EC2AU Agriculture Policy Note, The World Bank, Washington, DC

January 1997

Hungarian Land Reform and Farm Restructuring in the 1990s

Csaba Csaki and Zvi Lerman

Hungarian Land Reform and Farm Restructuring in the 1990s

Heritage and Sectoral Reforms in Aggregate

1. Agriculture has traditionally played a greater role in the Hungarian economy than in most industrialized countries. Of the 9.3 million total hectares in the country, 70% is arable land and 19% is covered by forest. The amount of arable land per capita is one of the highest among the European countries. Most of the agricultural land is relatively fertile, and climatic conditions are favorable for temperate agriculture. This fertile land represents one of the most important natural resources of the country, and provides the basis for a strong food and agricultural sector.

2. During the roughly four decades of socialism, Hungarian agriculture performed exceptionally well when compared to other centrally planned countries in Eastern and Central Europe and the Soviet Union. Between 1950 and 1989 gross output nearly doubled. The yields of crop and livestock products were comparable to many developed market economies and were the highest among all the Eastern Block countries. Hungarian agriculture's relatively good performance in the 1970s and 1980s was due in part to the innovative way in which central planning was managed. Hungary was in the forefront of attempts to reform and improve the performance of the socialist system of agriculture. Although Hungarian agriculture during the 70s and 80s had many strengths, the sector legacy is mixed. Agriculture in Hungary was constrained by the well-known shortcomings of socialist agriculture. Quantity was the major objective, while quality and efficiency played only a secondary role. Agricultural land did not have clear ownership, and land markets did not function. The whole sector required an expensive system of subsidies partly to keep consumer food prices low. The secure markets in other Eastern bloc countries resulted in little attention being paid to quality improvements. Incentives to stimulate the improvement of technology and product development as required by competitive market economies, did not exist.

3. In the last five years the Hungarian Government has also implemented an ambitious reform program to transform the Hungarian food and agricultural sector. The most important measures generally fall into three categories: (a) changes in institutions and regulations to enhance the functioning of markets; (b) privatization of the major means of production both in primary agriculture as well as in agroprocessing and input supply; and (c) introduction of programs of support for producers, processors, and traders consistent with the evolving new conditions. As the improvements in sectoral performance indicate, by mid-1996, most of the initial tasks of transition had been completed.

4. The process of reform has been difficult and painful for many enterprises and individuals. In 1990 Hungary had no other alternative other than to move to a market-based privatized agriculture sector if it wanted to compete in the international market. The implementation of this objective, however, according to many analysts, was more costly than originally expected. The shift from large-scale farming to privatization in general is a process of not only of building but also dismantling. This is especially true for the first stage of the process. Loss of a part of the stock

of fixed assets and other setbacks are an unavoidable side effect of such a process. Unfortunately, the behavior of the Government at times has tended to strengthen rather than counter-balance these unavoidable negative effects. Often the process was handled in an ad hoc manner with frequent changes and amendments, both retroactively and in the course of the process. The legislation that guided the agrarian transformation was not always based on clearly considered and formulated programs reached through a broad social consensus. The execution of some of the new laws was beyond the administrative capacity of the state administration within the original time framework set by the laws. On a regional comparison, however, the first five years of transformation in the food and agriculture of Hungary can been considered one of the most successful examples in the region. The almost complete land privatization, the creation of a market-conforming incentive framework, the full privatization and ongoing modernization of agro-processing, as well as the deep reforms of Government institutions in agriculture, represent the major achievements of the Hungarian agricultural reform process. This paper intentionally does not provide a full account of recent reforms in Hungarian agriculture. This study is focussed on land reform, farm restructuring, and related policy issues.

Pre-Reform Land Ownership and Farming Structure

5. Prior to World War II, Hungary was characterized by extreme concentration of land in large estates. As few as 0.1% of landowners owned 30% of all land; 85% of all farms controlled only 19.4% of cultivated land. There were 1.8 million landless peasants and farm workers in Hungary at that time - nearly 20% of the total population.

6. The political and economic changes after World War II included a socialist agrarian reform program. As part of the March 1945 land reform, all estates larger than 570 ha were expropriated and other farms were reduced by confiscation of land to a maximum holding of 57 ha. Livestock and production assets were confiscated with the excess land. Nearly 3 million ha of confiscated land were distributed to 725 thousand landless workers and smallholders in the process of the 1945 reform. The new holdings were limited to 8.5 ha for crops and pasture and 1.8 ha for gardens and vineyards. A 10-year moratorium was imposed on the sale of land received in the process of reform to prevent reconcentration in large estates. In 1948, in a second wave of land reform legislation, some 170 thousand ha of leased land was transferred from relatively large farmers to farm workers, smallholders, and cooperative farms for low rent payments.

7. The Hungarian land reform was part of an overall process of nationalization. Banks were nationalized in November 1947, industrial enterprises with more than 100 employees were nationalized in March 1948, and industrial enterprises with more than 10 employees were nationalized in December 1949. By 1950, 92% of gross industrial product originated in the socialized sector. Socialization of the agricultural sector, which was manifest in a transition from individual farming to cooperatives and state farms without total nationalization of land, lagged behind the rest of the economy. Although collectivization began in 1948, only 11.5% of gross agricultural product in 1950 originated in cooperatives and state farms, which controlled 950 thousand ha at that time. Fully two-thirds of the agricultural cooperatives were disbanded during the 1956 uprising, but the collectivization drive was renewed in full force at the end of 1958. By 1966,

77% of gross agricultural product originated in cooperatives and state farms.

8. In Hungary, socialization of agriculture never involved total elimination of private ownership of land, as it did, for instance, in the Soviet Union and Albania. Individuals joining cooperative farms after 1948 put their land into collective cultivation, but retained ownership of the land. Private ownership of land plots by members was registered in the books of the cooperative farms. However, when members left the cooperative or died without leaving heirs who were also members, their private land was purchased by the collective at a low price. A category of collective or cooperative land thus evolved over the years. In addition to the three categories of state land, private land in cooperatives, and collective land, around 5% of agricultural land in Hungary has always remained in private farms outside the collectivist framework.

9. In the last two decades of the collectivist era there were around 130 state farms and 1400 cooperatives in Hungary. State farms were more mechanized and much larger than cooperatives: they had more tractors, cultivated more land, raised more livestock, and produced more output (**Table 1**). Despite their size advantage, the state farms cultivated in total only about 15% of agricultural land, and the cooperatives were the dominant form of socialized agriculture in Hungary (70% of agricultural land). Many of these large-scale farms diversified into non-agricultural activities in order to supplement the income derived from farming. In the late 1980s the non-agricultural net income of many cooperatives and state farm was substantially greater than the net income from agricultural activities.

Table 1: Comparison of State and Collective Farms before the Reform: averages per farm 1970-1988

	State farms	Cooperatives
Number of farms (1988)	133	1400
Sown area per farm (ha)	4260	2117
Number of tractors per farm	71	28
Cattle (head) per farm	2023	647
Pigs (head) per farm	9975	869
Milk (ton) per farm	3345	797
Grain (ton) per farm	12121	6083

Source: Statisticheskii ezhegodnik stran-chlenov Soveta ekonomicheskoi vzaimopomoshchi, Moscow (1989).

