3. OPERATIONAL MECHANISM OF THE HUNGARIAN AGRICULTURE

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1. Introduction

The Hungarian agrarian economy /agriculture and food industry/ lives, undergoes the period of transition in the change of political system and of the markets since the middle of the year 1990./ In this period the permanent elements gradually come into being on areas connected with problems of ownership, organization as well as with the market operational mechanisms, but a number of solutions now taking shape can also be found.

2. Legislational frames of the transformation

The ownership and organizational transformation - beside a number of other Acts - are mainly effected by those disposing over indemnity, transformation of production cooperatives, over the bankruptcy and privatization.

2.1 The indemnity

Hungary did not stand for reprivatization, but undertook the historical reparation damages caused unjustly in the private property of the citizens. An integral part of this is the pecuniary reparation to be offered for the liquidation of land property. Parliament passed three indemnity Acts, the material, personal and temporal coming into force of which are essentially different. Namely:

a. The 1st Indemnity Act disposes over the partial indemnity for damages caused unjustly in the property of the citizens by laws passed by the State after 8th June 1949.

b. The 2nd Indemnity Act disposes over the partial indemnity for damages caused unjustly in the property of the citizens by laws passed by the State between the 1st July 1939 and 8th June 1949.

c. The 3th Indemnity Act disposes over the indemnity of persons unlawfully deprived from their life and freedom out of political reasons between 11th March 1939 and 23rd October 1989.

The essence of the indemnity is that the person entitled for it may have a share in a <u>partial indemnity</u> determined in a lump sum. The indemnity up to 200 thousand Forint amounts to 100 percent, while at over 500 thousand Forint the proportion is only 10 percent. The mode of indemnity is not pecuniary and in kind, but the entitled receives indemnity cards.

The thus received <u>indemnity card</u> is a transferable <u>bond</u> for the bearer, receives an interest for 3 years as of its issue and embodies a claim on the state.
The main areas of use for the indemnity cards are:
- purchase of assets, shares, business shares realized during the privatization of state property,
- purchase of land property,
- buying of a flat being in the property of the state or municipality,
- payment of life-annuity in the frame of social insurance.

A significant part of the transformation in the agricultural land ownership is connected with the indemnity, as about 50 percent of state owned or large scale cooperative land will be <u>compulsorily sold.</u> Any person entitled for indemnity may obtain land property, if he participates for the land at an auction with his cards and receives the right for purchase. The purchase price of a hectare of good quality land generally amounts to 10.000-20.000 Ft indemnity card. This land property acquisition is under way.

The other part of land having been previously in the possession of the cooperatives will become the property of the members of the cooperative without price on basis of the Act on Cooperatives.

2.2 <u>The transformation of the cooperatives</u>

The creation of civil values of alliance and the respective transformation of the operating cooperatives are ensured by the legislator in a basic act.
The Act on Cooperatives /Act I. of 1992/ strives to open market possibilities for the cooperatives mainly by the following legal institutions:

a. A cooperative may be founded by at least 5 members. beside underwriting even a minimal amount of shares. The statutes may allow also the participation of legal bodies /for instance in order to draw in additional capital/.

b. The cooperative self-rule has a wide autonomy in any case of the cooperative - on basis of the principle "one member - one vote".

c. The lawful supervision over the cooperative is provided by the Court of Registration. The member of the cooperative may ask for the judicial supervision of any infringement of his lawful rights.

d. 10 percent of the assets operated by the cooperative is indivisible.

e. The new legal institution of property between the cooperative and the member is the cooperative business share. For the owner of the share at his request a not transferable bond has to be made out which is saleable. The owner of the bond is entitled of an annual share out of the cooperative s yield after taxation.

The year 1992 has been secured for the previous cooperative members for deciding upon and execution of the organizational transformation by the Interim Act /Act II. or 1992/.

a. The first paragraph of the procedure is the designation of property i.e. the division of the cooperative s property in business shares among the members and entitled non-members. The basic principle of the designation is that the division should reflect the proportion of factors having a recourse on the realization and expanding of the assets.

b. The second paragraph of the procedure is the decision on the organizational change /split up, cessation. resp. transformation of the cooperative into an economic company/ or on the separation of members /individual or group-wise/. In the course of this the cooperative has to bring about a decision on the division of the assets. or handing out in kind.

With the institution of separation the members obtained an opportunity to change their business shares into means of production. i.e. to take out the physical assets. This meant a conflict between the members or their groups. since individual means of production were equally necessary for the remaining in the cooperative. or for those leaving. The earlier, separated members may start individual enterprize, or form a cooperative or company.

