

Restructuring and re-regulation of the Hungarian tobacco market – a case study

Abstract

This case study deals with the conditions and impacts of the implementation of Law CXXIV (2012) which has radically changed the regulation that applies to the Hungarian market for tobacco products.

The new regulation promised to provide significant political benefits for the ruling coalition because the majority of the population support the proposition that smoking by the young generation should be prevented. This is the reason why the Hungarian government and the national assembly played a significant role in the remarkable modification of the regulation of this market. Another important factor in this development was that one of the decisive market players – by mobilizing its political influence and connections – was involved in the legislative process from its very beginning. The efforts of candidates close to power (who wanted to enter this market) were not coordinated, but these players expected to receive good support from decision makers. But the new regulation was subject to a number of flaws and demonstrations. As a result of the new legislation there remained 1500 settlements without a shop for tobacco sales. This unexpected development and the high and growing number of loss-making tobacco shops forced the government (and the state company responsible for the tobacco market) to modify permanently the regulation after only a short period of time. The main reason for the disturbances in the market was the administrative restructuring of the market for tobacco products.

Keywords: market regulation, regulatory bargain, unexpected regulatory effects
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The aim of this paper is to reconstruct a regulatory story.¹ How did the development the implementation and adaptation of “Law CXXIV (2012) on the suppression of smoking among youth and on the retail trade of tobacco products” happen? What were the effects of the adoption of the law on the Hungarian market for tobacco products? Why did repeatedly re-regulating this disturbed market become unavoidable? The story has not concluded, so - somewhat arbitrarily – we conclude the description and analysis of the story in the weeks following the national election in spring 2014.

Definition

The scope of market regulation defines all the rules and prescriptions which are accepted by the market players voluntarily, or due to the constraints of the state and which somehow influence their costs and benefits. In this article we shall only tangentially deal with cases of

¹ This case study is one of the outputs of a research project named “The unexpected consequences and impacts of the regulation of markets” which was financed by the Hungarian Scientific Research Fund in 2012-2014.

regulation created by voluntary associations or which are accepted by coalitions of entrepreneurs. Our subject area will be narrower: we shall deal with the impacts of state regulation.² Therefore we shall accept and use the conventional definition used in the economic literature, whereby regulation is described as the mutual relationship between the state and the regulated.³

State regulation can take several forms:

- Public statutes, standards or statements of expectations.
- A process of registration or licensing for the approval and permitting of the operation of a service, usually by a named organization or person.
- A process of inspecting, or other form of ensuring standard compliance, including reporting and management of non-compliance with standards: In cases where there is ongoing non-compliance, then...
- A process of de-licensing whereby the organization or person concerned is judged to be operating unsafely, and is ordered to stop operating or suffer a penalty for acting unlawfully.⁴

One part of this defined set of rules was consciously designed to influence the market conditions of the regulated. There is another subset which consists of rules and prescriptions, the purpose of which is different, yet still influences the market conditions of the regulated. But the outcome is similar: these rules modify the costs and benefits of market players. There are no un-regulated markets. We cannot speak about 'unregulated' statuses in the case of brand new products and services either because the current operating rules apply to evolving markets as well.

Through our recent research we distinguish between designed (and within this category 'declared' and 'hidden') and actual ('expected' and 'unexpected') impacts. The regulatory institutions⁵ involved in the modification of the law explained to the regulated and to the interested public in some way (as part of the new rules, or in a related commentary) why they created new rules or modified the old ones. These statements consist of declarations about the aims of the regulation. Based on other statements, interviews, and by using the method of comparative text-analysis we can reconstruct the hidden (by the community or by the affected) and unrecognized (or only later recognized) purposes of the new or modified regulation. In this article we focus on clarifying the unexpected events and processes that took place. Careful description and evaluation of these phenomena may help to explain and to analyze "regulatory illusions" and "regulatory anger."⁶

² A regulated market or controlled market is a market where the government controls the forces of supply and demand, such as who is allowed to enter the market or what prices may be charged.

http://en.wikipedia.org/wiki/Regulatory_economics

³ ³According to the Chicagoans, "government" is simply a supplier of regulatory services such as price fixing, restriction of entry, subsidies, suppression of substitutes, and promotion of complementary goods. In exchange for these highly valuable services, the regulated industry can offer legislators campaign contributions, speaking honoraria, and the votes of industry employees and can promise highly remunerative future employment to regulators. Mitchell–Munger (1991) 514. pp.

⁴ http://en.wikipedia.org/wiki/Regulatory_economics

⁵ Namely, the state, voluntary associations, or *ad hoc* coalitions of entrepreneurs

⁶ These expressions have regularly been used by Hungarian economists over the last few years.

Players in the tobacco market before the 2012 Act

We assume that our chances of successfully evaluating and describing the unexpected developments in the markets for products or services are better than average as the radical (and the majority of) stakeholder-affecting changes took place recently. Unaware of the unusual developments to follow, we chose the market for tobacco products as the target of our research project in the autumn of 2012.

The reasons for our choice were, among others:

- that the opportunity for substituting these products is limited, therefore the boundaries of the tobacco market would be clearly designated,
- that the turnover of tobacco products is significant and accounts for a growing share of Hungarian retail traffic⁷, and
- that the entire production chain is located in Hungary.

Just briefly: a few hundred producers planted tobacco on 6366 hectares of land while a total of 10,923 tons of tobacco were grown in Hungary in 2013. In the first years following the post-socialist transition there were four privately-owned tobacco producing companies in Hungary. Before the transition there were four state-owned tobacco factories in Hungary.⁸ These companies did not engage in independent marketing activities and all of them produced similar, popular cigarette brands. The retail trade of tobacco products was managed by the state-owned wholesaler company Hungarotabak.

Privatization of these companies started in 1992. The biggest tobacco producer in the country became the foreign-owned **British America Tobacco Company Hungary.**⁹ **Continental Dohányipari Csoport (The Continental Tobacco Group)**, meanwhile is a family-owned private company which unified many European tobacco companies. Continental has more than 500 employees in Hungary. Phillip Morris Hungary was established in 1992 when Phillip Morris bought the Tobacco Factory in Eger. After privatization by sale the manufacture of tobacco products ceased at Eger and Phillip Morris Tobacco Trading Company Hungary started to sell and distribute the tobacco products of foreign partners.¹⁰ The Debrecen Tobacco Factory, privatized by the Reemtsma Cigarettenfabriken GmbH in 1992, is no longer actively producing. Ten years later the ownership of the company changed: The United Kingdom-based Imperial Tobacco (IT) announced the acquisition of the factory on 15th of May 2002. Two years after this event, IT stopped production at its factories in Hungary, Slovakia and Slovenia but continued to sell its products through its subsidiaries in Hungary.¹¹ Because only some of the tobacco products of the manufacturers are distributed either directly or through subsidiaries in the retail trade, the 24-25 **tobacco wholesalers** are important players in the market too.

Before the implementation of Law CXXIV (2012), tobacco products were transported from the factories of wholesalers to 40-42 thousand retail outlets. In this period – it is estimated – “about 80 percent of tobacco products were sold in food shops, and a few percent in cigar-stores, gas stations and through the dedicated tobacco shops of smaller supermarkets. The remaining trade was managed by the hypermarkets of multinational companies. (Tesco, Cora

⁷ Based on estimations the yearly turnover of these products is about 500-550 billion HUF.

⁸ In the towns of Debrecen, Pécs, Eger and Sátoraljaújhely

⁹ Previously, Pécsi Dohánygyár The number employed nowadays is about 800.

<http://www.dbmsz.hu/companies.php>*

¹⁰ <http://www.pmi.com/hun/pages/homepage.aspx>

¹¹ http://www.imptob.hu/index.php?topic_id=15

and others)".¹² A significant number of these retail outlets and small shops were not managed directly by the owners but were units of small privately-owned chains. In other cases, the owner, the manager of the shop and the license holder were different people.

Why the bill was submitted at all, and why in 2012?

The entry into force (or postponement, and perhaps prevention of amendments and extensions; in other words, the timing of market regulation) says a lot about the plans, intentions and tactics of the legislators and of those social-economic groups and organizations who wanted to influence them.

