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1 General review

1.1 General overview of agricultural and national economy developments

The Hungarian economy followed the development of the world economy in 2003-2004. GDP increased by 2.9% in 2003 and 4% in 2004. The speed of growth moderated from the second half of 2004 and it was 3.9% in the first half of 2005. This growth is higher than the EU average. GDP per capita in Hungary was some 60% of the EU-25 average in 2003.

Inflation decreased continuously from 1996 to 2003 (4.7% in 2003). This process stopped in 2004, when inflation rose to 6.8%, influenced by changes in VAT and other excise duties coming into force at the beginning of the year. Inflation is forecast at 3.8% for 2005.

The number of unemployed decreased continually until 2002 and then turned to an increase. The unemployment rate was 6.1% last year. In terms of harmonized Eurostat figures this rate is equal to 5.9%, what is below the EU-25 average. In most of the new member countries, the unemployment rate is higher, than in Hungary.

The balance of payments' current account deficit increased by 1.4 billion EUR to 6.4 billion EUR in 2003 when it was 8.7% of GDP. The rate of growth of the deficit decreased somewhat in 2004, but at 7.1 billion EUR (8.9% of GDP), the deficit is high, compared to the EU average and it could delay Hungary adopting the Euro as its currency.

The share of agriculture in GDP continues to fall (2.9% in 2003) as does the agri-food sector's share in employment (5.2% in 2004), exports (6% in 2004) and total consumer expenditure (27% in 2003),.. Agricultural gross output jumped by 22.6% in 2004 due to good weather conditions with a 49.3% increase in crops output outweighing a 6.9% fall in the output of livestock and livestock products.

1.2 Overview of agricultural and rural sector development

1.2.1 Production

The high increase in crops production in 2004 was due to increased yields of wheat, maize and triticale. The area of cereals increased by 2.7% and production almost doubled, thanks to optimal weather conditions. The EU cereals harvest was a record last year with the major increases in Hungary, Slovakia and the Czech Republic.

The Hungarian sugar-beet area increased by 17%, as higher producer prices following adoption of the EU sugar CMO encouraged farmers to grow the product. This and the weather resulted in a 72.2% increase in production. Sugar content also improved.

Although the production area of sunflower decreased in 2004 by 6%, there was a record output of 1.2 million tonnes (20.8% more than 2003) and one of the biggest sunflower productions of the last decade. The potato area in 2004 was the same as the previous year but output increased by 31.8%. Due to low temperatures in the late spring, the area of vegetables fell in 2004 by 8% causing a 3.3% decrease in production. Fruit production increased by 38%. Grape production grew by 33% and harvest began 2-3 weeks later, than usual, because of weather conditions.

Other than sheep, livestock numbers declined with dairy herd down by 2%, because of terminating the milking stocks. Conditions for meat production improved, encouraging some dairy farmers to switch to beef production. The pig breeding herd fell by 17% as profitability fell due to the high price of feed. Sheep are bred mainly on individual farms and their stock increased by 8%. Stocks of poultry fell, due to a combination of the strict EU breeding regulations and the availability of cheap imports.

1.2.2 Prices

The price level of agricultural products was lower by 6.2% in the first seven months of 2005, than in the previous year. Crop prices fell by 15.2% with cereal prices being a third lower in January-July, than in 2004 and equal to the level of the same periods in 2003. The decrease was influenced by oversupply from the record cereal production in 2004. Demand for vegetables has increased in 2005, resulting in vegetable prices rising by 6% in the first seven months of the year. Prices of fruits also increased (by 11.2%) in the same period with the price of sour cherries, one of the most important products, increasing by 45%.

Livestock and livestock prices were some 6% higher % in the first seven months of 2005 than in the same period in 2004. Pig prices rose by 10.7%, mainly resulting from higher feed prices, but poultry prices fell by 2.1%. The price of milk rose by 4.7%, the price of eggs declined by 4.8%, influenced by increased imports of eggs.