2.3 The Acts on privatization

The sphere of enterprize property remaining permanently in state ownership is determined by the government on basis of the Act LIII. of 1992. The negotiability of this property is limited, its alienation may be valid by the consent of the government. In this sphere of ownership the state licenses are practiced by the State Trustee Co. as a one-man Co.

The sale of property being provisionally in state ownership, its utilization and protection is regulated by the Act LIV of 1992. Indeed, this statutory provision - in its specific meaning - is the Act on Privatization, since it contains every material, legal and procedural rules of the state property's privatization allotted for alienation. It describes in detail the legal status, economy of the State Property Agency - as the budgetary organ practicing the property rights of the state.

Participation in privatization is served by the Small-scale Enterprize Guarantee Foundation, further the preferential Existency Credit construction and by preferences on instalment payments.

2.4 The Act on Bankruptcy

It is a statutory provision valid since 1.1. 1992, embracing three legal institutions. The bankruptcies proceedings aim at the restoring the solvency of the insolvent deptor. Liquidational proceeding will take place in case of insolvency /bankruptcy/, when there is no chance for the survival of the managing organization, and his property should be devided according to the regulations of the Act - after the indemnity of the creditors. The definitive settlement is the legal institution of the liquidation of the solvent management organization without legal successor.

The Act on Bankruptcy applies a "shock therapy" in order to radically put out of the economic action those being a deptor more than 90 days, independently from the fact what is the reason for the delayed payment. Namely, according to the binding self-bankruptcy institution the leader of the economic organization is obliged to declare insolvency, if the economic organization is unable to settle any of its depts within 90 days as off their falling due.

3. The role of the state

In Hungary - the same way as with our competitors the "regulated circumstances" will be characteristic also in the future in the agrarian sector. The income relations, development possibilities of the agrarian entrepreneurs will also be influenced by governmental interventions - budgetary backing ups, other kind of facilities.
From the beginning of 1993 the institutions and means of the so-called Act on Agrarian Regulation are under development. According to the Act, for the functioning an Office for Agrarian Regulation" has been founded by the Minister of Agriculture.

According to the Act, in the frame of the Regulation the following means may be applied:

a, guaranteed price,
b, guiding price,
c, production self-limitation,
d, determination of a quota,
e, in case of excess products, lack of product intervention,
f, contract for the regulation of the production with the Product Council,
g, determination of the degree and conditions of export or import promotion,
h, licensing of export or import,
i. price levy on export or import,
j. stockpiling, processing, storage by the state, sail of state stocks

3.1 Expectations

The branch specific allowances of the agrarian/ and silvicultural/ organizations earlier validated at returns taxation were essentially shifted as of 1st January 1992. The joint enterprises pay a normative 40 percent returns tax.
The agrarian small-scale producers obtain a personal income-tax allowance - obtainable in an alternative way. In case it is not suitable to keep written accountancy, it is due for tax exemption after an annual 750 thousand Forint gross income. If they chose a written accountancy, then - over and above the general 100 thousand Forint income of 0 percent tax - they may reduce their income-tax basis by a further 150 thousand Ft /i.e. by a total 250 thousand Forint/.
All those who are in possession of a periphery land exceeding 6000 sq.m., are obliged to pay land tax. The degree of the tax varies depending from the quality of the used land property and from its production branch. The starting land-owners have the benefit of tax-exemption for 3 years.

The individual and joint entrepreneurs paying income-tax after the agricultural activity may also reduce their income-tax with the sum of the paid land tax. Agricultural entrepreneurs pay on basis of their personal income-tax a 53 percent obligatory sum for pension and social security, the joint ventures pay a further 7 percent employee contribution and 1.5 percent schooling fee.

The VAT does not allude to the direct income of the entrepreneurs, however influences it through demand; for the agricultural products it amounts to 6 percent.

3.2 Subsidies
The budgetary connections of agrarian ventures in balance, in macro-level comparison show a payment surplus in the frame of income redistribution. About 8 percent of the production value will be devided as subsidy.

Slightly more than 20 percent of the subsidies improving the agriculture s profitability, a great part of the subsidies have a recourse to food industry resp. commerce. Out of this, indirectly and partially get something into the income of agriculture - through purchase prices.

3.1.1. Direct subsidies

The agricultural and food industrial export subsidies amount to 50 percent of the total, 20 percent of the intervention fund of the agrarian market.