In this case legislative activity was not justified by the existence of a **regulatory deficit**. "The bill on the reduction of smoking among youth and on the retail sale of tobacco products" (hereafter 'the tobacconist law') was adopted by the Hungarian parliament on 11th of September 2012. Little known is that less than a year before the submission and adoption of this law, the Hungarian parliament had already re-regulated in detail the market for tobacco products. Namely, in the form of XLI law of 2011, amending XLII (1999) "on the protection of non-smokers and on some questions concerning the consumption and trade of tobacco products" was adopted in May of 2011 and entered into force in January of 2012. This law tightened up and added further specified the provisions of the regulation. We have no information about its effects.

Pro-government MPs – based on survey made more than a year earlier – mentioned the inefficiency of the regulations (including the previously-mentioned law of May of 2011) only a few months later in the parliamentary debate about the tobacconist law of 2012. "The figures about young people's access to tobacco products show clearly that the current legislation does not meet the interests of young people because only every second retailer is protecting them from the effects of tobacco consumption. The current system of control and fines does not accord with the intentions of the legislature. Shop assistants are not adequately interested in protecting youth."¹³

Redressing market disruption was not among the purposes of the change in the regulation, in this case because Hungarian consumers were allowed to buy tobacco products without any difficulty in the decades before the tobacconist law was adopted.

The most frequently-mentioned reason for implementing the law – alongside the declared aim - was to **fight the harmful effects of smoking**. Government and opposition parties argued with each other about the importance of introducing anti-smoking regulation. As to the preamble of the law, the declared aim is "that fewer young people would smoke. The first step in achieving this public health priority is to limit the extensive availability and presence of tobacco products."¹⁴

Some disappointing data justify the unremitting fight against smoking, but compared to European standards Hungarian data about smokers are not radical outliers and do not indicate the presence of any unexpected, negative changes. Using the frequency of the smokers as an indicator for comparison, Hungary is located in the middle of the range for all European countries. According to some research made in 2012, there were no dramatic changes;

¹² http://hvg.hu/gazdasag/20111219_Dohany_Takacs_Zsuzsa_Lazar_Janos

¹³

http://www.parlament.hu/internet/plsql/ogy_naplo.naplo_fadat?p_ckl=39&p_uln=157&p_felsz=152&p_szoveg=&p_felszig=152 (speech of Dr. Tamás Heintz, MP, in parliament)

¹⁴ 2012. évi CXXXIV. törvény a fiatalok dohányzásának visszaszorításáról és a dohánytermékek kiskereskedelméről

moreover, some indicators show partial improvements in the situation regarding smoking. “The number of male smokers has decreased permanently since 2000 in Hungary but the ratio practically remained the same among women. Compared to 2009, a 2 percent decline occurred in 2012 in the group of 65 year old males. Among females the share of smokers increased by 1 percent in the same period.”¹⁵ These data show that changes in smoking habits are not enough to explain why Hungarians required a new law to reduce smoking among the youth.

Among the other reasons given for implementing the law, it was often mentioned that it was:

- a contribution to improving the effectiveness of the levy system,
- a (conscious, or unplanned?) test of a method of nationalization,
- an efficient way of building clientele; moreover,
- it modified the market shares of big producers and distributor companies.

We examine and re-think these assumptions in the following chapters.

Where was the bill prepared (and who prepared it)?

One important element of the story involves the revelation that, at a meeting of the Parliamentary Committee for Consumer Protection on 19 December 2011, the under-secretary at the Ministry for National Economy reported that **the bill was not prepared by Ministry staff**: “the bill was submitted on Friday evening, therefore development of the government's position has not happened yet. We may however indicate that we – the Ministry – agree with the aims of the submitter. We would like to coordinate the legal conditions even during the day.”¹⁶

So, who prepared the law if not the competent ministry? Who helped members of the parliament to create this bill as an independent filing? There was not a word mentioned about this issue during the general and detailed discussion of the bill. But a few days after the detailed discussion of the bill, opposition MPs noticed that the name *János Sánta*, the owner-manager of Continental Tobacco Company and the president of the Hungarian Association of Investors at the Tobacco Industry was contained on the data identifier of the file containing the proposal which was sent to Brussels.

Based on this information, *Katalin Ertsey* MP stated in her speech on 28th of February 2012 that “the tobacco lobbyist¹⁷ participated from the beginning in the creation of the tobacco law, the main purpose of which was to create a favorable position for his company on the market.”¹⁸ Moreover: “*Mr. Sánta* not only monitors carefully what minister *János Lázár*¹⁹ wrote into the bill but he himself formulates the law for the industry which unfolds with a tragicomic turn when the text is sent for comment to the European Commission.”²⁰

Secretary of State *Miklós Szócska* in his response negated, but did not deny, the statements made by *Ernyei*: “This (the adoption of the law) was a step which will defend the lives of several thousand people, several thousand young ones. Talk about this, please and do not state

¹⁵ <http://www.webbeteg.hu/cikkek/szenvedelybetegseg/13692/felmeres-a-magyar-lakossag-dohanyzasi-szokasairrol-illetve> http://www.oefi.hu/dohanyzas_tarsadalmi_terhe_OEFI_2012.pdf

¹⁶ <http://www.parlament.hu/biz39/bizjvk39/FVB/1112191.pdf> (post of deputy undersecretary László Szöllősi)

¹⁷ János Sánta

¹⁸ http://ertseykatalin.blog.hu/2012/02/28/a_dohanylobbi_diktalja_a_trafikatorvenyt_napirend_elotti_felszolala_som

¹⁹ One of the presenters of the bill.

²⁰ *ibid*

anything that is not true. Or if it is true, make a complaint. Or take the necessary steps which relate to the work of a member of parliament.”²¹

Minister *Lázár János* acknowledged that the tobacco owner-manager is an old friend, the opinion of whom he solicited about this issue. “I have known *Mr. Sánta* for ten years and I asked his opinion.” “*Lázár* emphasized that he requested an opinion from English and American-owned firms too, but these companies did not support the draft. They argued that it would harm their interests.”²²

The most important changes in market regulation defined in the law

The most important changes in market regulation as defined in the law are the following:

- nationalization of the tobacco retail trade²³
- limit to the range of products available for sale in tobacco shops
- limit to the number of market players and regulation of their spatial distribution
- identification of the potential range of consumers
- establishment of the Non-Profit National Tobacco Trading Company

The tobacco law decrees **the nationalization of the tobacco retail trade**: “The retail trade of tobacco product is an activity within the exclusive competence of the state, the exercise of which the state may assign to others for a specified period under a concession contract which is in accordance with the provisions of the Law XIV 1991.” Decisions or orders about such activities as concerns the operating licenses of tobacco dealers or in the business registrations of limited partnerships or of limited liability companies are no longer valid because the state withdraws these rights and permissions from them. Namely, “the retail trade of tobacco products can be carried out solely on the basis of a concession contract and by those in possession of an authorized license for tobacco trading.”²⁴

The new law regulates **the range of products which can be sold in stores**. “A tobacco shop is a non-mobile, separate, stand-alone retail space which only sells tobacco products or specified additional tobacco products, or other products according to the legislation.”

Moreover it regulates the **number and the spatial distribution of market players**: “the tender has to be issued that in settlements where the permanent population does not exceed two thousand people, a maximum of one person is entitled to sell tobacco products. If the population is more than two thousand people, one more seller is permitted and for each additional two thousand residents one further person is entitled to sell tobacco products within the settlement. If there is more than one tobacco shop in a settlement, a person cannot own more than two-thirds of it.”²⁵

The new law specifies **the range of potential customers** as well: “we must always strive to ensure that the sale of tobacco products to young people should be forbidden and tobacco products should not be available to them.”²⁶

²¹ http://hvg.hu/itthon/20120227_lazar_dohanylobbi

²² *ibid.*

²³ Part of Law CXXIV (2012) (there was no English language version of the rules so the text was translated by the author)

²⁴ Part of Law CXXIV (2012)

²⁵ Part of Law CXXIV (2012)

²⁶ Part of Law CXXIV (2012) (translated by the author)

There is an important way in which the law did not change compared to the former regulation: tobacco production and wholesale were not nationalized; the companies involved remained in private hands.