1.2.3 Agricultural Trade

The exports of agriculture and the food industry increased from 2003 to 2004, by 16.8%, while the imports grew by 42.4%. The balance of trade fell by 11%. Exports were higher last year than in 2003 in categories except cereals, eggs, fish and beverages. Because of rising international prices, livestock exports were higher in value though lower in volume than in 2003. However, exports of milk, milk products and eggs all saw a large fall in value. Exports of cereals and cereal products fell in value by 2.6%, because of reduced wheat exports. Surrounding countries had a very good cereal harvest and transport costs were very high, which together limited export opportunities. Fruits and vegetables exports increased 11% in value. Sugar, honey and tobacco exports also increased significantly.
72% of meat exports were traded into EU.

Hungarian trade is mainly with the EU-25: 68% of total food exports went to this group and 83% of imports originated from them. As a consequence of EU enlargement, these proportions were higher last year than in the previous one: with exports up by 19% points and imports up 33% points. European, non-EU countries are the other major partners: 26% in case of food exports and 9% in case of imports in 2004. The most important trade partner countries outside Europe are in Asia in case of exports and in America in case of imports

1.3 Agricultural and rural policy developments[1]

The first proportion of direct payments from EU budget (25%) caused disappointment but these subsidies together with national amendments (30% points) give a good opportunity, but actually the total payments to agriculture was only 71 per cent of the amount of 2003.

[1] (http://www.akii.hu/kiadvany/intezeti_kiadvanyok/magyar/AKII_TANULMANYOSSZEFOGLALOK/2004-5_PoppPotoriUdovecz.htm)
(http://iroga.hu/Magyarorszag_EU/vasa.htm)
(http://www.fvm.hu/main.php?folderID=1335&articleID=4154&ctag=articlelist&iid=1)

The situation of rural development can be characterised by the case that no payment was made at all in 2004 from ARDOP and NRDP. However, producers were expecting these payments, which also contributed in the disappointment. Nevertheless, in 2002 and 2003 there were implemented national measures on rural development, and they were popular not only for individual farms but also for large scale corporative farms.

In principle, the quotas and base areas agreed in the negotiations would give enough possibilities for a sustainable development in the dominant sectors, but the implementation (delay in payments, too strict regulation based on council directives, and institutional shortages) caused significant losses. Uncertainty also was increased the negotiations for reforming CAP, which speeded up after signing the Accession Contract. Subsidies for food quality and subsidy for compliance with the standards can be a possibility for Hungary. The nature environment and applying the relating standards is a must for getting subsidies.

Setting up of Integrated Administration and Control System is a very hard action with delays and dysfunctions.

1.4 Issues related to the enlargement[2]

Before Accession market price support formed the main element of support in Hungary. It was based on a system of guaranteed prices in the case of crops. Prices for milk, pig meat and beef were supported by a guarantee and guide price system. Subsidies were paid to processors who pay prices above the guide price to farmers or to farmers where the price they receive is below the guide price. In addition price premiums were paid for high quality milk, pigmeat and beef production. Area payments were granted to farms (with less than 300 ha of agricultural land, later to all from 2002) with payments inversely related to the land's production potential.

In the years immediately following Accession, the subsidies will not significantly increase but the allocation is more concentrated. The major winner is cereals sector, which gains about 70% of all subsidies. Sugar, honey and tobacco production also gains. However, honey producers are suffering from the improper labelling of the EU. Sugar reform makes the producers uncertain, and the foreign property of sugar and tobacco processing involves international considerations about the future of these sectors. Difficulties face the sectors that are not regulated by quotas, such as pig, poultry and fruit-vegetables production.

The improper implementation of CAP in Hungary gave rise to the first big agricultural demonstration after accession. In early 2005, a thousand tractors and agricultural machineries went to Budapest and stayed there for nearly three weeks. They left only when the agreement with the Minister was signed. A doubt can be for the future that not all points have yet accomplished.