10. The members and workers in cooperatives were always allowed to cultivate small individual plots of about 0.5 ha on average. The products grown in these small plots were intended both for personal consumption and for commercial sales. The cooperative usually assisted the individuals with the supply of farm inputs for their personal plots and often purchased their output. On individual plots representing 10% to 15% of all agricultural land, Hungarian peasants raised 20% to 30% of all cattle and around 50% of all pigs in Hungary. According to some estimates, this "private agriculture" accounted for 35% of gross agricultural product. The farm sector structure characterized by symbiotic coexistence of large cooperatives and small individual plots is often referred to as the "Hungarian model" of agriculture. A similar structure prevailed through most of the collectivist era in all other socialist countries, including the Soviet Union. Yet the "Hungarian model" typically fostered more integrated production relations between the household farms and the cooperatives,

which sometimes verged practically on "contract" farming, and a high degree of autonomy from central authority.

Basic Framework for Land Reform and Farm Restructuring after 1990

11. The economic strategy that Hungary adopted in the early 1960s brought the Hungarian economy much closer to market economics than the other CMEA countries. After the democratic elections in 1990, Hungary embarked on a full-scale transformation to a market- oriented economy. In agriculture, this involves privatization of land and production assets, including assignment of ownership rights in specific assets to individuals or entities, and restructuring of the large-scale cooperative and state farms in a way that will ensure personal involvement and accountability. The basic framework underlying the transformation is largely consistent with a market orientation for agriculture, as it eliminates direct or indirect state ownership of most farming entities and allows the existence of any form of farm enterprise (including cooperatives) that can remain viable in a market environment.

12. Government policies in the first six years after the 1990 change of economic systems created legislation and implementation programs to induce and facilitate change in the size, ownership, and internal management of farms. A key underlying assumption of government policy was that private ownership of land and farm assets would provide significant incentives for greater efficiency compared to cooperatives with their diffuse or collective ownership. The shift to private ownership was also served to compensate the large segment of population which had lost property to the state and to cooperatives through direct and indirect coercive measures after World War II. Most of the compensation program was to be funded by the land and assets of cooperatives, state farms, and other state-owned entities in the agricultural sector, inevitably leading to the emergence of a new private farm sector.

13. The legal basis for the transformation of land relations and farming structures is provided by four laws:

- Compensation Law (Law XXV of 1991, June 1991)
- Law of Cooperatives (Law I of 1992, January 1992)
- Cooperative Transition Law (Law II of 1992, January 1992)
- Land Law of 1994

14. The Compensation Law sets out the principles and procedures for return of land to individual ownership. The Law of Cooperatives introduces an organizational form based on standard Western concepts of voluntary cooperation in production and services. The Cooperative Transition Law is intended to regulate the process of transition from the traditional cooperatives that dominated Hungarian agriculture since the 1960s to new farming structures that include individual and corporate farms, as well as new agricultural cooperatives based on the principles of the 1992 Law of Cooperatives. Unlike the other laws, the Cooperative Transition Law was of limited duration and formally expired in December 1992, one year after being passed by Parliament. The fourth component, a new land law, was passed in early 1994.

Compensation Law

15. The full title of this law is "Law on Partial Compensation for Damages Unlawfully Caused by the State to Properties Owned by Citizens in the Interest of Settling Ownership Relations". It prescribes compensation of Hungarian citizens whose property was expropriated after June 1949, and is not restricted to compensation of landowners. Hungary opted for financial compensation, instead of physical restitution of land and assets. The compensation system was judged to be more appropriate to existing economic reality, more flexible, and more easily implementable on a technical level than actual restitution to former owners. In addition to compensation of former landowners, provisions were made for allocation of some land to current users, i.e., landless cooperative members and employees of cooperatives and state farms.

16. The instrument of compensation is a compensation coupon denominated in units of 1,000 forints. The coupon is a transferable bearer security and can be used by all to purchase state-owned flats, property, and shares offered during privatization of state-owned enterprises. However, only the first (original) recipient of the compensation coupon can use it to purchase farmland at an auction.

17. Although the Compensation Law deals with property of all kinds, 16 out of 30 articles are special regulations relating to farmland. In the absence of market valuation mechanisms, land in Hungary is valued in "gold crowns", which is a traditional Austro-Hungarian unit of land quality. Claims to former land holdings are made in gold crowns, and money-denominated compensation coupons are issued at an "exchange rate" of 1,000 forints to 1 gold crown. Each cooperative is required to set aside for purposes of compensation the land that it acquired under the relevant post-1949 legislation. The Cooperative Transition Law (Law II of 1992) stipulates that land in personal use or in long-term leasehold may not be set aside for compensation. The set-aside land is to be auctioned in individual parcels to coupon holders in three categories: (1) outsiders whose former land is in the possession or use of the auctioning cooperative, (2) current members of the auctioning cooperative, (3) permanent residents in the village or town where the auctioned land is located.

18. Land of state farms is set aside and auctioned in a similar fashion. The area of state-owned lands offered for auction was about 20% of the land area auctioned by cooperatives. In practice, state- owned land is not subject to direct claims, as it was created through confiscation of large estates in 1945-1946, prior to the critical date of June 1949 stipulated in the Compensation Law. Instead, the land in state farms will be used to satisfy compensation claims that cannot be satisfied from cooperative land.

19. The law stipulated an opening price of 3,000 forints per gold crown in an auction and a minimum price of 500 forints. Since 1 gold crown is equivalent to a 1,000 forint coupon. The new landowners are obliged to cultivate the purchased land and not to withdraw it from agricultural production within five years. Failure to meet this obligation will result in confiscation without compensation.

20. In addition to compensation of former landowners, a special land reserve is to be created by

cooperatives and state farms for their landless members and employees. The reserve is based on an allocation of 30 gold crowns of farmland per member and 20 gold crowns per employee. This is equal to 1.5 ha of average-quality land ("20-gold crown land") for members and 1 ha for employees, which will be allocated without any auction.

21. In the case of cooperative land, the cooperatives act as sellers in the land auctions and they collect the coupons in payment for land from the buyers. The cooperatives can use these coupons to purchase state-owned assets, as any other holder of coupons. A special provision stipulates that cooperatives can use the coupons to purchase at least 20% of the assets in state-owned food-processing enterprises undergoing privatization.

Law of Cooperatives

22. The cooperative form of organization, "created through voluntary association of people," is endorsed by the Hungarian Constitution. The January 1992 Law of Cooperatives is intended to provide the legal framework for the operation of Western-style cooperatives in Hungary, as distinct from the traditional cooperatives established in the collectivist era. The law covers cooperatives in general, and there is no special emphasis on agricultural cooperatives.

23. The main subject headings covered by this law are the following:

- Establishment of a cooperative
- Self-governing bodies in a cooperative
- Cooperative membership: rights and obligations, termination of membership, ownership relations
- Economic activities of a cooperative
- Liabilities
- Fusion, splitting, transformation, and dissolution of cooperatives

24. A cooperative in Hungary may be established by five members. Members are natural or legal persons. Members in a cooperative share some common interest or activity. The law makes a definite distinction between membership and employment: the new cooperatives do not have an obligation to employ their members.

25. The cooperative membership is sovereign to decide all questions relating to management and operation of the cooperative. The decisions are guided by the cooperative bylaws or statute, which must be approved when a cooperative is founded. The General Assembly is the highest organ of self-government in a cooperative, and it is the only forum qualified to decide on reorganization of the cooperative and division of property. All members have a say and a vote in the General Assembly, and the cooperative principle of "one person, one vote" prevails.

26. The law provides for two types of cooperative securities: cooperative shares and cooperative quotas. Shares are membership certificates and they are purchased when members join the cooperative. Each member must purchase one share and it entitles him or her to one vote at the General Assembly. Cooperative shares are nontransferable and receive an annual dividend from

profits at a rate decided by the General Assembly. Cooperative quotas, on the other hand, represent fractional ownership of the assets in the cooperative. They are transferable and inheritable, but nonvoting. Owning a quota is thus not a condition of membership: outside quota holders participate in the General Assembly but without voting. Quota holders receive an annual dividend from distributed profits. The value of cooperative quotas increases when the cooperative retains undistributed earnings and decreases when the cooperative reports losses.