5. Adoption of the law and founding of the Non-Profit National Tobacco Trading Company

The Hungarian Parliament passed the bill with a large majority on 11th of September 2012. In October 2012, a few days after the final vote, the government - following the requirements of the law - founded the National Tobacco Non-profit Trade Company with a 100 percent share for the state. The company only a few weeks after being founded launched the first tobacco retail shop concession tender. The main aim of the tender was that “in opposition to the existing 43 to 44 thousand sales outlets, in the new system there will be significantly below 10 thousand tobacco shops.”²⁷

Based on political statements, parliamentary dialogue and other comments we may reconstruct the list of indicators for the success of the tender. The most frequently-mentioned criteria for success were the following: The tender would be deemed a success if...

- the number of applicants greatly exceeds the number of concessions for tobacco products,
- the distribution of concessions does not cause any disruption of supply
- the tender does not lead to price increases, a deterioration in quality, or a remarkable increase in consumer effort
- the tender does not increase the size of the black economy
- the tender does not generate differences in profitability among the market players

Business plans

But how was the suitability of those who were interested in the tender evaluated? A significant number of our interview partners assumed that large grocery stores, gas stations and hypermarkets - which are responsible for the major part of the tobacco trade – would be unable to hive off the marketing of tobacco products, as required by new law. Therefore these market agents would not get, nor even ask for, a sales concession. These expectations increased the entrepreneurial inclination of other people. “We expected that if few were involved in tobacco marketing we would double our previous tobacco sales. We prepared a business plan on this basis – and it was a realistic option. For example, next to us there were eight places within some few hundreds of meters radius where you were able to buy tobacco products before the new regulation. We prepared our business plan based on these calculations.”²⁸

But it was difficult to estimate the extent of the market niche which would be generated by the change in regulation. One of the tobacconists weighed the chances of the company this way: “There are a lot of uncertainties. We don’t know whether the dealers will raise the price gap or not. How much of an increase in traffic will be associated with the fact that the cigarette boxes disappear from shop shelves? If I calculate that there are about a thousand places in Pécs where people may buy tobacco products at the moment, and from the summer there will

²⁷ <http://www.fidesz.hu/index.php?Cikk=185383>

²⁸ part of an interview

be not more than eighty, then my profit may be up to 10 times as great as now. But what can I do if it is only 2-3 times more?”²⁹

Another source of uncertainty in these cases was that the expected business behavior of the big chain supermarkets and petroleum stations was significantly determined by the share of tobacco products in their portfolio. When tobacco products were not significant contributors to turnover, the management calculated that total turnover and staff would be reduced to a lesser extent. The majority of respondents to a survey were pessimistic. “The vast majority of retail dealers (81.1%) forecast a decline in turnover due to changes in control and regulation. The new regulation would be fatal in 15.3 percent of cases. These shops should be closed because the loss of tobacco from their sales offerings may cause a dramatic decline in their overall traffic.”³⁰ Developments like this diminish entrepreneurial inclination.

Moreover, it was the common experience of applicants and those interested that smaller settlements were unable to maintain stores which were specialized in only a narrow range of products. According to the business plans and estimations of those who wanted to locate their businesses in big towns, “there is fantasy and money in tobacco shop operations but operating at least four to five units is the minimal condition for profitably operating. Real benefits can come to those who have ownership of more than this number, but such a network is manageable by coverers only.”³¹ Such calculations also diminished the number of applicants.

At the time our research finished, the list of applicants was not yet public therefore we used **indirect methods** to figure out who participated in the tender with such conditions, and why. We supposed that the applicants calculated that their income and savings would cover the costs of the business and they would generate a reasonable profit.

The business plan should include the direct costs of submitting the application, the costs of implementation and the operation of cash registers which are required to be connected to National Non-profit Tobacco Trade Ltd., and, of course, the concession fee. The costs of starting a business (property acquisition, rent or purchase of equipment or real estate, inventory) were the real determinants of applicants' intentions and level of interest. Popular media often quoted an estimation that “at least 5-6 million HUF monthly turnover is needed for a tobacco shopkeeper to maintain him/herself.”³² According to another estimate, “the start-up investment plus the initial stock for a tobacco shop may reach 5 million forints.”³³

No matter how thorough these calculations were, applicants did not decide based on these alone. Applicants had different business backgrounds, and **therefore estimated different costs profits and pay-offs.**

The owners of convenience stores and traditional tobacco shops compared potential total turnover to that which they were due to lose. Before the law came into force in 2012, these shops offered newspapers, candy and lottery ticket to potential buyers in addition to tobacco. In several cases these businesses were shocked by the loss of their tobacco products sales but they counterbalanced their declining market position successfully by improving or expanding the shop's range of supply.

²⁹ part of an interview

³⁰http://sw.marketingszoftverek.hu/newsletter/letter/c10678/uploads/Fustolgorok_Tarasaga_flmeres_2011_9_december.pdf

³¹ http://mno.hu/magyar_nemzet_belfoldi_hirei/a-tortenelmi-mult-miatt-puhulhat-a-trafikatorveny-1120065

³² http://hvg.hu/gazdasag/20130104_csodtol_tartanak_a_trafikosok#

³³http://index.hu/gazdasag/magyar/2013/02/23/a_kistelepuleseken_mozgo_arustol_vehetnek_cigit_az_ember_ek/

We witnessed similar considerations when an entrepreneur owned other shops in addition to the tobacco concession, such as a pub, café, shops or productive plants. One of our interview partners was not only an owner-operator of one of the pubs in a village but also managed a boiler repair shop and occasionally engaged in the production of clothing. The adverse consequence of the new regulation meant that this person could no longer sell tobacco products in his pub, and as a result his lottery traffic also declined. The concession owner was required to consider – as were others in such cases - how to offset their losses in terms of revenue.

Those who regarded **the concession as a marketable product for sale** calculated in a totally different way. “He said that in the eyes of K. that he was aware of the fact that K. was not among the winners of a concession tender - which is one of the basic conditions for starting a tobacco shop. However, he himself was among the winners. And it would involve bidding: he would be ready to rent the shop. If the family was interested in it he would employ one of them.”³⁴

There was yet another group of applicants and those interested in the tender. These people wanted to open a national tobacco shop (or shops) but did not directly submit an application. Front men - who could raise the investment costs and fit such businesses into their portfolios – were the real entrepreneurs. These stooges - because of the nature of things – covered for the real investors in a majority of cases. A few such undertakings were discovered and documented by the media which show that some (we don't know how many) of the concessions landed in the hands of such business people. “He knew months before that the concessions belonged to him and he distributed them among the employees of his company. He offered them ridiculous amounts of money to use their names. The specificity of the case was that he - to avoid attracting attention - signed over a part of his work force as early as January to 6-8 phantom companies. The majority of these employees are working in one shared office but they are formally employed by other companies.”³⁵

Another group of applicants included those who were/are business partners, employees and/or sub-contractors of the tobacco producer or trading companies. For example, the owners of the earlier-mentioned Continental company “stood by the law publicly and declared support and recommended everybody – including their employees and their family members and friends – to apply for large numbers for these facilities.”³⁶

The first change in the law

Open deliberation of these risk-increasing factors and the messages emerging from the professional organizations played a role in the fact that, days before the announcement of the tender, “the tobacco law seems to (have been) softened. In addition to the earlier ideas it was suggested that not only cigarettes but also lottery tickets might be supplied by the tobacco shops. Members of parliament certainly perceived that traditional tobacco shops had been selling not only cigarettes and cigars but newspapers, sweets and toys, because selling tobacco products did not provide the owners with enough revenue. The independent proposal by ruling party MPs on 19 November 2012, the aim of which was to modify Law CXXIV (2012), created an opportunity to expand the profile of the newly-established national tobacco shops. **The lottery (or in a broader sense, gambling) became a component of supply.** As

³⁴ From part of an interview

³⁵ http://index.hu/gazdasag/2013/04/25/stormanok_is_rarepultek_a_trafikbizniszre/

³⁶ http://hvg.hu/gazdasag/20130620_500_trafik_egyetlen_kezben_trafikmutyi

for the proposal of these MPs concerning tobacco shops, it was that “...regulated Lottery Gaming is tradable.”³⁷ Parliament adopted these proposals on 11th December 2012.