[2] Kovács, G. – Udovecz, G. (2005): The first year of Hungarian agriculture in the European Union. Gazdálkodás, Vol. XLIX. No. 5.

2 Assessment and Outlook

2.1 Wine sector

Hungary is a net exporter of wine, being the world's 15th largest wine producer according to FAOSTAT (in total production). Wine consumption increased since 1990 and was 26.3 litres/capita in 1995. Between 2000 and 2002 wine consumption increased further and in 2003 stayed at 32.2 litres/capita. At the same time, beer consumption fell by third. A wider range of types and qualities of wine over recent years has had a positive impact with consumption of quality winegrowing although table wines are still dominant. Unfortunately there is a relatively high proportion of illegal, falsified wines consumed (not made of grapes, but sold as grapes vine) but the proportion has decreased since 2000. Last year falsified wine was estimated as 600,000 hl, some 20% of total wine trade.[3] .

Consumer habits show that preferred wines in Hungary are the dry and white ones. Hungarian people choose domestic wines instead of foreign ones[4]. Traditionally Hungarian wine consumers were the elder people but last years youngsters also preferred wine (due to the marketing activities, like "wine tourism", wine festivals, and wine supply of premium HoReCa outlets).

2.1.1 Wine imports

Although wine imports have been increasing continuously, they remain a low proportion of consumption. Import is realized mainly because of widening the assortment in Hungary, what also means that the import of bottled wines increased, while barrelled ones decreased. The major partners are from the EU, mainly Italy and Spain. Import is not significant, but in the supply Californian, Chilean and Australian, etc. wines also tale place.

2.1.2 Wine production

The leading white quality wine grape variety is Italian Riesling (grown on about 10% of the total crop area) followed by Rizlingszilváni (about 4%), then Chardonnay, Ottonel Muscat, Hárslevelu, Furmint, Rhine Riesling, and Leányka. For quality red wines Kékfrankos is the most popular variety (grown on about 5% of the crop land), followed by Zweigelt, Kékoportó, Merlot, Cabernet Franc, Cabernet Sauvignon and Pinot Noir. Almost half of the most important 25 varieties are Hungarian and international ones. Some new planting intentions are expected to aim at growing traditional Hungarian varieties.

2.1.3 Vineyard area

The vineyard area been 93,000 ha in Hungary since 2001 but the area has been decreasing slowly over the last twenty years. As the location of vineyard areas often determines the wine quality, a vineyard cadastre system is being implemented in Hungary under a new Wine law of 2004. The cadastres are class1, with outstanding opportunities and class 2 with favourable opportunities. There are other areas, which are suitable for grape growing with given conditions. VINGIS is the information technological background of cadastre system and the base of subsidy controls. There are 22 different wine regions in the country. Each of them has its typical geographical, climatic and other attributes and their typical kind of wines. The Tokaj wine region has its own regulation in the law.

[3] Hungarian Government Portal, http://www.magyarorszag.hu/hirek/gazdasag/boraszat20040924.html?h=1
[4] http://www.date.hu/acta-agraria/2005-16/szakal.pdf

2.1.4 Structure of production

There were 36,606 Hungarian farms in 2000 specialising in growing wine grapes and this number almost doubled by 2003 (63,890 farms). Most of the farms are individuals (more than 99%) and a lower proportion of them are enterprises.[5] . Number of enterprises was more than double in 2003, compared to 2000 (344 vs. 136). The number of individual farms increased between these years by 74% (63,546 vs. 36,470).

According to the size category, measured in ESU, 90% of total number of specialist vine grower farms are under 2 ESU and almost 10% is between 2-12 ESU, while less than 1% is bigger than 12 ESU. In case of agricultural enterprises, more than the half of total number is above 8 ESU (55%), almost a quarter of the total is between 1.5 and 8 ESU and the remaining 20% is under 1.5 ESU. Agricultural enterprises are responsible only 12-13% of total grape wines SGM (Standard Gross Margin in million HUF) so the importance of individual farms is dominant in Hungarian production[6].