27. The law goes in considerable detail into provisions for termination of membership (Articles 48-51). One of the most relevant instances of termination of membership at the present juncture is when a member "secedes from the cooperative". The law does not require any formal approval of the decision to secede, apart from a written notification to cooperative management. The exiting member is entitled to a financial settlement (Article 51): "As part of the settlement, the assets put into the use of the cooperative on the basis of the membership contract must be returned to the former member... If an asset put into the use of the cooperative can no longer be traced, or is no longer in the use of the cooperative at the time of secession, the former member must be compensated for its value."

28. The law also indicates that the exiting member is entitled to receive his share of accrued cooperative profits (i.e., the accumulated increase in the value of his quota). The specific arrangements of this provision are not spelled out, however, and the procedural decision is left to the bylaws or the self-governing bodies.

29. In principle, the freedom of individual exit from a cooperative with a fair share of assets is all that is needed for relatively unrestricted restructuring of cooperatives in the future. Yet in addition to the individual exit provisions included in the context of termination of membership, the law contains a long and detailed section entitled "Fusion, Separation, Transformation, and Dissolution of Cooperatives". These terms are self-explanatory: fusion is merging of two existing cooperatives; separation is a split of an existing cooperative into two or more units; transformation is reorganization of a cooperative as a limited liability or a joint stock company; and dissolution is liquidation of an existing cooperative by a voluntary vote of the members, fusion with another cooperative, bankruptcy proceedings, or decline of membership below the legal minimum of five. Such restructuring decisions must be adopted by a two-thirds majority at the General Assembly, which can be convened by a written request from 10% of the members (Article 21; Article 80 on the other hand requires a petition from 15% of the members to discuss a transformation proposal; the origin of this discrepancy is not clear).

30. In case of a separation proposal, the General Assembly is convened in two rounds. The first assembly debates the separation proposal. If the separation proposal is approved (by a two-thirds majority), the management prepares a plan for division of assets and liabilities between the splitting entities and the plan is brought for approval to the second assembly. The law makes no provision for resolution of conflict if the second assembly does not approve the division of assets by the required majority and thus effectively blocks the proposed split. In principle, the injured group can turn to the courts for a review of the decision (Article 13), but international legal practice shows that courts are reluctant to interfere in matters that are within the purview of cooperative bylaws and the General Assembly.

Cooperative Transition Law

31. The so-called Cooperative Transition Law (Law II of 1992) provides procedures for entry into force of the Law of Cooperatives (Law I of 1992) and sets out transition regulations intended for the restructuring of traditional cooperatives. This transition law had a limited duration: it was applicable to existing agricultural cooperatives until December 31, 1992. When the law was being prepared in 1991, the assumption was that the transformation of cooperatives would be completed by the end of 1992. This proved to be an over-optimistic assumption, and the transition law had expired long before the restructuring processes in Hungarian agriculture was complete.

32. The main operational topic of the law is the assignment of property rights in land and assets to cooperative members. With regard to land, the law follows in full the provisions of the Compensation Law discussed above. In addition, it allows a kind of a "private arrangement" between a member holding a compensation coupon and the cooperative: the member may surrender his coupon to the cooperative and receive in return land for the full gold-crown value of the coupon without participating in the auction (this land, however, will be allocated only from what remains after the auction). The land left as cooperative property after compensation auctions is to be assigned to the members (Article 25). These changes in land ownership must be registered in the Land Register, and the new owner must bear the associated costs.

33. With regard to non-land assets, the law introduces a procedure of "property designation," which involves assignment of property rights in the assets of the cooperative less agricultural land. The state waived its ownership rights to property which was in cooperative use prior to January 1989 and allowed inclusion of this property with the rest of cooperative assets for property designation.

34. Property is assigned in the form of cooperative quotas, which are transferable nonvoting securities. The main beneficiaries of the property designation process are the following:

- Current members who were admitted before January 1991;
- Persons who were members for at least five years prior to the adoption of the new law (or their heirs);
- Persons who terminated their membership after January 1988 but remained employees of the cooperative (and are thus entitled to restoration of their membership).

35. Quotas are thus assigned not only to members (both active and pensioners), but also to outsiders - former members of sufficient seniority and former members who maintained employment relations with the cooperative after exiting.

36. In addition to these beneficiaries, the General Assembly may assign cooperative quotas to other groups of outsiders: all employees of the cooperative, all former members and their heirs, and family members who regularly help the cooperative in production work. These special quotas must not exceed 10% of the total assets available for assignment.

37. Up to the end of 1992, individuals and groups were allowed to leave the cooperative without

the consent of the General Assembly. The seceding members would exit with a proportional share of cooperative assets (and liabilities). This provision applied to individuals and groups taking away not more than 10% of the assets of the cooperative.

38. Apart from secession of individuals and small groups with less than 10% of the assets, the law also envisaged a process of internal reorganization of an existing cooperative with the objective of improving the overall performance (again to be completed before the end of 1992). The reorganization plan, involving physical distribution of assets to the new organizational units, had to be approved by a two-thirds majority at the general assembly. The plan had to be based on the principle of "independent functionality" of the new economic units. Cooperative liabilities had to be distributed together with the assets, so that the creditors had to approve the reorganization proposal.

39. If the General Assembly failed to approve the asset distribution plan by the required majority, a closed auction would be organized between the cooperative and the interested members. The members would bid for assets with their cooperative quotas. Assets remaining after the closed auction would be offered to outsiders for cash at a public auction.

40. The transition law included the basic principles needed for farm restructuring: assignment of property rights in land and assets, freedom of individual exit with a share of assets from the cooperative, asset distribution procedures for internal reorganization of cooperatives, and a conflict resolution mechanism through auctions. Unfortunately, the law expired in December 1992 before the process was completed, and not all of its components are incorporated in the Law of Cooperatives.

41. Some amendments to the cooperative law were passed by the parliament in its last session prior to the elections, but they have not yet been signed into law. These amendments mainly simplify the procedure which needs to be followed if a village-based section of a multi-village cooperative wishes to split off. By making it easier for segments of cooperatives to establish unit sizes that are more compatible with managerial considerations as well as with social cohesion, this amendment would add to efficient transition. However, the amendment does not resolve the problems outlined above regarding the difficulty of effecting a split when there the asset distribution proposal is blocked by the general assembly.

Land Law of 1994

42 The Land Law which was in effect in Hungary up to 1994 was enacted in 1987, and it did not reflect the changes in economic orientation and in the patterns of land ownership that have emerged after 1990 as a consequence of the Compensation Law, the Law of Cooperatives, and the Cooperative Transition Law. In fact, many of the provisions of the 1987 Land Law were nullified by new regulations or provisions which are part of other laws. In particular, the 1987 law recognizes ownership of land by cooperatives (which was in fact the most common form of ownership prior to 1992), while under the Cooperative Transition Law all cooperative land is to be either given as compensation or distributed to individual ownership. Only in the first quarter of 1994 was a new, updated land law passed. The new land law deals specifically with agricultural land under post-reform conditions.

43 The 1994 Land Law contains a number of provisions which can unnecessarily inhibit land market activities and have negative implications for investment incentives as well as credit markets. The law recognizes only individual ownership of agricultural land, but not corporate (or cooperative) ownership. This tends to limit considerably the range of enterprises that might otherwise wish to create consolidated, larger farms. The inability to own land hampers the investment incentives of corporations, and also puts them at some disadvantage in credit acquisition. The law specifically seeks to block ownership by foreigners, but it should be possible to achieve this objective even if corporations are allowed to own land, through appropriate definition of when a corporation is mostly under Hungarian ownership. The law also establishes an upper limit of 300 ha for individual ownership. Although this will not be a binding constraint for most family farms, it may limit the range of operations of some commercial types of farms.

