings, but generally as a result of market actions. A proportion of the new private enterprises were able to begin their operations under more favourable conditions (although this did not guarantee their later success).

11. Based on these findings, it cannot be said that the progress (i.e. the increase in the number) of small and medium-sized undertakings in the '90s was the result of improved competition. The private undertakings that stepped into the place of the disintegrating socialist undertakings and declining co-operatives did not achieve better positions in the classic competition, as the compulsions and opportunities of the early stages of the transitional economy were due to the radically changing regulatory and institutional environment existing at the time. Competition on the Hungarian sector of small and medium-sized undertakings was much weaker during the period when there was a rapid increase in the level of employment than during the period when there was a slower improvement, the latter of which occurred when the market stagnated.

12. The problem of the correlation between decreasing employment and improved competition necessitates a supportive system which is aimed at increasing or maintaining the number of employees working for an undertaking. With this in mind, the government often provides support to those undertakings wishing to modernise their technology on the condition that these undertakings maintain or increase their number of employees. Those undertakings which are newly established in Hungary automatically fulfil this condition. However, generally after 3-5 years the modernisation of the undertakings' technologies has been completed and it is then difficult for the undertakings to fulfil the

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<sup>2</sup> Ibid., page 17.

requirement of maintaining or increasing their number of employees, as their improved technologies increase productivity and result in less people being needed. The expansion of the market as a result of the increase in productivity stemming from the improved technologies is rarely great enough – if at all possible – to compensate for the decrease in the number of employees.

13. To sum up, in the beginning of the ‘90s the significant increase in the economic role of small and medium-sized undertakings took place against the backdrop of a structural change, during which the improvement of competitiveness was not an essential condition for being a part of the market and for expansion. However, this status was temporary and belonged to the early stage of the transitional economy, and the opportunity of an extensive expansion came to an end step by step from the beginning of the ‘00s.

14. By the beginning of the ‘00s, the great changes that had been brought about as a result of the transitional economy had come to an end. The number of state property enterprises did not decrease further – by this time the rate was also low on an international level –, the rate of foreign property stabilised at a high level, and the share of Hungarian private property ownership hardly changed.

15. In conclusion, the ‘00s can be characterised as a period in which the small and medium-sized sector was able to preserve its competitiveness, in the face of the sector of large enterprises which was mostly owned by foreigners by this time<sup>3</sup>.

## 2. The change in the unemployment rate in Hungary during the crisis

16. In Hungary, as a consequence of the financial crisis of 2007-2008 the unemployment rate substantially increased in the period between 2008-2013 (see the statistics in the chart below):

*(Figures in percentage)*

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
7.2	7.5	7.4	7.8	10	11.2	11	11	10.2	7.7

Source: Hungarian Central Statistical Office

[https://www.ksh.hu/docs/hun/xstadat/xstadat\\_eves/i\\_qlf001.html](https://www.ksh.hu/docs/hun/xstadat/xstadat_eves/i_qlf001.html)

## 3. Amendment of the Hungarian Competition Act regarding merger control

17. Under the Competition Act (HCA) the Government may issue a decree to exempt mergers from the clearance procedure of the GVH, if certain public policy interests are affected. As stated in the HCA, such public policies are for example: assuring the security of supply and preservation of jobs. These are the so called “concentration of undertakings of strategic importance at the national level”.

18. So far, there have been three instances in which concentrations were exempted from the clearance process by reference to the preservation of jobs. Two of them concerned the banking sector and one the rail vehicle production industry.

<sup>3</sup> Ibid., page 19

#### 4. Reflecting employment considerations in the fining policy of the GVH

19. The GVH issued a *'Guideline on Fines'*<sup>4</sup> in antitrust cases on how the decision-making body of the GVH, the Competition Council, calculates the amount of the fine in the cases of antitrust infringements. Since 2012, when setting a fine, the Competition Council may, upon the request of the undertakings concerned, assess the company's alleged financial distress. The antitrust guideline sets out two possibilities for the Competition Council to take into account the deteriorating financial condition (including the potential job losses) of the party to the proceedings.

##### 4.1 *Deferred payment by instalments requests in pre-decision making phase*

20. The parties to the proceedings may apply for deferred payment of the potential fine after the delivery of the statement of objections (SO) but only prior to the adoption of the final decision of the Competition Council. The procedural rules allow the submission of this request only prior to the adoption of the final decision. The SO includes an explicit reference to the possibility of granting deferred payment, however, since the introduction of this possibility into the Hungarian fining policy, only a few undertakings have applied for it (e.g. in 2014 only three undertakings). The deferred payment means that the party to the proceedings may pay the fine in monthly instalments over a period of time rather than in a lump sum payment. By granting this payment relief the Competition Council thoroughly deliberates the financial situation of the company (including the potential of job losses) and assesses the numbers of other financial indicators. The company has to prove its adverse or loss-making situation through the submission of written and objective evidence. The Competition Council may grant this deferred payment if the company proves that the payment of the fine in a lump sum would irretrievably jeopardise the economic viability of the undertaking concerned. The company has to provide the Competition Council with its balance sheet and demonstrate that it has access to capital and credit possibilities based on which the Competition Council is able to assess the amount of the instalments the undertaking is able to pay on a monthly basis.