Both subsidy aims belong to the permanent elements of the subsidies in agro-economy, and is in harmony in its system with the basic principles of subsidies applied in developed countries. On the other hand, its amount - on account of the material possibilities of the Hungarian national economy - is only a fraction of that applied in Western Europe.

The increasing burdens of energy consumption are reduced by the partial compensation of the exsize duty being in the price of gasoil used by the agricultural producers. out of the intervention on agromarkets.

Equally, the allowance on credit interest amounting to 1/3 of the short-term credits is ensured by the intervention sources in the sphere of promoted plant production.

The Agricultural Development Fund is an institution started in 1993 the degree of which in 1993 amounts to ab. 1 percent of the gross agricultural value of means.

The aim of the Fund is to promote the change of rapidly ageing agricultural implements, the development in agro- and silviculture, the preservation of biological bases, the structure and operation of indispensable expert advice system in the changing agriculture.

The Fund provides final resp. returnable subsidy, and also credit interest refunding.
The respective producers may utilize the subsidy on basis of tender.

3.2.2. Other resources

Beside the expressed agrarian subsidies agriculture is also preferred by the Government in the frame of the Area Development Fund. The resources of the Fund will help the agricultural producers operating under disfavourable conditions, the reduction of employment problems of those living in "undeveloped areas" and the Fund promoted the non-agricultural utilization of agricultural production lands.

A very important means for the transformation of agriculture, the managing of insolvency is the subsidy having a recourse to the transformational /reorganizational/ programme of the agricultural organization.

In the framework of the programme there is a possibility to utilize an interest subsidy - in av. 70 percent-, however the 50 percent of the required own source for bank credit for those living in the "economically underdeveloped" areas is also ensured by this Fund.

The interest allowance may be asked for maximally 7 years after those bank credits which will be used for the purchase of assets of liquidated or transformed cooperatives, for additional investments required for their operation, or for investments serving the utilization of assets of the transformed cooperatives. As of 1993 the interest allowance may be utilized also for the purchase of determined assets of state owned agricultural, silvicultural farms, food industrial enterprises.

4. Banking background

The greater part of agricultural producers, cooperatives always required a significant degree of external resources for their production and development. The price of agricultural products reflected maybe the value of input under better than average production conditions.

Since the development of the two-level banking system the agricultural producers may obtain credits by normative conditions - not counting with the financing peculiarities of the agricultural production.

All these led in the last two years to the greatest liquidity crisis. The demand for external resources is increasing, the agricultural production is showing a deficit year by year, the products market changes hectically, the movements in the organization cause uncertainty.

The resources available at the commercial banks generally have a 90 days run. Interests, though they were reduced since the middle of last year, are nevertheless unbearable high /30 percent/. With the exception of constructional credit business and World Bank credits, there is practically no way to obtain a bank resource of over a year amortization. Therefore exceptionally increased the number of short-term obligations of management, though the production was reduced by ab. 30 percent.

During the last years the long-term debts have been reduced in a certain way. But on account of the long-term credit demand for replacement of implements especially beside the increasing investment price level - they should have been increased.

In this transitory period it is especially important to help contractors not having enough pecuniary insurances by various credit guarantee institutions. The "Agro-entrepreunial Credit Guarantee Fund" serves this aim.
The legal and economic condition system of mortgage-credit and the development of provincial banking network is under elaboration.
Both the land bank and the provincial banking network wish to fulfill a suppletory role in the Hungarian agriculture.

The establishment of the institution system in our opinions important, however a lot of essential preconditions for its operation - similar to the practice of a number of countries - are still lacking.

There is no trade in land, the land has no real price, the demand for mortgage-bonds still has to be developed, therefore the good operation of the institutions may be envisaged in a short term only, if their commencement is coupled by a determined state support. Utilization of external resources /like PHARE subsidy/ seems to be expedient and possible.

5. Institutions of market economy

The Hungarian agroeconomy even under disfavourable material condition system is doing its best in the period of transformation - to build out the market institution system suitable for the requirements of market economy.

5.1 Wholesale markets

a. The Budapest Commercial Exchange

The Budapest Commercial Exchange is one of the youngest market institutions in the world, its operation started in 1989. The original founders were banks and commercial companies.

At present future deliveries are operating on two sectors /cereals and livestock/.