The second modification of the law

One of the most important elements in the business plans and calculations was **the potential margins** of the saleable products. Professional organizations drew attention to the fact that “shops cannot be operated economically in the long run considering the 3-5 percent margin obtainable through the sale of tobacco products.”³⁸ The most important message which was sent to producers and distributors was this: renounce some portion of your profit in favor of tobacco product salesmen: “up to now, the tobacco trade was only profitable for salesmen if producers paid them separate so-called sales and marketing incentive contributions. But by prohibiting this practice, as demanded by the insiders who sponsored the tobacco law of 2012, they put an end to this.”³⁹ However, according to professional organizations of producers and wholesalers **the further expansion** of the tradable product range would ensure a balanced, profitable business for retailers of tobacco products. “It is essential for the creation of an operational tobacco-retail structure in the long run that the conditions for a truly secure income should be ensured for the winners of the concession tenders. One of the basic conditions for this would be providing them with a wide range of products that can be sold in national tobacco shops, and the secure and long term financing of these activities.”⁴⁰

The government changed the regulation in favor of producers and wholesalers. Meanwhile, it asked these market players to exercise restraint. They were also informed at this time that regulatory power remained in the hands of the government. According to *János Lázár* “the government will not allow tobacco producers to force a too low margin on the national tobacco shops, therefore this issue will be regulated by law if it becomes necessary...if the tobacco-lobby hopes that its spasmodic affection to low margins will hamstring the market position of retailers than I have to disappoint them: we have performed much harder tasks already”.⁴¹

The results of the first tender

The second change in the law (submitted on 12th February 2013) would also have been a factor in the fact that “the National Non-profit Tobacco Trade Ltd extended the date for submission of applications.”⁴²

Applicants were obliged to administer their modified applications within a few days but this did not change the outcome that the first tender was successful: “15633 applications arrived for the concession tender of tobacco shops. Four, five or more times as many subscriptions were applied for as concessions in the more frequented areas of the capital and in some counties – reported National Non-profit Tobacco Trade Ltd.”⁴³

The third change in the law

³⁷ <http://www.parlament.hu/irom39/09165/09165.pdf>

³⁸ Ábrahám Ambrus – Batka Zoltán (2012)

³⁹ Ábrahám Ambrus – Batka Zoltán (2012)

⁴⁰ http://www.piacprofit.hu/kkv_cegblog/kell-az-udito-es-a-lotto-a-nemzet-trafikjaiba/

⁴¹ http://nol.hu/gazdasag/belenyulhat_az_allam_a_dohany_arresebe

⁴²

⁴³ <http://privatbankar.hu/kkv/modositottak-a-torvenyt-igy-sokan-palyaztak-trafikra-255583>

The results of the tender (the list of 5415 winners) were made public on 23th April 2013. But the new concession owners had not yet received official notification when *János Lázár* submitted another proposal “on the modification of certain laws related to smoking.”⁴⁴

The unexpected and unfavorable consequences of the tender inclined the government to modify the law again. Namely, in the absence of candidates no tobacco shops could open in a significant number of Hungarian settlements. “There are 1417 settlements in Hungary where nobody submitted an application. Looking at the list it is striking that these are mainly small villages of 2000 inhabitants, or even smaller settlements. The yearly rental fee (for such as shop) would be altogether less than a hundred thousand forints but it seems that it isn't worth it for locals to maintain a separate tobacco shop.”⁴⁵

The third change in the law would facilitate legal trading in settlements which remained without tobacco sales outlets. If exercising the rights to tobacco retail ceases (or rather, is not awarded to a settlement), the Hungarian state may exercise the right to sell tobacco products to a limited company or a company-authorized individual until such time as a concession contract is signed, based on a successfully-awarded permit.”⁴⁶And it will be possible for the state to exercise the right to trade in tobacco products through the use of a mobile shop as well.”⁴⁷

Another way to improve conditions for business was through the (proposed) raising of the up-to-four percent margin of these products: “the minimum trading margin rate is (would be) ten percent of the (gross) retail sale price of the tobacco products.”⁴⁸

The third change rewrites the rules of competition among suppliers too. It eliminates the opportunity for so-called ‘slotting’ (or payment of ‘shelf money’). The owner-operator is prohibited from entering into any agreements, either directly or indirectly with the supplier; moreover suppliers are prohibited from receiving accepting gifts, discounts, or other benefits from the relationship (excluding the usual-conventional trade margin), the aim of which is to facilitate the start up or practice of the tobacco retail trading”.⁴⁹ Moreover, “the provision of preferences or benefits for establishing, operating or installing tobacco shops is considered unlawful.”⁵⁰

Tobacco scandal No. 1.: the main arguments of opponents

The result and method of the distribution of concessions was subject to an overwhelming nationwide response. The characteristic and typical objections of those who were dissatisfied with the outcome of the process included the following:

1. Dispossessed traditional tobacconists became common figures in the media during these weeks. There were numerous reports about the checkered fates or shutting down of tobacco

⁴⁴ <http://www.parlament.hu/irom39/10881/10881.pdf>

⁴⁵ http://index.hu/gazdasag/2013/03/29/1417_telepules_maradhat_dohanybolt_nelkul/

⁴⁶ <http://www.parlament.hu/irom39/10881/10881.pdf>

⁴⁷ <http://www.parlament.hu/irom39/10881/10881.pdf>

⁴⁸ <http://www.parlament.hu/irom39/10881/10881.pdf>

⁴⁹ <http://www.parlament.hu/irom39/10881/10881.pdf>

⁵⁰ <http://www.parlament.hu/irom39/10881/10881.pdf>

shops that once belonged to successful tobacco shop owners; honorable members of local society.

2. That persons inexperienced at trading tobacco commonly won concessions provoked opposition not only from tobacconists and their representatives but the wider public. According to our information, “the big multinational tobacco producers and distributors also reviewed the list of 5400 concession winners – presumably in search of potential business partners. They compared this list of names to their database of former clients (not only including tobacconists but also innkeepers). To the best of our knowledge they were able to identify only 800 of their former business contacts. This means that the vast majority of the concessions – namely, 4600 licenses – were received by persons who had not previously traded tobacco.”⁵¹

3. Opponents also complained that contributors and contact partners of any of the big players on the tobacco market won a surprisingly large number of concessions: “From July more than 500 tobacco shops will be managed by persons who are connected somehow to the Continental Company at Hódmezővásárhely. Persons belonging to tobacco trading companies, the owners of which have or had - in the role of acting or silent partners - business connections with Continental Company or with its distributor Taban Trafik Limited, or other stakes of Continental, won nearly the same number of concessions.”⁵² Continental informed those interested that “this process was managed only by our fellow workers, without any kind of ‘central involvement’, because in the last 8-10 years they had noticed in their daily work that they were regularly forced out of the sales places of tobacco products - thus their work and their livelihoods were at risk – as we have read in the communiqué. Namely, the company itself also believes that these people represented Continental’s interests in the competition for concessions.”⁵³

4. We have identified several media stories which have covered the fact that the winners of tenders have a friendly-family or subordinate relationship with the local or national leaders of the governing party alliance or with state officials who are involved in the decision-making processes of local or central government.⁵⁴ “For example, the 19 year old son of the mayor at Fonyód won 3 concessions. Two of these tobacco shops will operate in Fonyód; another in Balatonfenyves. (The family relationship is revealed from the biography of the mayor and from the Open database too). There are other settlements where our local readers suspect that members of the mayor’s family are among the winners of such tenders. At Algyő, for example, *Mrs Istvánné Herczeg* won two of the town’s three tobacco shops. The name of the mayor is *Mr. István Herczeg*. Furthermore, the mayor of Izsák, *Mr. József Mondok*, and deputy mayor *Mr. István Zámbo* at Kisvárd (delegated by FIDESZ) are among the winners.”⁵⁵

⁵¹ (B.Z.) 2013

⁵² http://hvg.hu/gazdasag/20130620_500_trafik_egyetlen_kezben_trafikmutyi

⁵³ http://hvg.hu/gazdasag/20130522_Continental_dohanygyar_kozlemeny

⁵⁴The theory of regulation describes this phenomenon: “Occupational licensing. The licensing of occupations is a possible use of the political process to improve the economic circumstances of a group. The license is an effective barrier to entry because occupational practice without the license is a criminal offense. Since much occupational licensing is performed at the state level, the area provides an opportunity to search for the characteristics of an occupation which give it political power”. Stigler (1971) p. 13.