2.1.5 Wine yields

Wine yield showed a range in the relevant years between 5.19 and 9.39 tonnes/ha. The standard deviation of the yield is 1.6 t/ha. Yield is impacted by weather, diseases of grapes and insects. Additionally the age, the structure, the technology and vine per hectare has effects on the yield. General experience, that the quality of wine improves at lower yield (under 6-7 tonnes/ha) and worsens above high yield (above 11 t/ha). Special quality wines are made of grapes, which has a yield lower than 6 t/ha[7]. The yield is the highest in Northern Hungary and Southern Great Plain. It is the lowest in Northern Great Plain and Central Hungary. Other regions' yield is about the country average (Central Transdanubia, Western Transdanubia, and Southern Transdanubia).[8].

2.1.6 Wine production

Wine production in Hungary presented a level between 3,300-5,400 hl a year in the last six years. The standard deviation is 916 hl in these periods. There were two peaks, one in 2001 and the other is in 2004, while the lowest year was 2002. Year 2001 was the most productive one since 1990. The grapes are harvested mainly in private farms: 91% and this rate was stable in the last decade. Only a very few percent of grapes are table grapes, while the highest part of grapes are harvested for the wine sector (94-97%). The proportion of table grapes has decreased continuously in the last ten years. The bottled wines give 1/3 part of the total wine production. Only 40% of this part is quality wine, while in the case of barrelled wine it is 45%. It means that table wines are dominant but over recent years the ratio of quality wines has begun to increase. This has been due to changing local consumer habits, which is gradually tending towards quality wine; and the collapse of eastern markets (as Russia).

2.1.7 Production cost and competitiveness

The income of wine production is determined by production costs, yield and selling price.
Based on a study by AKI, the cost of wine production on private farms increased continuously in the last four years. Since 2001, the costs have been very high compared to the value of production, about 88-94%. The lowest production year was 2002, when output prices fell

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[5] Agricultural enterprises are partly originated from collective farms before transition (after a privatisation process) and partly newly funded organisations.

[6] www.ksh.hu
[7] www.akii.hu
[8] www.ksh.hu

below costs of production. That year the market price and subsidies together did not exceed production costs. The income of small farms was negative in the beginning of the '90s but in the middle of the decade income became positive and increasing till 1996. Since then cost/income worsened again. Above mentioned mean, that wine sector is neither cost-effective, nor competitive in the economy. The SGM of farms in Hungary is equal to the unit production value of products and services net of variable costs. SGM increased from 2000 to 2003 by 57%. SGM per enterprise is lower in case of individual farms, than agricultural enterprises[9]. Wine production has very strong traditions in Hungary, and this can cause, that the farmers take higher risks, than they would be reasoned. Many producers assumed that after Accession the sector will be in a better position and they were aware of the difficulty to enter to this business later.

2.1.8 Wine exports

About 20% of total wine production is exported, mainly to the EU-15 (80-90% of total exports) and to the new Member States. The weakest year was 2001 in the near past (in volume and value as well) and since then the export level is hectic. The decrease began in 1998, after the economic crisis in Russia.
There is not much hope to expand exports to other member states. Potential but existing markets are Russia, Canada, USA and Japan.

It is thought that there could be opportunities for increasing exports of white wines, but weak marketing effort has been blamed for not exploiting these possibilities

2.1.9 Policy issues

On the day of accession, the new EU conform Wine Act (XVIII/2004) was introduced. After the accession Hungary lost the possibility of new wine grape plantations. According to the regulations, we have the right for replant at a quantity of 12,500 ha till 2010, after the cut-out plantations, but new plantations are not allowed. This can cause social tensions and ecological problems. There are subsidies for plant cut-outs but using these subsidies cause social tensions, ecological problems and losing of the right of replanting. Implementing cadastre system.