The Budapest Commercial Exchange is in command of the basic rules of regulation, the know-how of clearing system put out for a serious showdown has also been established. Its activity is carried out in a modest infrastructural condition system.

b. Wholesale markets

Beside the earlier basically state investment, private and municipal financing is markedly appearing in the establishment of wholesale markets. Nowadays wholesale markets can be found in a number of larger cities. The centrally located Budapest wholesale market /36000 sq.m open stand, 10.000 sq.m closed storage, 28.000 sq.m internal road network/ recently build out its basic services. The market's technical development is continued.
The establishment of special wholesale markets is also under way. At present three flower markets are under organization in Budapest and in Szeged recently commenced the establishment of the flower market. The cattle-shows are systematically held in the country.

c. The Market-hall Management /CSAPI/

In the capital 46 market-halls are situated. Out of this 11 market-halls resp. market are managed by CSAPI, having a total of 23 premises. Markets operating in the individual districts are run by the municipality.

Market prices are daily collected by CSAPI. as well as the amount of new consignments. The quality differentiation of prices are followed up by the early products only. The collected information - also on a daily basis - are forwarded to the Statistical Agency and to the Ministry of Agriculture. Information gathered in this way get into the National Marketing Information System. Subscribers may ask the data out of the system continuously against payment.

5.2 Integrational organizations

On of the characteristic of the food industry is that the sales opportunities, as well as the financial situation is different; this undoubtedly influences the integrational connections too.

The bulk of company connections is handled mostly in the frame of contract for bulk delivery of goods. Earlier, in certain branches greater role has been given to permanent production of many years, however these connections slackened as soon as a surplus agricultural products appeared on the market. The integration of private producers is definitely maintained nowadays by the cooperatives. The production systems bought about for the integration of large-scale production were gradually transformed into advisory and commercial companies.

The domestic retail commerce is characterized by the extreme dimensions. Their bulk is mainly a small shop /under 90 sq. m/, or the venture for some "business". Along with this already appeared some multinational company, however certain wholesale and export-import companies still kept a fair market share.

a, Product Councils

Such were not operated in Hungary earlier. Councils having been organized spontane before the Act passed in 1993 have unsettled scope of duties, the conflicting interests are frequent among the producers, processors and the commerce. Processing and commerce of productional interest is minimal. The product council is intended by the act in the state regulation. Since the organizational mobility is fairly big in the sphere of the three interested - salesmen, processing industry, producers -, so the degree of organization is greatly varying. At present, councils were formed for these functions in the beef-cattle and meat sector, in poultry, milk vegetable, fruit, plant oil, sugar and cereal branches. They still do not have a state recognition.

b. Business federation

Following the change of political system a wide range of business federation was established, however apart of the producers - mainly the private producers sphere - does not belong to any of the federation. The majority of the organizations operate in the form of associations, does not lead economic activity. In the majority of the business federations takes part a separated group of part activity, but there are also those organized on basis of vertical connections.

In the association operating under the name Hungarian Agrarian Chamber the majority is the member of state owned farms a part of them are members of cooperatives, but one may find there private producers as well. The same way, members are significant state and private owned food processing and research institutes.

It operates as a business federation, since there does not exist an Act on Councils for the constitutional status.

In the National Federation of Agricultural Cooperators and Producers the decisive number of members are the cooperatives resp. the companies brought about after the transformation, but private entrepreneurs and branch associations also joined the organization. The Federation operates in each administrative region has an organization /branch/ and staff of experts. In its organization self-reliant bodies represent the producers of separate branches /pig breeders, cattle, poultry, sheep breeders, wheat producers, producers of industrial plants, vegetable growers, board of silviculture/.

Increasing business federation is the National Alliance of Farmers' Society, the National Council of Farmers, the Union of Farmers. The Union of Gardeners started its operation earlier. The Alliance of Peasants has been organized explicitly from small-scale producers. In certain cases processing companies maintain together with salesmen a self-standing representation organized by branches.

There were also established such business federations which vertically cover the producers, the processing industry, and the retailers. Such exist of instance in the poultry, grape and wine production.

In certain branches successfully operate alliances for breeding varieties, like Holstein-Friz, Limousine, Association of Hungarian Spackled Cows.

The determinant national economic business federations operate the "Agro-Coordinational Forum" serving for expressing an opinion and uniform attitude towards the government. The lack of successful representation may be attributable to the difference of interest impeding conciliations to the political influence found in a part of the organizations.