44 The new Land Law limits the duration of a lease on agricultural land to a maximum of 10 years (with longer lease terms for orchards and forest plantations). This could limit the incentives of some investors for land consolidation through leasing if the pay-off period of their projected investment exceeds 10 years. According to another lease-related provision in the new law, the landowner is required to compensate the tenant for certain natural calamities by reducing the rent. This diminishes the incentive of landowners to lease out. Similarly, tenants are granted a right to terminate the lease contract for health reasons. This may provide a loophole for tenants that penalizes owners and thus deters rentals.

45 The Land Law also contains a whole range of regulations the objective of which is to ensure environmentally sound utilization of land. For that purpose, it provides significant discretion to local land department offices to determine whether utilization is appropriate, and whether changes in cultivation schemes are acceptable. An implicit assumption underlying some of the regulations is that agricultural utilization has higher priority over other uses. While the logic of environmental concerns is sound, they should be addressed through a less discretionary procedure. Otherwise, inconsistencies and bureaucratic abuse can become factors deterring investments and hampering consolidation.

Current Status of Land Reform and Farm Restructuring

46 At the end of 1996 the privatization and restructuring of large-scale state and collective farms is nearly complete. The outcome of this process has been a rather fragmented structure of land ownership with a mixed and further evolving farming structure (**Table 2**). While the initial issues of land privatization have been resolved and the new farming organizations are consistent with the conditions of a market economy based on private ownership, the consolidation of ownership and farming structures will require further time and appropriate Governmental policies.

Table 2: Registered Operations in Agriculture and Forestry

Type of Operation	1994	1995
Company	3,342	3,848
Limited Liability Companies	3,140	3,636
Shareholding Companies	171	171
Cooperatives	2,048	2,117

Other Legal Persons	114	415
Under Liquidation	37	33
Total Operations Registered as Legal Persons	**5,541**	**6,413**
Registered Operations Without Corporatization	2,462	2,735
Registered Individual Farms	29,130	29,976
Under Liquidation	299	261
Non-corporatized Registered Operations	**31,891**	**32,972**

Source: Research Institute for Agriculture Economics

47 Land Privatization. Privatization of land was based on a compensation policy as well as on the legislation guiding the restructuring of collective farms discussed previously. Of the 5.6 million ha farmed by the collective farms in 1992, 36.3% was formally in the private ownership of the collective members, but there were restrictions on land use. This land became full-fledged private property by the end of that year. The compensation policy had an impact on both collective and state farm land. Through auctions about 2.7 million hectares were privatized. About 1.5 million new owners received, on average, less than 2 hectares of land per person. The remaining collective farm land has been distributed to members of the collective farms. By mid-1996 the compensation process was completed for about 85% of the land, and the land of new owners have been physically identified. The physical distribution of the land shares for collective farm members is lagging behind; only about 20% of this category of land had been distributed by mid-1996. As a result of the land privatization, which is expected to be fully completed by the end of 1997, over 90% of agricultural land will be privately owned.

Box 1. Utilization of Arable Land (in percent)

User	1994	1995
Companies	19.3	18.7
State enterprises	1.9	1.9
Cooperatives	39.9	33.1
Private farmers	40.8	48.2
Total	100.0	100.0

48 Reorganization of Collective Farms. The reorganization of collective farms was based on 1992 legislation which provided a framework for distribution of assets and the privatization of land. The actual restructuring took longer than originally envisaged. The first phase was completed only in 1995. From the initial assets of the collective farms, 41.5% was given to the active members, pensioners received 38.7%, while those who left the farm earlier received 19.9%. In the first phase of reorganization, most of the active members opted to remain under the umbrella of cooperative farming organizations. Only about 15% of active members left, and about one-third of these created smaller cooperative organizations or partnerships. The restructuring of these new cooperative organizations has continued throughout recent years and it is on-going. The share of cooperative farms in total arable land declined by a further 20% from 1994 to 1995 and was only 33.1% (see **Box 1**). The features of the remaining cooperative farms are evolving toward service and marketing types of cooperation or toward holding type structures.

49 Privatization of State Farms. The privatization of state farms was almost fully completed by mid-1996. Of the initial state farm land (411,000 hectares), 47% was used to compensate previous owners. Out of 121 state farms, 86 have been fully privatized so far, 44 of them were purchased by Hungarian nationals (mainly the managers and former workers of the farms), and only 3 farms were

sold to foreign investors. Thirty-nine farms were liquidated and their assets were sold through auctions. The privatization of seven additional farms is in process and will be completed by the end of 1996. The privatized farms currently use 118,000 hectares of state owned land, leased from the state for ten years with the option to buy. Twenty-eight former state farms were turned into joint-stock companies and remain in majority state ownership. Nearly 48% of the assets of the former state farms and 36% of their land remained with these farms. Twenty-five percent of the shares of these farms are intended to be sold to private owners (mostly likely current managers and employees) in the near future.

50 The New Farming Structure. As a result of collective farm restructuring and state farm privatization, a relative heterogenous farming structure was created (**Table 2**). These farms include: (a) incorporated, mainly privately owned, larger farms; (b) cooperatives operating in various forms based on fully privately owned land; and (c) individual private farms. The latter category includes about 50,000 - 60,000 full-time family farms, most of them are larger than five hectares, and about 1.2 million part-time farms (**Table 3**).

Table 3: Individual Private Farming in 1994 (Full and Part-time Individual Farms)

1) Land Only	
Hectares	Number of Farms
Less than 0.5	342,488
0.6 - 1.0	33,919
1.1 - 5.0	36,475
5.1 -10.0	5,518
10.1 - 50.0	4,293
More than 50	640
Total	423,333
2) Mixed Crop and Livestock operations (% of crop production in gross output)	
Less than 20%	100,390
20.1 - 40%	196,466
40.1% - 60%	139,997
60.1% - 80%	69,220
More than 80%	24,164
Total	530,237
3) Livestock Only (number of livestock units)	
1	226,913
1.1 - 2.5	14,969
2.6 - 5.0	4,395
5.1 – 10	736
Total	247,445
Grand Total	1,201,015

Source: Central Statistical Office

51 The financial results of farms show signs of slow consolidation. The performance of incorporated agricultural enterprises significantly improved during the last two years (**Table 4**). The

profits before taxes increased threefold from 1994 to 1995. Bankruptcy laws are strictly enforced. In 1995, 105 registered agricultural enterprises reported a bankruptcy, compared to 160 in 1994. As a result of these bankruptcies, 50 enterprises were liquidated in 1995. Investments in large farms increased by 31% in 1995 over 1994 figures. Foreign investment was initially rather modest in primary agriculture, but the interest of foreign investors has begun to turn toward agriculture. The amount of foreign investment in primary agriculture increased by 7% in 1995. There remain however, still financial difficulties for some restructured cooperatives, in addition to some individual private farms. Some of the larger family farms are doing quite well, while a significant portion of smaller farms struggle to survive. It is expected that many of the weaker farms will go out of business in the near future. As a result of the further restructuring of cooperative farms and the concentration land ownership and increase of farm size, the share of mid-sized and large family farms in total production and land use will increase.