Hungary received restructuring subsidies of 10 million euro from the EU 8,000 EUR/ha) for replanting and modernising 1,261 hectares of vineyards in 2004/2005.
Generally, there were not any major problems or changes during implementing the EU regulations, because the previous Wine Act (in 1997) was created by taking into consideration these regulations of the European Union. The changes were only in the details.

A current market disorder has other negative effects. Wine production was very good last year, and high stock levels are taking place, resulting in lower prices. In contrast to the recommendation of professional organisations ('vine-growing communities'), a growing number of farmers accept lower prices than contracted, because they have no more capacity to store. The price in this autumn can be only two third of the production cost.

In order to ease the market disorder in Hungary, a crisis distillation was approved for 500,000 hectolitres; however offered production for intervention will be certainly lower as the decision was made after normal distillation has started and estimation has indicated much less production than previously expected.

[9] www.ksh.hu

2.2 Sugar sector

2.2.1 Sugar consumption

Per capita consumption has declined over recent years, falling from 38.2 kilograms per head in 1990 to 32.6 kg in 2002. This resulted from lower demand by both consumers and manufacturers who now use more isoglucose and artificial sweeteners for their products, due to the low transport cost and input prices.

2.2.2 Sugar imports

The sugar imports into Hungary have risen from around 15,000 tonnes in 2000 to almost 80,000 tonnes in 2004; it is a huge increase. The majority of import is now of refined rather than raw sugar. :

2.2.3 Sugar beet area

After fluctuating in the 1990s (between 50,000 and 120,000 hectares), the sugar beet area has now become more stabile, averaging 57,537 hectares from 2001 to 2003. However, in 2004, due to adoption of the sugar CMO, 64,616 hectares were planted with sugar beet. The share of sugar beet in total sown area has been increased from 1.3 to 1.5 per cent. Several individual producers increased the sugar beet area over the 25 per cent ceiling. The main areas can be found in the southern-east and in the western part of the country.

2.2.4 Structure of production

In Hungary, there are 5 main factories (located at Szolnok, Szerencs, Kaposvár, Petoháza, Kaba) in the hands of 3 groups: Nordzucker, Agrana and Eastern Sugar. The combined capacity of these companies is 37,000 tonnes. Their demands for sugar beet are met by 752 farms that have the right to deliver. However, the number of producers is higher (809 farms). On the whole, sugar beet is grown on above-average sized farms. The producers can be classified into two main groups: the large ones (above 1000 hectares) and the smaller ones. The share of sugar beet has increased from 2 to 3.5 per cent in agricultural output. Due to the new proposals, for reform of the sugar CMO, there could be great structural changes in the sector as only the efficient survive.

2.2.5 Yields

The average yield in tonnes of sugar beet per hectare was around 42-43 in 2001 and 2002, then came a huge fall to 35.12 tonnes in 2003 and then an increase in 2004: 54.3 tonnes. This fluctuation is mainly caused by weather. After the reform, yields below 50 to 55 tonnes per hectare will be barely profitable. In a European comparison, Hungarian yields are lower than in many countries but higher than in Finland, Ireland, Italy and all new member States.

2.2.6 Sugar and isoglucose production

The sugar production of Hungary is fluctuating, but it is around 400,000 tonnes of refined sugar in an average year. The year of 2003 was disastrous for the whole of agriculture including the sugar sector, with only 250,000 tonnes being produced. However, 2004 was a record year with a total sugar production of around 500,000 tonnes. This year (2005) also seems to be fine. Under the current conditions, Hungary would normally maintain a production level of 400,000 tonnes.

Hungarian isoglucose production was around 140,000 tonnes yearly between 1997 and 2001, and the quota is a little below that. Isoglucose is produced in the most modern factory of Europe, in Szabadegyháza, which corresponds in size to two Hungarian factories producing the white sugar equivalent output. At present, maize is used for isoglucose production.