⁵⁵ http://index.hu/gazdasag/2013/04/23/a_nagy_nemzeti_dohanymutyi/

Members of the Government were associated with the list of winners as well. The prime minister's involvement seems to be proved by the fact that some of his intimates won concessions. **Károly Junek**, the son-in-law of *János Flier* who is the co-owner and tiller of eighty acres of land owned by *Anikó Lévai* (the wife of prime minister *Viktor Orbán*) – won the concession for the only tobacco shop in Felcsút. The businessman who enjoys this monopoly in the village can sell his wares to visitors to events held at the Ferenc Puskás Football Academy which is managed by a foundation of *Viktor Orbán*'s. The son-in-law of *Flier* won a concession for a national tobacco shop in the next-door village of Bicske as well.”⁵⁶

The power-driven distribution of concessions is clearly observable in the case of the town of Szekszárd. One of the municipal representatives reported openly on how the concessions were distributed in the town. “It was not a formal meeting of the local council but it was some sort of policy coordination. The members of the (FIDESZ) fraction were present and the constituency chairman said that ‘here is the list of applicants for the tender’. He asked us to look at the list and select our acquaintances and select suitable candidates. I was surprised. It is known that there are lobbies but it was surprising that this happens so openly. I was forced to argue for an old and long-established retailer couple – that they should not be disadvantaged because they have no friendly connections. We practically reviewed the whole list. We assessed the names and we voiced our opinions about people we knew.”⁵⁷ On the other hand, the mayor of Szekszárd said that he - as constituency chairman – had not seen any listings. Moreover, he could not have seen such a list because the tender was managed by National Non-profit Tobacco Trade Ltd. The mayor insisted on his own statements when the details of the process of the distribution of concessions (that he was managing) was confirmed in the records.”⁵⁸

The Hungarian prime minister evaluated these stories as random events. “There are hundreds of leftists among the winners of the concessions” – said *Orbán Viktor* in an interview. The prime minister refused to admit that decisions were made according to political criteria. He argued that: “I am a gentle man, therefore this is not a threat, but I say that if we had wanted to enforce our political strength using such a concession tender system, not one person from the left would have won.”⁵⁹

Those who invited entries to the competition argued similarly. The president of the National Non-profit Tobacco Trade Ltd said that “neither any constituency chairmen nor politicians were included in the decision making. We prepared these decisions in collaboration with ministry staff and the hanging committee decided. They prepared ranking lists of applicants by settlement which were later approved by the Minister. We have created a closed system to manage the applications. No one could take the names out of the building.”⁶⁰

The president of the company stated that the widespread outcry was provoked by the media activities of influential business circles who were liable to suffer from being financially damaged. “I would rather figure out whose interest it is to stimulate this political scandal. I think that serious, well-paid groups are handling this issue. There are a lot of people who lost

⁵⁶ Ferenczi Krisztina (2013)

⁵⁷ http://hvg.hu/itthon/20130430_trafikmutyi_Szekszard_fideszes_kepviselo

⁵⁸ http://hvg.hu/itthon/20130509_trafik_Szekszard_Fidesz_hangfelvetel

⁵⁹ (B.Z.) 2013.

⁶⁰ http://nol.hu/gazdasag/20130430-tizennegy_titkos_szakerto

their tenders and therefore are dissatisfied with the situation. This is understandable. However, when the law was complete it was absolutely clear that it was not in the interest of certain groups to stand up to the system in July. 90 percent of the market was controlled by multinational companies until now. This 400 billion HUF yearly turnover will be in the hands of Hungarian families henceforth. This creates an enormous loss for the multinationals. The new system creates equal opportunities. The multinational companies – based on sponsorship money – have been able to take a considerable share of the market until now. Some companies have paid billions to trade their products exclusively in a certain store. Now they will have no chance to do that.”⁶¹

Tobacco scandal No. 2.: Unexpected and unusual consequences

The organized action of the losers⁶² did not create any delay. ”Because of the present tobacco law, people who have lost their means of existence in part or entirely are trying to create a means of virtual and real interest representation after it has been proven that the institutions created for that purpose - due to their involvement – are completely unable to fulfill their tasks. Today, as a first step we have started a Facebook page....Our goal is to destroy the extremely corrupt results of the tender and/or to force those who are competent to withdraw the law due to their involvement which makes the tobacco retail into a state monopoly. In the interests of this, we shall consult all the national and EU bodies involved in the near future, and we will express our discontent on the streets as well.”⁶³

“People harmed by the regulation of the tobacco trade took to the streets on the 15th of March 2013. About 200-250 people gathered to listen to speakers who emphasized that they had taken to the streets to defend the interests of their own and others’ family businesses. Their aim was the annulment of the law. They emphasized that this demonstration was a party-independent event.”⁶⁴

Opposition parties also criticized the handling and the consequences of the tender. “LMP⁶⁵ is initiating action before the tribunal to judicially enforce the publication of the list of tender applicants - announced *Pál Schiffer* at a press conference on Tuesday. The independent MP said that they had asked National Non-profit Tobacco Trade Ltd on 18th of April for the whole set of documentation and the scores of the applications received. They got the answer from the NNTT boss *Zsolt Gyulay* on Monday that the chief manager was refusing to hand over the applications – he mentioned”.⁶⁶

Another parliamentary party, Jobbik, initiated the setting up of an ad hoc Parliamentary Inquiry Commission to investigate the tobacco retail tender – announced *György Szilágyi*

⁶¹ http://nol.hu/gazdasag/20130430-tizennegy_titkos_szakerto

⁶² Instead of a forced or a voluntary exit, economic actors may choose the option to protest or speak up: “The firm’s customers or the organization’s members express their dissatisfaction directly to management or to some other authority to which management is subordinate or through general protest addressed to anyone who cares to listen: this is the voice option. As a result, management once again engages in a search for the causes and possible cures of customers’ and members’ dissatisfaction. Hirschman 1970) p 5.

⁶³ http://www.nyugat.hu/tartalom/cikk/erdekkepiseletet_hoznak_letre_a_trafik_karosultak

⁶⁴ http://www.nyugat.hu/tartalom/cikk/erdekkepiseletet_hoznak_letre_a_trafik_karosultak

⁶⁵ LMP=Legyen Más a Politika (English: Politics Can be Different) is the name of a political party in Hungary.

⁶⁶ <http://www.galamuscsoport.hu/tartalom/cikk/209745>

(MP)⁶⁷ Activists from this party demonstrated in support of tobacco shop keepers at the party headquarters of FIDESZ.⁶⁸

Many people sympathized with the losers. According to public opinion polls, the majority of the population rejected not only the results of the tender but its method of execution: “less than one-fifth of those surveyed agree with the tobacco tender of the government. The majority of them refuse to accept that the government has the right to decide who may trade cigarettes. According to nearly half of the Hungarians who were questioned, the winners were selected not in a professional way but through political connections/networks-of-friends. Even a quarter of pro-Government voters suspected that there was corruption in the tendering process.”⁶⁹

Further tenders

The Hungarian government and National Non-profit Tobacco Trade Ltd. perceived the increasing discontent of the public. A few days after the publication of the list of winners the regulation was modified again. On the one hand the government sought to increase the (according to a significant proportion of general public, unreasonably low) share of former tobacconists among the winners. On the other hand, the government and the limited company attempted to identify a solution to the problem that no one had applied for a concession in 1417 settlements so that consumers could not legally buy cigarettes in those areas.