Table 4: Farming Units Providing Statistical Information in 1995

		Pre Tax (in Million HFt)			(in Million HFt)		Aggregated profit, %	
	# of Units	Profit	Loss	Aggregat-ed Profit	Sales	Own Capital	Sales	Own Capital
	According to Employment (# of persons)							
0	1,276	1,379	1,297	82	16,164	29,514	0.51	0.28
1-20	1,868	3,634	3,789	-155	73,173	31,598	-0.21	-0.49
21-50	642	6,642	2,324	4,318	75,030	45,366	5.75	9.52
51-100	471	6,381	2,114	4,267	78,498	63,823	5.44	6.69
101-300	397	8,787	2,391	6,396	146,852	122,789	4.36	5.21
301-500	30	2,201	103	2,098	29,706	28,610	7.06	7.33
> 500	18	2,993	0	2,993	44,953	36,875	6.66	8.12
Total	4,702	32,017	12,018	19,999	464,376	358,575	4.31*	5.58*
	According to Type of Farm							
Limited Liability	2,764	10,499	3,394	7,105	166,685	46,288	4.26	15.35
Share-holding	133	5,557	1,647	3,910	77,331	75,136	5.06	5.20
Other Corp.	4	14	47	-33	397	396	-8.39	-8.41
Coop.	15,888	15,568	6,525	9,043	211,070	232,914	4.28	3.88
Individual	32	80	34	46	1861	161	2.46	28.48
Other	181	299	371	-72	7,032	3,680	-1.02	-1.96
Total	4,702	32,017	12,018	19,999	464,376	358,575	4.31*	5.58*

	According to Ownership							
Domestic	4,099	29,691	10,789	18,903	430,860	329,117	4.39	5.74
> 50% Foreign	464	1,084	950	134	20,274	19,119	0.66	0.70
25-50% Foreign	99	1,068	240	827	9,971	3,880	8.30	21.32
<25% Foreign	40	174	39	135	3,271	6,459	4.14	2.10
Total	4,702	32,017	12,018	19,999	464,376	358,575	4.31*	5.58*
	According to Pre-Tax Profit							
Profitable	2,571	32,017	0	32,017	329,761	278,857	8.15	11.48
Loss	2,038	0	12,018	-12,018	71,198	73,192	-16.9	-16.4
No Profit	93	0	0	0	417	6,526	0	0
Total	4,702	32,017	12,018	19,999	464,376	358,575	4.31*	5.88*

*Average percentages
Source: Research Institute for Agricultural Economics

52 Farming Organizations. Agricultural producers have established a wide range of associations to represent their interests. The cooperative farms are represented by the National Association of Agricultural Producers (MOSZ). There are several organizations established by private farmers, but none of them can be considered the Asole@ representative of the private farmers. In 1994, the Chamber of Agriculture was organized with a regional network, along the lines of the German system, to provide support for all types of farming organizations, collect information, and support the implementation of agricultural policies. Two political parties are dominated by agricultural concerns. The Independent Smallholders Party is tied to private farmers and rural entrepreneurs. This party is currently the third largest party in the Hungarian Parliament (about 10% of seats) and the leading force of the opposition. The Agricultural Alliance has close relations with MOSZ, but is represented in the Parliament only by one seat.

Land Markets and Registration

53 As pointed out in the preceding discussion, the compensation-based land distribution mechanism has produced a considerable fragmentation of the ownership of land holdings and parcel configurations that are not compatible with efficient cultivation. The average private holding size is about 1.9 ha. In many instances, these are not viable farm sizes, and the extreme fragmentation does not allow efficient cultivation even with small scale equipment. Consolidation is therefore essential. Consolidation can be accomplished through land markets, i.e., through purchase, sale, and leasing of land. However, land markets are not yet fully functioning in Hungary, and their speedy development is therefore essential.

54 Many of the small owners or their heirs who are not particularly suited to manage farms will consider the merits of renting out or selling their land to individuals or corporations who are better qualified to run larger and more efficient farm operations. By virtue of their higher efficiency and better qualifications, these operators would be able to offer a rent or a land price which is higher than the value of the land to the original, less efficient owner.

55 The current laws do not restrict the ability of individuals to buy or sell land, although the Law of Cooperatives and the Cooperative Transition Law imply that present cooperatives need to distribute all their land to individuals. Hungarian law recognizes only individual and private ownership. Lease contracts are legally allowed and are enforceable like any other commercial contracts, and the civil code specifies the mechanisms of land registration and title issuance. It would therefore seem that there are no legal obstacles to the smooth operation of land rental and sale markets.

56 Land markets operate only partially in the country. The land that was privately owned before 1990 can be traded, while land received through compensation and as a share from the collective farms cannot be sold for three years after receipt. Land ownership, and land transactions, are further constrained by existing legislation which sets at 300 hectares the upper limit for individual land ownership and prohibits agricultural land ownership for legal persons (corporations) and for foreign citizens. While the land market remains in an embryonic stage, there is a very active and quickly developing lease and rental market. A large portion of land received through compensation is leased to individuals and cooperatives as well as to private companies (**Box 2**). Though there are over two million land owners in Hungary, about 50% of the land is used by about 4,000 farming organizations.

Box 2. Share of Land Owned by the Operator in Various Farming Categories (1995)

Farm Size (ha)	Percentage
Up to 1	80.6
1-5	76.1
6-10	60.8
11-20	51.7
21-50	35.6
51-100	22.8
100+	26.3
Total average	62.2

57 In fact, lease agreements are already fairly common in Hungary. A survey conducted for the World Bank showed that lease transactions by private farmers in 1991 and 1992 involved annually 15% of the land in the sample. Land sales were much less frequent in the survey, involving only about 2% of the land annually. One should bear in mind, however, that widespread private ownership by people who are essentially not qualified to be farm operators is a very recent phenomenon in Hungary, arising out of the compensation process. The new landowners have not had enough time to decide between the option of farming and the option of selling or leasing out their land. In addition, if land received as compensation is sold within three years from time of possession, the seller is required to pay income tax on the entire sales revenue, which obviously acts a deterrent to land sales. Another potential obstacle to land sales is the attitude of the banking system. The 1992 World Bank survey shows that Hungarian banks are reluctant to lend against land and overwhelmingly prefer the house and personal possession as a collateral. Lack of land mortgage mechanisms may seriously delay the development of land markets in Hungary.

58 One would thus perceive the present situation as a pre-equilibrium setup, with adjustments in ownership (and consolidation through sales and purchases) towards an equilibrium in the next few years. Given this likely scenario, two factors need to be assessed: (a) Can the land registration and titling apparatus cope smoothly with the anticipated increase in the volume of land transactions? and (b) does the proposed new land law limit in a significant way the operations of a land market?

59 Hungary's land registration and titling administration is currently handled by the Department of Lands and Mapping, which is within the Ministry of Agriculture (although the Department deals also with urban real estate). The Department oversees a system of 20 county land offices and 113 district land offices, with a total staff of about 4300 persons. The process of compensation and distribution of cooperative land placed a significant load on the land registration and titling administration, as hundreds of thousands of parcels need to be demarcated and registered, in addition to residential apartments that are being transferred to private ownership. The Department benefits from the services of about 1000 private surveyors, who are contracted by cooperatives to survey lands scheduled for division among members. Compensation land, on the other hand, needs to be surveyed and demarcated at the expense of the state, and this work is done by the Department of Lands and Mapping. The existing backlog of registration and titling applications varies in different county offices, but in many the average lag time between possession of land and issuance of titles is about 18 months. With the anticipated increase in sales and mortgage registration activities in the near future, the pressure on the existing limited capacity will increase. The speedy issuance of ownership titles is important for the development of the land sale market: lack of reliable (state-confirmed) evidence of ownership may deter potential buyers from the purchase of land due to the risk that the seller in fact is not entitled to alienate the property.