2.2.7 Production cost and competitiveness

The production cost of sugar beet is around 300,000 HUF per hectare (2002: 299405 HUF, 2003: 301,329 HUF, 2004: 305,309 HUF with a 20-30% deviation).

This corresponds to around 1200 Euro/hectare. The Commission's proposal to set the average price at 25.08 Euro/tonne would certainly drive many Hungarian producers out of sugar beet growing as only 35% of them could cover their production costs. According to our calculation, a minimum price of 30 Euro/tonne is needed to supply the needs of the processing capacities. Processing companies would demand the current supplies at a price not lower than 450 Euros/tonnes (refined sugar).

However, the current location of sugar beet producers corresponds to a situation when 12 sugar plants were operating. Since 1997, 7 plants were closed but the producer communities are still supplying; and the transport cost is rather high.

In contrast to other sectors like milk, the government did not regulate the allocation of producer rights but empowered the professional organisation, the Sugar Product Council, where both sugar beet producers and processing companies are represented, to decide about distributing sugar beet production rights. In 2002, the producer rights were distributed mainly to the previous structure, but the rules of buying and selling were not established. Producers would prefer to have transactions, but sugar plants rejected it. Due to this failure, the structure of beet suppliers is frozen since 2002. Far and inefficient producers also have a small return at the current prices; they implement their producer rights as they can not sell it. A rational allocation of sugar beet suppliers would result in a significant decrease of transport cost, which is now 30-40 euro/tonne (refined sugar).

The average size of a sugar plant in Hungary is about 20 per cent lower than in EU-15. However, it is double or nearly double than in Poland, Czech and Slovak republics. In the Product Council's estimations, Hungarian processing costs (230-250 euros per tonne, refined sugar) are much lower than in EU-15 (which is estimated at 270-300 euros per tonne)[10].

2.2.8 Exports

Hungarian sugar export has fluctuated in the recent years. In 2000, it was around 30,000 tonnes, in 2001, around 12,000 tonnes, in 2002, 82,000 tonnes. From 2002 we can see a permanent and huge decline: 2003 with its 32,000 tonnes and 2004 with 4,000 tonnes. The amount of raw sugar export has been negligible since 1999, when it was still 5 per cent of the total.

[10] CUB (2005): The situation of the Hungarian sugar beet sector in the light of the EU reform (in Hungarian)

2.2.9 Policy issues

Sugar was one of the few agricultural sectors which offered benefits for Hungary. In the first two years after Accession producers and processors were indeed satisfied. However, the Commission's proposal has caused a huge uncertainty in the market. Hungarian actors do not have a clear strategy to adjust. The possible response to the reform is quite uncertain: all owners of sugar plants are foreigners, who certainly prefer to close the plant rather in Hungary than in their mother country. Their strategy is not clear for Hungarian actors in this regard. Management certainly would have interest to maintain the plants, like sugar-beet producers. Nevertheless, the Sugar Product Council has analysed the situation considering the possible responses on the implementation of the reform. The closure of two plants also was considered. In these talks it was assumed that in the worst case each of the three groups would maintain one factory. If Agrana should close one, it would be Petoháza, which is much bigger than Kaposvár, which is supplied by large agricultural enterprises. Petoháza is supplied by individual farms, which are less influential. At the same time, for the plants it is easier to contract less but big farms than more but small suppliers. Nordzucker has other points to consider: Szolnok factory is newer than Szerencs, but suppliers produce on worse area with lower yields; thus certainly Szerencs would be maintained.

Anyway, closures will be decided in an international context. The Product Council also considered the possible responses to increase the competitiveness. In this context, the most important improvement can be a rational reallocation of production rights. In labour, relatively small achievements can be realised, because in the production field it should be offset with high cost of technical improvements; however administration costs could be reduced. Depreciation is more favourable than in EU-15, but the same as in NMS.