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## 1 General review

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### 1.1 Major agricultural market developments in 2005

The share of agriculture in Hungary's GDP has fallen over the years and amounted to 3.3% in 2005 while the share of agriculture in investment was 3.9%. The share of agriculture in employment has fallen to 5.3%. Crop production accounts for some 57% of GAO with livestock and livestock products the other 43%.

The most significant market change in 2005 was the appearance of cheap imported supplies of chicken from China and Brazil and significant imports of pork from Denmark which have challenged domestic producers on the one hand and food safety on the other. National authorities were not completely prepared for regular food safety controls and it took some months to achieve satisfactory monitoring of imports.

Two typical but contrary market developments are shown in the sugar sector, which was considered as a winner from EU-Accession (before reform of the EU sugar regime) and the milk sector which showed falling production before Accession.

Sugar beet has not been a major sector of Hungarian agriculture in the past, but provided reasonable income for several thousands of people engaged in the sector. Both the areas under sugar beet and yields have fluctuated from year to year. Between 2002 and 2004, sugar beet was one of the most profitable products besides sunflower seeds and maize for agricultural producers with gross margins per 100 HUF of inputs being 78 for sugar beet, 40.5 for sunflower seeds and 13.2 for maize. 2005 was also profitable for Hungarian sugar beet producers; however reform of the EU sugar regime now causes some uncertainty among beet producers. FADN data shows that 30 to 40 % of sugar beet growers will have to quit because their production costs will exceed the intervention price post reform. This will be rather painful first, because some of the machinery used in sugar beet production is product specific and second, due to the low profitability of other agricultural products it will be difficult or impossible for producers to replace sugar beet with other products giving a similar margin to that which they previously enjoyed from beet growing. National agricultural policy tries to provide some assistance for those who quit sugar beet production, but strong financial and administrative constraints do not leave too much room for that. It is estimated that at least two of the five existing sugar refineries might be closed post-reform.

Milk production in Hungary declined sharply during the transition period, with the national dairy herd in 2005 being only half of that in 1989 though yields were gradually increasing. Milk producers suffered from low market prices prior to EU-Accession and many small producers have stopped keeping dairy cows because of high production costs. Prior to Accession, the Government paid subsidies to dairy plants that paid at least a minimum price to milk suppliers. Since EU-Accession, production costs have increased and income decreased. Under SAPS, the Government has offered a subsidy to milk producers from national envelope based and paid on quota which could not exceed €8.71/t in 2004. However, although Hungary's milk quota was well below the requested level, it is still not fully utilised due to falling demand partly from consumers, due to high prices, and partly from processors as they made better deals buying milk for processing from neighbouring countries at lower prices for a short period of time.

The overall performance of the agricultural sector has improved. In 2003, the aggregated profit of the sector reported by the Minister of Agriculture was HUF -7 billion (a loss of some 27 million euros); in the year of Accession, 2004 it was HUF +19 billion (about +77 million euros), and in 2005 +55 to 60 billion (about +220 to 230 million euros). In general, the profit level of agricultural production was still low in 2005; however, in some branches notably sugar beet, crop production and beef, profit levels were high or at least increased in comparison with the previous year.

## **1.2 Agricultural and rural policy developments in 2005**

In the spring of 2005, the most urgent issue facing farmers was delayed farm support payments. In the last report of the new Minister of Agriculture before the elections of 2006, listed his most important achievements as follows:

- Delays in payments are eliminated;
- Cereals are stored even in peak years;
- Improvement of food safety is realised.

The most significant problem in agriculture since the EU-Accession has been the decline of livestock products, mainly pigs. The government has implemented the three following measures to stabilise the sector:

- Support of animal health treatments;
- Support of financing feed purchase
- Support of land purchase for livestock farms.

The positive effects of these measures cannot be monitored yet. However, the last of listed measures has received more attention among experts and is opposed because the pig and poultry farms in EU15 belong to the most profitable ones due to cheap feed and higher conversion rate of feed into meat although they have very small farmlands in use.