60 An expansion of the registration and titling capacity is thus warranted. Some of this expansion can be achieved by transferring manpower and resources from the compensation offices, which will be winding down their activities in the near future. But it is clear that significant additional resources for the enhancement of the land administration capacity are necessary.

61 Hungary inherited a solid system of cadastre and land titling, but this system, had to be adjusted to the needs of a modern land market and market economy. The upgrading of the land titling system is in progress, with the significant financial support of EU for the computerization of 115 regional land registry offices. Though Hungary began with an existing system of land registration fully conforming with European standards, the administration of the compensation and land privatization process represents an immense task. The titling of newly privatized parcels is lagging. By mid-1996 about 55% of parcels covered by the compensation were properly titled. The titling of land shares provided to the collective farm members is however, still at a rather early stage. Only about 10% of owners received titles, at best. On the whole, about 20% - 25% of the country's agricultural area still requires titling. The completion of this process, given the available resources, will require an additional two years at minimum.

Sectoral Performance after the First Six Years of Land Reform

62 Growth. Both agricultural production and the output of agroprocessing industries declined

significantly between 1990 and 1993. Agricultural production fell by 33% while agroprocessing contracted only by 14%. Growth in both agricultural production and agroprocessing resumed in 1994, but this recovery has been relatively slow and modest in primary agriculture. Somewhat less than 2.9% growth was recorded in 1994, 2% in 1995, and another 1-2% annual growth is forecast for 1996. Current overall output remains 27-28% below the 1990 levels.

63 The recovery has been somewhat more robust in agroprocessing. In 1994, output increased by 3%, followed by an additional 3% growth in 1995, and current growth forecasts for 1996 indicate 2% growth. The output of agroprocessing for 1996 will be around 95-96% of the 1990 level (see **Table 5** and **Figure 1**).

Table 5: Growth of Agricultural Production and Agroprocessing (Gross Output, 1990=100)

Year	Agriculture	Crop Production	Livestock Production	Agroprocessing
1991	93,3	103,8	84,4	93,2
1992	79,8	77,2	73,4	89,5
1993	67,6	70,1	66,4	85,7
1994	69,6	74,2	63,6	91,7
1995	71,0	75,8	65,6	94,4
1996 (est.)	72,3	.....	....	96,3

Source: Central Statistical Office

Table 6: Employment in Food and Agriculture(share in total employment, %)

Year	Agriculture	Agroprocessing	Together
1981	19,6	4,1	23,7
1982	20,1	4,1	24,2
1983	20,7	4,1	24,8
1984	20,6	4,1	24,7
1985	20,0	4,1	24,1
1986	19,1	4,1	23,2
1987	18,2	4,1	22,3
1988	17,8	4,2	22,0
1989	17,4	4,2	21,6
1990	17,0	4,2	21,2
1991	15,2	4,2	19,4
1992	13,0	4,6	17,6
1993	9,3	4,4	13,7
1994	8,8	4.0	12,8
1995	8,5	3,8	12,3

Source: Central Statistical Office

64 Agriculture=s share in GDP and in employment has declined significantly. The food and agricultural sector accounted for about 22% percent of GDP in the 80s, but contributed only 11.5% in 1995. This comparison, however, has to be treated with some caution due to the fact that pre-reform GDP indicators were calculated differently than under the current methodology (a change from an organization-based to an activity-based GDP statistics calculation). There has been a remarkable decline (43%) in the number people employed full-time in food and agriculture (**Table**

6). As a result of these changes about 160,000 agricultural workers became unemployed, at least temporarily, since the beginning of the reform period. In 1995, 12.3% of total employment were engaged in some agricultural pursuit (8.5% in agriculture, 3.8% in agroprocessing) compared to 21.6% in 1990.

65 Primary agriculture. The contraction in production has been somewhat greater in livestock than in the crop sector. This has caused the crop share of total production to rise from 49.4% on average during 1986-90, to 55.2% in 1995. Even so, crop yields and overall output declined significantly from 1991 to 1993. Crop yields and production fell back to the level of the early eighties, however, labor productivity has increased significantly. The decline in the livestock population has not been combined with a significant decrease of yields as in the crop sector because the contraction took place mainly at farms with lower production efficiency. The latest statistics indicate the beginning of recovery in the livestock sector. After five years of unbroken contraction, cattle and pig stocks have been increasing since early 1995.

66 In spite of the positive trends in outputs, evident in 1995 and 1996, primary agriculture as a whole has not yet stabilized. The use of chemicals continued to decline (70-80% compared to the pre-reform period) even in 1996. The use of fertilizers increased somewhat, but the application of other chemicals contracted further. The level of agricultural technology at the various farms is becoming more differentiated, the larger commercial farms are able to maintain higher levels of technology, while according to recent surveys, technology and inputs are inadequate on 30-40% of areas cultivated. About half of the farms use inadequate seed, fewer chemicals and fertilizer. Outdated field machinery and farm and storage equipment result in not only rising harvest and storage losses, but in reduced product quality as well. The increased investments in 1995 and 1996 have not yet offset bottlenecks attributable to the absence of investments in the previous years. Short-term liquidity and financing problems are still the tightest constraints on improving production technologies and production efficiency in general.

67 Agroprocessing. There has been a significant increase of productivity (30% rise between 1990 to 1995) in the sector and utilization of existing production capacities has also improved. Currently the sugar, beverage, poultry and canning industries are developing the most rapidly. The agroprocessing industries have gone through a significant modernization during the last two to three years, 25% of all industrial investments took place in the agroprocessing sector.

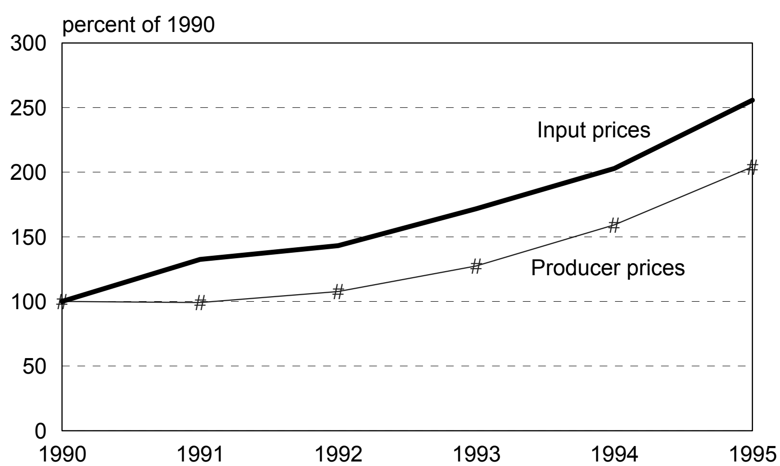
68 Foreign Trade. The country traditionally has been a net exporter of food and agricultural products, which provided about 25% of total export earnings in the pre-reform period. The early years of transition had a negative impact on the trade performance of the sector as well. Exports declined by almost 30% from 1991 to 1993. Net exports however remained relatively large (US $1.2 billion in 1993). The country remained the only one in the region able to maintain a positive balance of agricultural trade, even with the EU, during these difficult years. About 50% of food and agricultural production was already exported to non-CMEA countries in the pre-reform period. Export performance significantly improved in 1994, and in 1995 again reached the US $3 billion level of the late 80s. The increase in imports was more modest than in most of the other countries in the region, allowing net exports to quickly resume their US $2 billion pre-reform level. This positive trade performance continued in 1996, and exports of somewhat more than US $3 billion are

forecast, together with a positive trade balance of about US $2 billion. There has been a significant change in the composition of exports. In 1995, and to date in 1996, about 75% of agricultural exports were processed products of higher quality. In 1995 and 1996, exports to OECD countries increased significantly, while there is a slight decline of exports to CIS countries. During the first half of 1996, 55% of food and agriculture products were exported to OECD countries (47% to EU) and 44% were exported to the former socialist countries. There has been a dynamic increase (42%) of exports to the CEFTA countries. Imports decreased by 13%, continuing the trend established in 1995. Of those imports, 44% was food and agriculture products imported from the EU and 38% from the developing countries.