The prime minister joined the opponents of his government on 2nd May 2013: “It is not acceptable that people would lose their livelihoods whose main job it was to manage a tobacco shop but who did not win a concession” announced the prime minister in his interview on Friday. He informed the public that the government was looking for a legal opportunity that ensures that those shopkeepers who have been engaged in the tobacco product retail trade until now do not lose their livelihoods.”⁷⁰

The responsible person from the government, *János Lázár*, announced a day later that “a significant share of former tobacconists received a concession. A re-evaluation of tenders was offered to those who were not successful at this turn. According to the secretary of state, about one hundred tobacco retail shops are involved in the re-evaluation process which will be undertaken on a case-by-case basis.”⁷¹ An important codicil, however, was introduced: “in contrast to the original conditions...only those may apply who owned a tobacco shop which remains in the same location as it was in twenty years ago, and which obtains 80 percent of its revenues from tobacco products.”⁷²

Another tender was announced on the 2nd May 2013, the aim of which was to solve the problem of unsupplied settlements. The sale of tobacco products was greatly facilitated in these small villages. It was decided that tobacco retail trade could be carried on not only in tobacco stores but in other retail shops in settlements where the number of inhabitants is fewer

⁶⁷ http://index.hu/belfold/2013/04/27/trafik-ugy_a_jobbik_vizsgalobizottsagot_allitana_fel/

⁶⁸ http://tablet.hvg.hu/itthon/20130510_Jobbikosok_tuntetnek_a_Fideszszekhezaznal

⁶⁹ http://www.atv.hu/belfold/20130508_a_magyarok_60_szazaleka_ervenytelenitene_a_trafikpalyazatot

⁷⁰ ⁷⁰ http://index.hu/gazdasag/2013/05/03/orban_is_megszolalt_trafikugyben/

⁷¹ <http://www.nepszava.hu/articles/article.php?id=642778>

⁷² http://www.blikk.hu/blikk_aktualis/igy-lehetetlen-trafikot-nyerni-2189961

than 2000, provided that these shops comply with the rules and other legal requirements concerning the sale of tobacco products. Such sales would be possible only in shops where a separate area may be created which facilitates the trade of tobacco products and which is not visible to young customers.”⁷³ The results of the announced “corrective” tender of 3th of May 2013 were published on 30th of August 2013.

Provisional and long-term market effects

The decline in the sale of tobacco products (observed since 2012) continued and moreover speeded up after the adaptation of Law CXXIV (2012) and its modifications. Compared to the previous year, turnover of these products of about 25 has dropped by in 2013.

Several experts had expected market disruptions and supply difficulties during the period of change in the market (i.e. in the months when the pre-existing shops were removed from the market and the new entrants came into play).⁷⁴ But these pessimistic forecasts and estimates were not realized – no significant disruptions occurred to the market. Smokers had easy access to their desired cigarettes, cut tobacco and cigars without difficulty because “80 percent of the national tobacco shops opened on schedule, on the 1st of July.” The chance of a smooth transition occurring increased because numerous smokers - counting on some temporary difficulty in obtaining their preferred smoking product - had thought to buy in greater than usual stocks. Turnover of tobacco products had increased by mid-2013, and more so in the second quarter of this year. But thereafter - mainly in the last months of the year - dramatic declines in monthly turnover took place (see Table 1).

Unfortunately, this is not a sign of the desired reduction in smoking of members of Hungarian society but rather relates to an increase in the illegal trade of tobacco products which occurred after the opening of the national tobacco shops. According to a survey managed by GfK Hungaria⁷⁵ in August-September of 2013, “After experiencing a downward trend in recent years, last year was the first when - because of multiple increases in excise duty - the black market repeatedly grew over a relatively short period of time. The share of tobacco products of foreign origin was 4.2 percent in 2011 5.8 percent in 2012 - and this year it increased to 7.7 percent.”⁷⁶

The research company registered further increases in the illegal trade in the fall of 2013. “The (market share of) illegal trade in tobacco products increased by 11 percent at the end of the previous year in Hungary, compared to the nearly 8 percent measured by the first survey done by the company in May-June.”⁷⁷

According to the evaluations of the government the fact that only a temporary decline occurred (caused by the immediate conversion of the tobacco market) was awarded great significance. “It seems that the transitional period which started in July with the establishment of the national tobacco shops’ network is coming to an end, drawing conclusions from the latest data” said Deputy Secretary of State at the Ministry of National Economy, *Zoltán Pankucsi*. During the first days of October 2013 he stated that the tobacco companies had paid excise tax amounting to HUF 24 billion in August. This amount remained below last year's otherwise outstanding sum. But much more money was collected for the budget in September. Revenue may reach 35 billion HUF this month - said the ministry leader, who noted

⁷³ http://nemzetidohany.hu/assets/Nyilvános-koncessziós-pályázati-kiírás_2013.05.02..pdf

⁷⁴ http://index.hu/gazdasag/2013/05/29/cigaretta_nelkul_marad_az_orzag_juliustol/

⁷⁵ Hungarian market research company, member of the international network of GfK see more: <http://www.gfk.com/hu/Lapok/default.aspx>

⁷⁶ http://index.hu/gazdasag/2013/05/29/cigaretta_nelkul_marad_az_orzag_juliustol/

⁷⁷ <http://www.hirado.hu/2014/01/17/osszefogast-surgetnek-a-feketepiac-visszaszoritasaert-a-dohanyipari-befektetok/>

accordingly that the previously average level of revenue was derived from the last months' legal trading in cigarettes.⁷⁸

Table 1
Free trade of products subject to excise duty (monthly data in 2013)

2013	Cigarettes, Cigarillos, Cigars (Million)	All Tobacco (thousand kg)
January	717.04	355.68
February	804.39	431.02
March	917.34	452.52
April	992.93	439.08
May	926.37	447.13
June	1054.75	523.90
July	672.79	429.70
August	960.52	333.48
September	915.16	491.34
October	583.99	492.21
November	518.88	378.90
December	722.60	411.19

Source: National Tax and Customs Office (NAV)

But “normal conditions” were not restored in the coming months. Based on preliminary data for October (2013) the tobacco excise tax revenue was estimated to be 18 billion for the month, which is about half of the September amount. Because of this trend, analysts at the Ministry reported a loss of HUF 26 billion which, together with the decrease in VAT revenue, means a loss of approximately HUF 40 billion from the yearly budget⁷⁹.

Others - counting in illegally consumed tobacco - assumed an even higher share of black market turnover: “According to the president of the Hungarian National Association of Tobacco Growers⁸⁰ harm to tobacco plantations is occurring more and more often in the region. Moreover, on several occasions a significant amount of leaf-tobacco which was in the process of being dried was stolen.⁸¹

Analysts explained the increase in illegal traffic by pointing to two factors: one is the required increase in the margin, while the other concerns changes in the sourcing strategy of smokers who have remained without legal purchasing options. For example, the “Ukrainian cigarettes ‘Feszt’ are much cheaper to purchase for 470 HUF than legitimate goods at twice the price. Cut tobacco is the cheapest of Furta’s products in tobacco shops. A forty-gram package will

⁷⁸ http://mno.hu/magyar_nemzet_gazdasagi_hirei/lecsaptak-az-illegalis-dohanyra-1188326

⁷⁹ http://www.napi.hu/magyar_gazdasag/zuhanas_cigarettafronton_meglepodott_a_kormany.568816.html

⁸⁰ Magyar Dohánytermelők Országos Szövetsége (Madosz)

⁸¹ http://www.piacprofit.hu/kkv_cegblog/sokmilliardo-ongol-a-trafikrendszer

cost 820 HUF. Of course there are a lot for whom that price is not affordable. So then they buy cut tobacco 'second hand'.”⁸²