5.3 The market Information System

The earlier data collection system is already not operating, the new one is till not operating at the desirable level. The information gathering ministries do it first of all for themselves. In certain cases they even do not hand over each other the collected information. The market information of the commercial companies is very feeble.

a, The Central Statistical System

The Act on central data collection has recently been passed by Parliament. This determined the kind of centrally and obligatorily collected material. From among the institutes undertaking the collection of various data the entitled will be selected by a professional committee. At the same time, the significance and practice of data collection based on representative survey is increasing. The thus collected data will be systematically published.

b, Data banks, scientific information networks

Systems established partly from foreign aid, partly from domestic state, company and business federation resources are operating independently from each other. Depending from the interests of those creating them they serve state targets and offer market services. The operation of the Marketing Information System /MIS/ to be established centrally in the framework of the PHARE programme started two years ago. The aim is to establish a computer aided information system of national level fully covering the production, processing and commerce. It will contain the planning of producers' decisions, the realized producers' decisions, the continuous assessment of yields, the information connected with the getting into market of the producers, the prices established on each market, the product volume to be processed and the connected prices, the product volume to be exported, the export prices and the exchange information. Information will be gathered for the database by the producers, processors, salesmen. They will be able to use the full information basis against payment. The works of this information system are in progress.

6. Entrepreneurial margin

This margin of the Hungarian contractors is basically influenced by the land property terms, the change of organizational forms under way, the lack of capital and the limited amount of information to be gained about investment possibilities.

In the Hungarian agriculture start in this period the ventures which have to lay the base - by producers's aim, at own risk and by private means - for the livelihood of families, eventually generations.

Undoubtably, there are advantageous circumstances for the agricultural venture, like good ecological features, enough work force, expertise, cooperation of small- and large-scale farms, low wage level and in some cases advantageous state means as well.

Considerably no less are the disadvantages to be taken into consideration, such as lack of capital, high interest, the low wages, the weakness of market mechanisms, market uncertainty, weak contractual discipline etc.

There is an indispensable need for available, reliable exposer advice in orientation, market information, in decision making /business plan/, as well as in execution /solicitation of credit/ and during the venture /administration, taxation etc./

The old and the new private farms equally need continuous information. They have to know the market possibilities, the quickly changing demand in quantity, quality and processing.

They have to know the risk factors connected with production in order to prevent their harmful effects in time, even before the venture collapses. They also need help in the choice of the preconditions for gaining footing.

It must also be increasingly realized in the sphere of present contractors that to work successfully may be only on basis of a business plan. The elaboration of the business plan will be the most important condition for the starting and operation of the venture. Banks nowadays require in a widespread way a high-standard business plan based on real calculation. At the preparation of the business plan it comes into the foreground marketing and real cash-flow professional knowledge. Contractors must be increasingly be prepared to handle only marketable products beside preparing a real cost expenditure, lest failure is unavoidable.

Most effectively a vertically organized expert network employing outstanding specialized staff and based initially on state subsidy could operate. A basic condition is to have it accepted by the farmers, fell that is from among them and to require their cooperation. It is also important that it should be a performance oriented organization, because it can be envisaged only to have their support in the future and their material support.

They should become indispensable, continuous allies for the agrarian contractors to whom the contractors in need may turn with problems of technical, business management, marketing, financial and tax policy, cooperational problems, further in connection with accountancy, bookkeeping, data administration, analysis of economy.

It belongs to the tasks of the expert network too to organize the recording of farmers not versed in book-keeping, since for that there is yet no established system.

The system of taxation is yet overcomplicated even for intellectuals. The farmer does not know what and when should something be registered: if he fails to this, he may be prosecuted even after 4 years. At the general turnover tax return is also required, it is not enough to pay the turnover tax, it must also be registered, since its omission is coupled with fine.

Producers beside direct expertise use separate expert services in special cases and from time to time. One should pay more attention to the fact that the subsidies should get to those in need, in order to prevent purchasers to establish price cartels, to prevent the increase of prices excessively, in other words to operate the market regulation in a real way. In all these a well organized expert advisory network may undertake an effective role.

Conclusions

So, the most important aim of the Hungarian agricultural policy is the change over to a more effective production as at present. All these should be attained by the arrangement of regulated market mechanisms, transformation of the structure in production, by better utilization of natural resources.

For the promotion of transformation a number of basic economic acts have been passed by the government in recent years in which arrangements were made for property ships, the legal, institutional frame for the regulated agromarket are created and the operational mechanism is held on ashort leash. Further, the order of intervention by the state is regulated at a statutory level, its form and system of means, speeding up by this our integration into the European Economic Area.

The successful transformation of a number of large-scale farms is proven by the fact that whatever thorny path stands before the transformation, our potentionalities, the interestedness based on private property and the entrepreneurial spirit will again bring the Hungarian agriculture into the international leading field.