Ancillary Policies

69 The farming structure evolving in any country in transition is affected by various government taxes or subsidies. To the extent that these taxes or subsidies have a distinct bias for or against particular farm organizations, or particular sizes of operations, the implications need to be analyzed, as the outcome may inhibit the emergence of economically efficient farms, or may artificially encourage less efficient types or forms. As the government of Hungary operates several subsidy schemes as well as differential tax policies to different segments of the farm sector, an assessment of these policies and their impact on farm transformation is warranted.

Input Prices and Producer Prices



70 Prices. Both producer and consumer prices are fully liberalized, and despite some distortions, reflect border prices. Producer prices are about 30% lower than EU domestic producer prices, but not far from border prices (**Table 7**). Consumer prices are somewhat higher, around the US consumer price levels but still lower than EU domestic consumer prices. The dynamics of domestic prices, above and beyond, world market prices, are driven by the still relatively high inflation rate which has averaged 20% to 25% annually in the last two years. Producer prices increased by 27.9% in 1995 and there has been a further 35% increase in producer prices in 1996.

As a result, relative prices of agricultural products improved in the last two years. The price increases for agricultural products were somewhat more than the price index for inputs used by food and agriculture, in both 1995 and 1996. Yet when viewed over the period between 1990 and 1995, input prices increased 25% more than agriculture producer prices (**Figure 2**). In 1995, consumer prices increased by 28.2% while food wholesale prices increased by only 22.2%.

Table 7: Average Producer Procurement Prices of Main Agricultural Products and Live Animals

Year	Wheat	Maize	Barley	Sunflower seed	Potatoes	Cattle	Sheep	Pigs	Poultry
1991	5.50	6.70	5.60	15.10	12.80	64.10	176.60	64.50	70.30
1992	6.80	7.10	6.30	13.70	12.50	69.80	179.60	79.90	73.60
1993	9.40	10.20	8.10	14.30	15.40	82.00	148.20	89.30	86.30
1994	9.30	9.90	8.50	24.50	19.10	11.30	229.10	17.20	110.10
1995	10.90	12.30	9.20	31.30	33.70	151.30	307.60	168.20	124.00
1996*	23.50	20.30	21.70	34.60	22.70	156.00	372.90	158.70	144.80
US$/ton	188	134	143	228	178	1026	2453	1044	953
1996, % of 1995	227.6	179.6	249.8	116.2	53.8	105.0	123.2	98.5	124.5

*January-August 1996.
Source: Central Statistical Office

71 Support Programs. Subsidies provided for food and agriculture represent the most critical component of Hungarian agriculture policy. Subsidies to agriculture were significantly reduced in 1991 and 1992. In 1993, however, the budgetary allocation for agriculture support programs increased by 23% percent, and in nominal terms increased an additional significant 34% in 1994 (Table 8). The increase in the cost of support programs, in nominal terms, has continued through 1995 and 1996. However, the increase in 1995 was only 6.4% and a 20% increase is budgeted for 1996. The recently approved budget for 1997 keeps the agriculture support programs on the level of 1996 in nominal terms. This trend represents a significant decrease in the value of agriculture supports in real terms, as inflation was more than 20% in 1995 and is expected to be around 20% in 1996. Though agriculture interest groups lobby intensively for increased subsidies, the determination of the Government to speed up macro-economic stabilization has put a hold on any increase in agricultural supports, even in nominal terms.

72 The total cost of Hungarian agricultural support programs can not be considered excessive when compared with rates in other OECD countries. In 1993, the value of Hungarian agricultural programs in dollar terms amounted to US $750 million (about 2% of GDP or about 3% of total Government expenditures). As budgeted, the 1997 support programs will cost about US $490 million, about 30% less than four years ago, in US dollar terms, and only about 1.1% of GDP (Figure 3). Even these scaled-back programs represent more support for agriculture than the sector receives in other countries of comparable per capita GDP.

73 Support Programs in 1996. The direct budgetary support to agriculture in 1996 is budgeted as 88 billion Hft (**Table 8**). The major components include:

- Market support programs: 41.65 billion HFt (47.3%). Most of this amount is export subsidies of 39.65 billion Hft, or 45% of total support expenditures. The budgeted expenses for the minimum price guarantee program (mainly milk price supplements) are almost negligible (2 billion HFt - 2% of the total).

- Producer subsidies: 14.7 billion Hft (16.7% of the total). The two major components are: (a) interest rate subsidies at 7 billion Hft (7.9% of the total) provide a 30% interest rate subsidy to short-term credits for agricultural operations; (b) deficiency payments for farms with unfavorable soil conditions at 6 billion Hft (6.8% of the total). The latter is a new component of the Hungarian support program introduced to address increased regional income differences. The cultivation of land however, is a condition for receiving this subsidy.

- Investment subsides: 16.05 billion Hft (18.7% of the total) used as grants and subsidizing interest rate payments.

- Support to reorganizations: 12 billion Hft (13.6% of the total) used to support the improved use of resources in restructured large-scale farms after privatization, as well as to maintain labor force and increase production for export purposes.
- Other programs: 3.6 billion HFt (4.1% of the total) used for land amelioration, for forestry development and for other purposes.

Table 8: Agriculture Support Programs (Million HFT)

	1992	1993	1994	1995	1996	1997 (est.)
Market Support	30,192	42,707	41,600	47,600	41,650	42,300
Export Subsidy	22,841	25,531	34,600	45,100	39,650	---
Domestic Price Support	7,301	17,176	7,000	2,500	2,000	---
Production Subsidiaries	7,369	4,556	12,350	11,600	14,700	18,000
Interest Rate Subsidy	5,487	626	11,850	11,600	7,000	10,500
Deficiency Payment	---	---	---	---	6,000	4,300
Investment Subsidies	3,574	2,686	10,192	5,400	46,050	18,500
Reorganization Support	352	1,225	4,750	7,500	12,000	5,300
Other Subsidies	190	118	---	700	1,850	3,850
Total	41,677	51,291	68,922	73,300	88,000	88,000
US$ equivalent (mill.)	641	662	689	586	568	489

Source: Ministry of Finance

74 1997 Support Program. This program will result in a significant decline of the real value of agriculture subsidy programs, even with the possibility of budget amendments allowing for additional funds later in the year. The budgeted amount, 88 billion Hft, is the same amount as the 1996 amended budget, however, the structure has been changing in the right direction, namely moving toward the Agreen box@ type subsidies. The most notable changes are the increase of budgeted support for producer and investment subsidies at the expense of support to reorganization, and the further decrease of export subsidies.

75 Domestic Price and Intervention Policy. The Government market intervention in agriculture is based on the so-called Agriculture Market Regime Act. The Government market intervention covers five products: wheat for food, feed corn, pork, beef, and cow milk. For these products the Government sets guaranteed prices and quotas. The prices are set around 82% - 85% of domestic production costs. So far, the program had been implemented only in exceptional cases and has had little or no effect on market price determination, due to the fact that market prices mainly exceeded the guaranteed prices. The operation of market regulation programs is subject to a great deal of uncertainty from year to year due to the lengthy annual process of negotiations as to the levels of guaranteed prices and methods of interventions. The so-called AProduct Counsels@ are the organizations of producers and traders created to represent the interest of their members in debates about Government intervention and trade policies.