The action of the government – another tender

The Government used administrative measures firstly to offset the unintended negative effects of regulation. The power of inspectors and the number of market monitoring activities would increase, “therefore the ministry's tax law proposal expands the possibility of checking those finance guards who are digging illegal cigarette shipments. According to this proposal, the legislation would allow official persons to enter any premises and scan any buildings if they have reason to believe that unlicensed tobacco is hidden therein.”⁸³

The third advertised tender (12th August 2013) of National Non-profit Tobacco Trade Ltd tried to ease the supply problems of 1500 settlements which were left without a tobacco shop. It read that ““tobacco retail is allowed not only in tobacco shops but in other shops in settlements where the permanent population does not exceed two thousand people if this business otherwise meets other legal requirements for the sale of tobacco products. Such sales may only be conducted in such shops in a separate, isolated space, or when a reserved section of a room can be created which will permit the sale of tobacco products...separately.”⁸⁴

Tobacco producers and wholesalers in the new system

Meanwhile, new details have come to light concerning the real or perceived political ties of the new tobacco shop owners and their relationships to the large suppliers. The Hungarian government has not denied but only interpreted such news. According to the state Secretary at the Prime Minister's office, one of the important players in the market is behind the newspaper articles which criticized the distribution of concessions: “They were lobbying in Brussels first, then the adoption of the law tried to stem this...and at last they tried to take action to discredit [the law]” – claimed *János Lázár* about the multinational tobacco producer company Philip Morris Ltd. According to him, the opposition media were unable to identify Fidesz ties to 90 percent of the winning bids. Mr. *Lázár* was convinced that the regulatory changes caused a serious conflict of interest at Philip Morris. “They sent a clear message to us that they would do everything to prevent the introduction of the new system on July 1st. At a company of such a size, it is a matter of a few hundreds of millions to finance a communication campaign” - he added. The owner-manager of Continental Company used similar arguments. “Companies - the interests of which were damaged - consciously helped these newspapers. It is in someone's interest to constantly damage the reputation of Continental.”⁸⁵

Competition between the major tobacco suppliers (partly employing political means) sharpened. This development was connected to the fact that these companies tried to maintain or increase their market shares in a constantly shrinking market due to the rapid spread of

⁸² Kácsor Zsolt (2013)

⁸³ http://tablet.mno.hu/magyar_nemzet_gazdasagi_hirei/lecsaptak-az-illegalis-dohanyra-1188326

⁸⁴ http://nemzetidohany.hu/assets/Kiírás_3.-pályázati-kör_teljes_2013.08.12.pdf

⁸⁵ <http://www.168ora.hu/itthon/dohanykoncesszio-continental-trafikbotrany-santa-janos-114374.html>

illegal trading. The deteriorating market situation reduced the performance of these companies as early on as 2012. “BAT Ltd. suffered in 2010 1.9 billion, in 2011 3 billion and in 2012 4.2 billion HUF losses in Hungary”, while according to the court of public data losses to the tobacco industry in 2010 were 5.3 billion, and in 2011 8.6 billion HUF – as can be read in the communiqué of the tobacco company. Moreover “performance measured as profit before tax was not outstanding at these companies either. At Philip Morris profit dropped from nearly 1 billion HUF to 756 million in this period....also, the performance of the Hungarian-owned Continental weakened in 2012. Its net sales increased by HUF 19.1 billion to 23.4 billion but other expenses increased from 12 to 15.8 billion (because of excise duty), and the final operating profit was reduced to less than 200 million. The company's pre-tax profit was 165 million HUF, the balance sheet said 122 million and the company did not pay dividends.”⁸⁶

In such a market situation it was particularly important to the large suppliers what proportions of their products were located on the shelves of the national tobacco shops. As we mentioned before, the April 2013 amendment of the law banned the payment of so-called shelf money. It prohibited the drawing up of exclusive contracts and also outlawed other discounts. These changes of regulation did not equally affect market players. The owner-manager of Continental made no secret of the fact that the new legislation was favorable to them. “Of course the multinationals do not want to introduce the new system. Because they have paid a lot of shelf money for years. They bought the retailers ‘by weight’ so that they would sell their products only, and that the products of ours - or of other small and large manufacturers - were not on retailer’s shelves. It is very difficult to sell a product that the consumer does not meet with. In 1996, when we started our business many stores sold our products. Then the multinationals – based on various marketing contracts – ‘bought out’ the shops and did not invite us to join in their so-called ‘self-negotiations’. The tobacco law eliminated the competitive disadvantage of the smaller tobacco companies. That prohibits all marketing activities, including the shelf money which they employed to gain unfair advantages and displace domestic producers. It would be a great pleasure for me if everyone - Hungarian producers, Hungarian employers - helped each other in Hungary, and not just foreign capitalists, who are here only to hinder production and take out money. Although this is not the primary purpose of the law, this consideration should be one of the subjects for its opponents too.”⁸⁷

The first months of 2014

Hungary experienced further a contraction in traffic and the expansion of the black market at the end of 2013 and in the first quarter of 2014 as well. This adversely affected the new national tobacco shops' performance. The chief manager of the National Non-profit Tobacco Trade Ltd acknowledged in November of 2013 that “According to our accounts, 200 tobacco shops from the 6300 which operate in hypermarkets, malls and petrol stations obtained 17 per

⁸⁶ http://index.hu/gazdasag/2013/06/04/gyengultek_a_dohanycegek/

⁸⁷ http://www.delmagyar.hu/hodmezovasarahely_hirek/a_continental_a_trafikpalyazatrol_/2331157/

cent of market turnover. In contrast, 2500 tobacco shops are fighting for survival.”⁸⁸ At the end of December 2013 they stated that “recalling the miserable traffic-related data, the government report acknowledges that a significant number of national tobacco shops face operating difficulties. Their revenues fall short or barely reach the level of sustainability.”⁸⁹

The government’s response to this unplanned phenomenon was a further change in the regulation. “The director of the National Non-profit Tobacco Trade Ltd justified the governmental modification decree of the licensing procedure through referring to the disproportionate differences in traffic.”⁹⁰ According to the Government Regulation published on November 28, 2013 “A tobacco shop may not be established or related to buildings in which operate a.) Shops (commercial units) of more than 2,500 m² of floor space b.) service stations and commercial units which serve the station. Tobacco shops may also not be established in shopping arcades.”⁹¹ Using everyday language this means that national tobacco shops can operate only until 30 May 2014 in supermarkets with more than 2,500 square meters of space, at hypermarkets and petrol stations.”⁹² Furthermore: “According to the Regulation, until 30 May 2014 tobacco shops are not allowed to operate in parking lots and parks around these sites, including those which otherwise had received permission from customs and are currently operating.”⁹³ The government’s decree was aimed at consolidating the tobacco product market and further declared that “until 30 May 2014 a tobacco shop cannot operate within 200 meters of any entrance to another tobacco shop.”⁹⁴ Concerning the effects of these changes of market regulation we may share some estimations with the reader: “The government’s decree works against TESCO most, because it would affect 116 tobacco shops operated in hypermarkets owned by the supermarket chain. Auchan has 19 and Interspar 31. CBA, however, has only three such stores.”⁹⁵ The big oil companies which manage petrol station networks may be among the losers of the new rules as well.

Analysis and conclusions

We have described in our article how in the case of Law CXXIV (2012) that any unexpected, increasing negative impacts of smoking did not justify the diligence of the regulator. There was no dramatic deterioration in Hungary as concerns smoking habits, nor significant rises in the proportion of smokers. The Hungarian tobacco market was not characterized by severe market disruptions, nor supply difficulties before the implementation of this law. Moreover, the tobacco excise revenues in the budget were not dramatically lower by 2012. We have documented how illegal traffic did not significantly increase during the same period. No

⁸⁸ http://hvg.hu/gazdasag/20131129_Tul_sokat_kaszaltak_ezert_teszik_ki_a_tra

⁸⁹ Danó – Batka (2013)

⁹⁰ <http://privatbankar.hu/kkv/ezert-nem-lehetnek-trafikok-a-plazakban-es-a-benzinkutakon-263618>

⁹¹ A Kormány 453/2013. (XI. 28.) Korm. rendelete a dohánytermék-kiskereskedelemmel összefüggő egyes kormányrendeletek módosításáról

⁹²

⁹³ http://hvg.hu/gazdasag/20131128_Kirugjak_a_trafikokat_a_benzinkutakrol_es

⁹⁴ A Kormány 453/2013. (XI. 28.) Korm. rendelete a dohánytermék-kiskereskedelemmel összefüggő egyes kormányrendeletek módosításáról

⁹⁵ http://index.hu/gazdasag/2013/12/11/trafikszabalyozas_a_tescora/

evidence of a regulatory deficit was found because Hungarian legislation had tightened up the conditions for the sale of tobacco products less than a year earlier.