##### 4.2 *Inability to pay as a mitigating factor when adopting the decision*

21. In exceptional cases, the Competition Council may, upon a request, take into account the undertaking's inability to pay as a mitigating circumstance in a specific social and economic context in a case when the bankruptcy of the company cannot be avoided by granting deferred payment. The Competition Council does not mitigate the fine solely by invoking the adverse or loss making financial situation of the company or even by referring to the fact that the fine would drive the company out of the market. The Competition Council would also find the mere fact that the company has bank debts as an insufficient argument to mitigate the fine on the ground of the inability to pay. Taking into consideration the specific social and economic context, the amount of the fine can only be reduced if the fine that would have originally been imposed would have substantially deteriorated the structural condition of competition on the market and would have led to the disappearance of the undertaking as a going concern. By assessing the inability to pay as a mitigating factor the Competition Council analyses the following factors<sup>5</sup>:

- whether the company's assets would diminish from the market,
- whether the production of the companies that have business relations with the party to the proceedings in the production chain would be significantly endangered,

<sup>4</sup> Guideline No. 1/2012 of the President of the GVH and the President of the Competition Council on the methodology of setting fines for antitrust cases

<sup>5</sup> Guideline No. 1/2012 of the President of the GVH and the President of the Competition Council on the methodology of setting fines for antitrust cases

- whether the unemployment rate would significantly rise at a regional or wider level,
- whether the immediate danger of bankruptcy would indeed be caused by the fine.

22. The undertaking has to demonstrate these factors through the provision of objective documented evidence. When assessing these, the GVH does not only rely on historical data but also uses projections.

#### **4.3 Post decision phase: request for suspending the execution of the GVH decision (interim relief)**

23. When submitting an appeal against the GVH's decision the party to the proceedings may claim that if it had to pay the fine at the time of the decision, its financial situation would significantly deteriorate and jobs at the company would be lost.

24. In 2013 the GVH adopted 63 infringement resolutions<sup>6</sup> out of which 39 companies challenged the decision before the Court. In 21 cases the parties claimed interim relief to suspend the execution of the fine. The Court suspended the execution of the fine only in 2 cases. In 2014 the GVH adopted 72 infringement resolutions<sup>7</sup> out of which 64 companies challenged the decision at Court. In 42 cases the parties claimed interim relief and the Court suspended the execution of the fine only in 7 cases.

## **5. Case study**

25. Due to an infringement of the competition rules the GVH imposed a fine of approximately 3.4 million EUR on one of the largest retail companies. In its request for the suspension of the execution of the GVH's decision (interim relief) the company claimed that the immediate execution of the fine would destabilise the market position of the company. The company also envisaged the implementation of collective redundancies, which would mean a job loss of 6000 employees out of which 300 employees were people with reduced abilities. The collective redundancies would affect 10% of its total employees. The company also argued that the state would need to finance the reintegration of those employees who would lose their jobs due to the collective redundancy. The company also pointed out that the execution of the fine would be detrimental to the implementation of the social and employment policy of the government.

26. The Court rejected the interim relief request by stating that the execution of the GVH's decision would serve a public interest. The Court emphasised that the granting of interim relief is an exceptional power of the Court that must be treated with great caution. The Court ruled that it has the discretionary power to decide upon these requests. It ruled that these submissions must be well-documented and must demonstrate with a sufficient degree of probability that the execution of the fine would likely result in the company's bankruptcy. In this particular case the Court highlighted that the company owes substantial amount of tangible fix assets and claims. The Court ruled that the liquid assets (accounts for capital) of the company exceeded the amount of the fine. The Court argued that the company had reserved a certain amount of money for the potential GVH fine. The Court studied the documentation of the company submitted in order to prove the necessity of the interim relief and concluded that the company was capable of paying the fine without implementing a collective redundancy. To sum up, it can be ascertained that the Court in this particular case did not find the argument of the loss of jobs admissible.

27. Moreover, in 2013-2014 another 14 companies invoked, among other justifications, in their requests for interim relief the loss of jobs argument to demonstrate the financial distress of their companies. The Court suspended the execution of the fine only in 1 case.

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<sup>6</sup> Not including the number of termination orders and merger decisions.

<sup>7</sup> Not including the number of termination orders and merger decisions.

28. In other cases the companies raised the following arguments in relation to the loss of jobs. They stated that by paying the fine at the time of the decision:

- a high number of employees would be made redundant and therefore the income of these families and their financial situations would be endangered,
- paying the fine would endanger the company's solvency and the fine would be paid at the expense of the salaries of the employees,
- paying the fine would directly endanger 44 jobs (the company's own employees) and indirectly several more jobs because of the operating business relations with contractors/ subcontractors,
- the company would close several branches and therefore more than 100 jobs would be ceased,
- the company is a family run business and paying the fine at the time of the decision would endanger the payment of the employees' wages.

29. To conclude, it can be stated that both the GVH or the Court takes into account the potential loss of jobs argument by granting payment relief only in exceptional cases. When granting the payment relief the GVH and the Court require a well-documented submission from the company in question, which is then reviewed taking into account the social and economic context of the company and market in question.