76 Credit Subsidies. Credit subsidies are a major component of the current Hungarian support programs. In the 1996 program 30% interest rates subsidies were provided for short-term credits and 25-30% subsidies were provided for investment credits. The interest rate subsidies are provided as tax refunds through the tax administration. In 1997 the short-term interest rate subsidy will increase to 40% of the Central Bank refinancing rate plus an additional 4% maximum.

77 Export Subsides and WTO. The export subsidies represent the most crucial and debated component of current agriculture support program in Hungary. In general the long-term effectiveness of this program is questionable. According to objective analyses the export subsidies have little significant impact, either on the producer or on domestic consumer. The export subsidies partially benefit Hungarian export trading firms or benefit the foreign buyer. This program does not enhance the competitiveness and efficiencies of the producer. The Hungarian export subsidy programs are not transparent, and reflect the often narrow agenda of Hungarian export trading and processing firms. Nothing illustrates this better than the fact that the 1995 Hungarian budget provided 5 billion Hft in export subsidies to wheat traders, at a time when the world market prices were the highest in a decade. The revision and phasing out of export subsidies is therefore strongly recommended and this proposal has the backing of many Hungarian experts.

78 Export subsidies are not the only form of inefficient support for food and agriculture in Hungary, but they represent the most significant problem for Hungary, in their current magnitude, in fulfilling its agreement with the WTO. In 1995, the first year the WTO agreement became effective, Hungary exceeded its commitment regarding export subsidies (39 billion HFt in actual subsidies as opposed to 21 billion Hft originally committed) and a similar outcome can be expected in 1996 as well. Hungary=s compliance with its commitments has been questioned by a number of countries, and the Government is being called upon to reduce agricultural export subsidies in accordance with the WTO agreement. The Government is trying to renegotiate the commitment rate of depreciation of the Hft. The outcome of these negotiations will have an impact on actual export subsidy programs and may lead to an overall revision of the support programs in agriculture.

79 Trade Regime. Hungary's commitment under the GATT resulted in the elimination of all import licenses and quotas. The new tariff rates were set according to the agreement, resulting in a relatively high (30% - 40%) protection rate for food and agriculture. In March 1995, an additional 8% import tariff was introduced uniformly as a temporary measure to speed up the stabilization of

the overall economy. According to the agreement with the WTO, the extra tariffs will be fully phased out by March 1997. Export licensing is required for a few products, including grain. The export of products covered by licensing are not subsidized. Export quotas are granted by the market regulation office of the Ministry of Agriculture, based on agreements made at the Product Councils. Export quotas are transferrable and often not utilized. Foreign trade of agricultural products is competitive and fully demonopolized. Approximately 4,000 private trading businesses deal with the export and import of food and agricultural products, compared to eleven state-owned enterprises with monopolistic positions in the pre-reform period.

80 Inflation and Exchange Rate Policy. Agriculture suffers from inflation, which makes the financing of restructured and privatized farms more difficult. As a part of the stabilization package introduced by the Government in March 1995, the HFt was devalued by 9%, followed by a crawling peg. Though the devaluation contributes to inflation, the current exchange rate policy, which prevents the over-valuation of HFt, is beneficial for food and agriculture. The significant export growth of the sector in 1995, is partly a result of this policy.

81 Taxation. The personal tax for all private individuals is progressive, with a maximum tax rate of 48% (42% in 1997). The income of smaller-scale agricultural producers of up to 1 million HFt is tax free. Those with revenues of 1- 2 million HFt may pay personal tax rates and may choose not to do cost accounting for business taxes. Those with gross revenues of 2 million Hft or more must do cost accounting and pay tax as a business. The corporate tax rate on net income is 18%, down from 40% three years ago. Employers are paying 42.5% on wages to the social security system in 1996 and will pay 39% in 1997. Cooperatives pay corporate tax and members pay personal tax on personal income. Land tax was eliminated in 1995. There is a refund of 70% of the fuel excise tax (on the basis of the use of up to 90 liters per ha). The refund rate will increase to 85% in 1997. On the whole, agriculture enjoys significant tax preferences, and compared with other countries, the tax burden on agriculture is relatively low. It is difficult to estimate the exact amount of these preferences. A modest estimate is 10 to 12 billion HFt per year, or about 12% of the total support to the agricultural sector.

82 In 1996, only 47% of production was covered by taxation, though the support programs are linked to taxation. Those farmers who are not registered with the tax authorities are not receiving any subsidies. As a result, the subsidy programs cover only about half of agricultural production, namely the commercial and more viable part. *De facto,* most of the individual private farmers do not pay tax, social security, and hardly any provide information to tax and other authorities, and therefore do not receive any subsidies. There is an increasing under-reporting of outputs. The lack of comprehensive tax administration makes improvements in tax collection rather difficult. According to recent estimates, a significant portion agriculture production, 10% - 15%, has moved completely to the shadow economy, remaining out of reach for taxation and statistical purposes. The Government has made a decision to change this situation. Beginning January 1, 1997 all producers marketing any agricultural products must be registered at the tax authorities, even if they do not fill out detailed income statements and become eligible to receive subsidies. At the same time, obviously, they will be monitored by the tax authorities.

Anticipated Long-Term Evolution

83 While much progress has been achieved, Hungarian agriculture is still in the process of evolution toward a structure that would be fully compatible with the rigors of national and international market forces. The existing legal and institutional framework, as well as the basic incentive framework, generally provide correct guiding signals for a long-run transformation to a viable farm sector. As pointed out in preceding discussion, some distortions exist, which require amelioration. Nonetheless, the basic forces at work produce a likely transition path, whereby the role of private, family-based farms will increase, and the cooperative sector will undergo a change in structure and focus.

84 In the transition process, many small household farms (a large part of which are operated on a part-time basis) will be consolidated, through purchase and lease by individual entrepreneurs and limited- liability companies, into larger farm operations. At the same time, small but capital-intensive farms specializing in high value crops will emerge. Such farms will be essentially based on family labor, although to some extent they will also use hired labor (mostly in the high season).

85 Many of the commercial family farms would be associated through service cooperatives, jointly owned by the member farmers, and providing services which entail economies of scale, such as input supply, marketing, and some forms of processing. Similar services could be provided through "production systems", owned by associations of farmers (or their service cooperatives) jointly with input suppliers and product processors or marketers.

86 The existing production cooperatives will evolve, over time, towards increased reliance on internal contracting arrangements for most production activities, which will be the responsibility of individuals or small groups with private ownership of land and assets. The core of the cooperative activities will focus on service functions, thus becoming in essence a service cooperative. The beginnings of this process could already be observed before 1990 in some of the more successful cooperatives, and the performance of these organizational improvements is a market testimony to the higher efficiency and better labor incentives which they entail.

87 As in other market-oriented agricultural economies, one would expect the emergence of some large scale corporate farms, utilizing professional management and skilled hired labor. At the other end of the farm spectrum, a class of part time or marginal farmers will exist for some time. Neither of these, however, are likely to become the backbone of Hungarian agriculture.

88 The consolidation of the emerging new farming structure and the full completion of land reform still requires further action. The most critical tasks are as follows:

- Acceleration of the process of titling new privatized land.

- Amendments of land ownership and land market regulations by: (a) allowing land ownership for legal persons (companies and corporations); (b) removal of upper limits for land ownership; and (c) allowing agricultural land ownership for foreign citizens.

- Refinement of the legal framework for cooperatives in agriculture providing more transparency of ownership and a framework for easy further restructuring and division of cooperative farms.

- Introduction of measures to facilitate a speedy consolidation of land ownership and changes in farm sizes.

- The development of a strategy for further privatization of remaining state farms.