Why the new law was needed?

One of the reasons for the birth of the law should have been the expected policy benefits.⁹⁶ It is no coincidence that the rollback and control of smoking was the most important aim (as declared) of the introduction and adoption of the law. The number of shops and purchase points which legally sold tobacco was radically reduced after the adoption of the law. The state authorities improved the efficiency of the monitoring system, increased the number of checks and the magnitude of penalties. This is why legislators and the government gained the recognition of domestic and international anti-smoking organizations and media employees.⁹⁷

The goal of improving Hungarian entrepreneurs' and the domestic middle class' socio-economic situation also often featured among the declared intentions of legislators during parliamentary debates. This goal was partially met because a significant number of sales points ceased to exist in foreign-owned business centers and hypermarkets stores of gas stations. Accordingly, after the law came into force the likelihood of Hungarian small entrepreneurs engaging in tobacco retailing was probably increased.

Important but hidden goals were also accomplished. A significant number of interviews, personal communication and press-matter documented that local authorities were often involved in the process of allocating concessions. Not only were a large number of relatives, friends and party sympathizers on the winners list, implying a policy-driven distribution process, but the bargaining power and influence of stakeholders and their relational capital prevailed in the drafting and submission of the "tobacconist law" and its modifications. Large tobacco-supplying companies were involved at different intensities and at different levels of efficiency in the regulatory process, in influencing the state and in the mobilization of applicants. One of the important market players – using its political ties - took part from the beginning in the regulation and transformation of the domestic market for tobacco products.

We may interpret the law as a test case of top-down restructuring of Hungary's property and market structure. "According to the Prime Minister: matters like these - but of greater importance - will occur again in this election cycle and in the future and will provoke similar debates because we will manage similar market restructurings in this election cycle and in the future as well. If we think that within the law, and respecting European competition rules, we

⁹⁶ "The government itself now has powerful political incentives to broaden membership among the privileged. Governments will be sorely tempted to offer still more licenses to practice law or medicine or to operate liquor stores, taxicabs, and barber shops. Such rents, of course, are not manna from the heavens; they must be supplied by political decision makers. The goals of these political actors may be pursuit of the public interest, or at least their own version of it. The task of the government is to devise politically optimal restrictions and entitlements that effectively limit market competition yet maintain the ruler's own power and revenues. Michel-Munger (1991), page 526.

⁹⁷ <http://www.origo.hu/itthon/20131008-orban-dijat-kapott-a-dohanyzas-visszaszoritasaert.html>

have a chance to support small and medium size entrepreneurs then we will intervene and reorganize things.”⁹⁸

The legislative changes, proposals and government regulations listed in Table 2 detail the bargaining between market participants and market regulators, about the not-completely-expected effects of the new legislation and about the efforts of the government to avoid or to alleviate market disruptions in the period 2012-2014 for the tobacco product market in Hungary.

Table 2

Problems and modifications

Changing or modification of the rules	unexpected phenomenon which caused the change	Change or modification	Consequences and effects
First amendment of the law ² 12 December 2012	Number of applicants is fewer than expected	Expansion of the range of authorized products: namely, lottery	More intensive recruitment
Second amendment to the law, 12. February 2013	Few applicants from small villages	Further extension of authorized product range to include alcoholic beverages, coffee, mineral water, soft drinks, magazines	Provisional improvement of supply in villages
Third amendment to the law, 12. February 2013	Less profit than expected No applicants from small settlements Diminished regulatory advantages of multinationals	Increase of authorized margin Provisional trade in other shops Prohibition of shelf charge	Provisional improvement of supply in villages
Tender for pre-existing tobacconists, 3. May 2013	Social tensions Tobacconist scandal	Special tendering conditions	Distribution of 60-70 concessions
Tender for non-served settlements, 12. August 2013	Growing illegal trade in tobacco products	Provisional trade in separate section of grocery stores	Provisional improvement of supply in villages

⁹⁸ http://index.hu/belfold/2013/05/30/orban_lesznek_meg_piacokat_atszervezo_lepeseink

Government decision	Growing illegal trade in tobacco products	Mayor of a settlement may appoint a trader of tobacco products	Provisional improvement of supply in villages
Government decision 28. November 2013	Tensions caused by variations in profitability	Prohibition of trade at petrol stations and in shopping malls 200 meters distance required between tobacco shops	Unmeasurable impact

Turning back to the indicators of success (as specified by the government: namely, the reduction or stagnation in growth of the share of smokers and improvement of the market position of the Hungarian entrepreneurial strata) we should mention here that these indicators are inappropriate for measuring the – mainly negative – outcomes or costs of the law and its amendments. Due to the prohibitive limits on supply, several (mainly tobacco-selling) shops ceased to exist. The loss of income from tobacco weakened the market position (and the probability of survival) of a significant number of other small shops and restaurants. Among the negative effects we also should mention that the increase in the illegal trade of tobacco products generated losses at the newly-established national tobacco shops as well. Another negative and unexpected impact of the new regulation (more exactly, of the growing share of illegal trade) is the less-than-planned budget revenue. These are the negative effects and unplanned losses stemming from the implementation of Law CXXIV (2012).

It has also been demonstrated in this paper that several of those regulated – losers and winners alike – did not remain inactive. They forced the regulator (the state) to redistribute profits and losses and successfully pressed state authorities and parliament to repeatedly ‘correct’ this piece of legislation. The ongoing process of re-regulation was associated with disturbances and unplanned side effects which did not arise from those who had left or been displaced from the market. These persons, companies or their representatives did not have significant bargaining power. They used the spectacular and noisy instruments of exit and voice but only small groups took part in unusual and provocative actions. A significant fraction of the losers of the new regulation partly or totally counterbalanced their losses caused by crowding-out. They sold a greater number of products or services which were not affected negatively by the new regulations.

It was not only the government’s ongoing re-regulation but their protection of big companies and newly-selected players on the market (the winners of concessions or those who bought concessions on the secondary market) that contributed to the recurrent regulatory failures. A significant number of actors entered the market on the basis of unfounded and overly optimistic business plans. They often did not take into account the likely shrinkage of the market and they underestimated the speed of the expansion of black market turnover. Moreover, they did not assess carefully the impact of the spatial location of their shops on

turnover. We have documented how these disgruntled and disappointed new players often indicated their dissatisfaction to the regulative state via protest and exodus.

Not to minimize the importance of these factors, we are nonetheless convinced **that the main source of market disturbances was the fact that the state - following its hidden political goals – repeatedly rearranged and reorganized the market for tobacco products.** Table 2 shows clearly that the regulatory failures and miscalculations (one and a half thousand settlements without points for making tobacco sales, the lower-than-expected number of applicants, the greater-than-expected number of loss-making new businesses) forced the initiation of the rapid feedback and continuous correction processes that were managed by the regulatory state or by National Non-profit Tobacco Trade Ltd. Avoiding expected political losses was the reason for state regulators to extend the range of goods and services available at national tobacco shops and why they eased the rules of isolation concerning the trade in tobacco products. This explains why regulators empowered the mayors of smaller settlements to appoint local tobacco product traders.

These are the reasons for the various modifications of the regulation. These are the reasons why the impatient regulator was unable to wait for regulated market players to adapt. The adjustments, however, caused new regulatory disturbances and tensions and led to further regulatory amendments. The story is not yet over. We do not know whether the regulatory state has learned from the process. Will it start on further experiments with nationalizing markets? If so, how will its combat strategy change?

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