About 90 % of the land is in private ownership, but 1.5 million hectares are still in unshared, joint ownership. Co-owners may claim to establish and register their individual ownerships before June 2006. Till now (end of March) 240000 co-owners have presented claims for areas totalling 1.2 million hectares.

The Government has high expectations about the Rural Development Network, which is due to be established before 2007 and wants to simplify the public administration in agriculture, making a client-friendly system. For the modernisation of Hungarian agriculture, support of young farmers also will be a significant measure; however an early retirement scheme is not implemented yet.

## **1.3 Issues related to the enlargement**

The government communication is focusing on the expansion of support to agriculture and rural areas in the near future and the mid term, while domestic factors of market imbalances and institutional weaknesses, notably a lack of business and professional guidance (extension services), an obsolete information system for producers and poor consumer information and

protection in the enlarged food market of 25 MS are nearly forgotten. Thanks to the elections in spring 2006, most recently owed payments were completed in time, food quality controls were tightened up and action taken against falsified and/or date expired food, which enters the country as cheap imports. (For example, red peppers, wine, eggs, salami and meat products unfit for human consumption were found in stores, shops and food chains.)

Arable crops, especially cereal production (mainly wheat and maize) is competitive in comparison with EU-15 MS, however, the competitiveness has diminished in the past years. Consumer prices before Accession tended to be about the level of the EU-15 average, but 2004 saw peak yields which drove prices far below the level of EU-15 (and EU-25 as well). Many producers had to resort to selling into intervention and Hungarian stocks now constitute the majority of the EU intervention stocks. In 2005, yields reverted to more normal levels, but due the size of stocks, prices remained low.

Oilseeds, most of all sunflower seeds became increasingly competitive before the Accession. As the monopsony buyer in the Hungarian oil sector paid oilseed growers low prices, which were fixed at or below the international price level.

Institute for Agricultural Economics experts calculate that the market share of competitive wheat producing corporate farms might increase from 34% pre-Accession to 52 % in 2005, maize producing farms from 30 to 40 % and sunflower producing farms from 43 to 57 % within EU-25. The Accession thus has contributed to a growing competitiveness among grain and oilseed producing farms

Farms in the vegetable and fruit sectors lack capital, thus most of them are dependent on cooling storehouses. The situation of tomato production was analysed and there were some competitive farms, but the majority does not fall to this category. The apple sector shows a little better performance, but fragmented land holdings, low yields and poor varieties hinder competitiveness.

The competitiveness of Hungarian dairy farms has fallen and the number of competitive<sup>1</sup> farms declined before the EU-Accession. Due to that, milk production and the number of dairy cows fell. The Institute of Agricultural Economics estimates that 54 % of the dairy farms might be competitive in 2005. Nevertheless, the competitive share of dairy farms can be increased after Accession, however, there will be no capital for the necessary modernisation and no access to adequate levels of (cheap) finance.

The Hungarian pig sector has tended to lose competitiveness. The proportion of pig farms that could compete with imports has declined from 73 % before the Accession to 33 % in 2005; however, the lower prices of cereals may counterbalance this trend. In the poultry sector, not even scale of economy has positive impact on the competitiveness, as far as large poultry farms still have not been modernised. [11]

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<sup>1</sup> Competitiveness was measured by Domestic Resource Cost (DRC) and Bilateral Resource Cost (BRC).

## **2 Assessment and outlook: market integration in the cereal sector**

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### **2.1 Introduction**

2000 and 2002 were normal agricultural years; in 2003 there was a drought, 2001, 2004 and 2005 were notably good years for the Hungarian agriculture [7]. Wheat, maize and barley together account for 90% of cereal production on a total harvested area of around 3 million hectares. Yields fluctuate in the ranges: wheat, 3 to 5 tonnes/ha; maize 5 to 7 tonnes/ha, barley 3 to 4 tonnes/ha. [5].

In a typical year, around 50% of the wheat production, 45 to 50% of maize production and 70% of barley production is used internally, mainly for personal consumption, industrial processing and feed [1]. Around 16-20% of wheat and maize production and 10% of barley production is exported, imports are negligible [5]. The rest goes to intervention and private storages: 30% of wheat, 35% of maize, 20% of barley. 2006 is expected to be an average year for producers.

According to national experts, Hungary has comparative advantages in producing cereals, and can be considered as competitive [2]. Hungarian farmers produce grain at relatively low cost e.g. wheat for 80-85 EUR/t producer price, which is below the average producer price of the world, and well below the European average of 95-100 EUR/t, but with the transportation costs, it will be above 100 EUR/t to export outside the EU [3]. It follows that producing for intervention stocks at 101.31 € per tonne is secure and quite profitable for many Hungarian producers.

### **2.2. Expert views on infrastructure**

#### **Storage**

Storage capacity has been increased in the past two or three years, (2.5 million tonnes in 2005 alone [6]) because the livestock sector crisis has reduced demand for feed at a time when the intervention system makes cereals to be one of the most profitable crops to grow in Hungary. Due to the EU intervention system in this sector, the need to store cereals is growing year by year. In 2005/2006, 6.44 million tonnes of cereals were offered for intervention within EU-25, of which 53% was offered by Hungary (see chart 1.) [8]. The intervention system has become very important to Hungary. The country is estimated to have storage capacity for 14 to 16 millions (equivalent to annual cereal production), of which 7 to 8 millions are the intervention capacity. However 30% of the total capacity is obsolete, where it is risky to store, and another 40 % is 20 to 30 years old. [6].

#### **Transportation**

The most common mode of cereal transportation is on road by truck. Transport by rail, is slower partly because of the extra times in loading and reloading but also because the railroad system is quite slow too. Average prices according to experts are: 0.06 EUR/t/km for road, 0.07 EUR/t/km for rail and 0.08 EUR/t/km for ship [3]. It should be considered, however, to transport the cheap Hungarian cereals to the Adriatic Sea in line with improving the infrastructure nationally. Transportation facilities, like quality, should be improved in order to enhance competitive advantage.

### **2.3. Expert view on quality**

The quality of Hungarian cereals is traditionally good. Thanks to weather conditions and improved technologies, it meets environmental challenges and the requirements of both the world market and the internal processing industry. Quality is consistent from year to year save for the occasional effect of unusually bad weather. The gluten and protein content and the falling number are extremely good in most cases. In 2005, just 10 to 15% of production could not reach the national standard [8], which is, in most cases, higher than that of the European Union.

### **2.4. Expert view on possible or existing market distortion**

In Hungary, the intervention system of the European Union has ambivalent effects. On one hand, it is quite advantageous for producers because they get a fixed price, which is above the usual Hungarian market price. On the other hand, it is harmful to the agricultural sector because it encourages the production of grain on less suitable land and could result in the accumulation of huge stocks which will create a problem for storage of the new harvests. Furthermore there is a double cost to the EU budget, which has finance the system and carries the cost of restitution when the intervention stocks are finally sold abroad. Last but not least, if the system results in monoculture in areas of Hungary, there could be a harmful impact upon the environment.

The phenomena above certainly cannot be maintained in the long run. It is detrimental for both Hungary and the EU though it brings short term benefit to many farmers. Hungarian experts advocate encouraging cereal farmers to participate in the National Agricultural-Environmental Protection Programme, by increasing the agro-environmental payments from 80 EUR/ha to a level of 230 EUR/ha, which is below the EU ceiling for aid but attractive for Hungarian farmers. The experts calculate that intensive and ecological production would then be equally profitable thus encouraging environmentally friendly farming, improving quality and stopping overproduction and the build up of intervention stocks.

Of course, another possibility can be a reduction of intervention price, but this would cause losses for farmers. Other ways of improving the situation are through encouraging production and use of bio-fuels especially bio-ethanol projects [9]. Hungary already has some bio-ethanol plants under construction which should help to absorb excess supplies of maize.

### **2.5. Assessment of the market integration**

The integration of the Hungarian cereal sector into the EU market of the European Union is not yet complete. Initially after Accession, Hungary made many mistakes in documentation and subsidy payments were delayed. Hungary, alone among NMS, experienced producer prices always below, sometimes far below the intervention level and there were problems over intervention administration. However, there is general optimism that these teething problems will be overcome.

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