

# **TRANSFORMATION OF AGRICULTURAL ENTERPRISES IN HUNGARY**

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## **Key words:**

Transformation of agricultural enterprises, Hungary, critical factors, qualitative analysis, uncertainty, infra-structure, monopolies, markets, prices and time.

## **Klíčová slova:**

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## **1.Introduction**

Radical changes have taken place in the political and economic system of the Central- and East-European countries since 1989. Agriculture as an important element of the economies of most Central- and East-European countries, also underwent major changes: the abolishment of state control over prices and production and the privatization and transformation of state farms, cooperatives and agro-industries being the most important.

This process of transformation is rather complex and is influenced by many external factors with a high degree of uncertainty. Also internal factors as the professional skills of managers, the working attitude of the employees and the financial position will play an important role determining what kind of new production structures will emerge. Most of these factors are difficult to estimate because of uncertainty and the poor information situation.

In such a situation model calculations, often used with success in exploring and planning adaptation of farms to changing circumstances, have only limited scope and value. Instead, a broad but perforce more qualitative analysis of critical factors determining the conditions in which a viable production structure or enterprise can operate, seems to be a more suitable approach to analyze the adaptation process of agricultural enterprises in Central- and East-Europe (Renkema, 1992).

The aim of this paper is to discuss a number of above mentioned critical factors determining the future possibilities for development of agricultural enterprises in Hungary. Most attention will be given to external factors. Some concluding remarks on the path of future developments will be made paying attention to the critical factor of time.

The paper is based on two case studies carried out in April 1993: the first on a cooperative in the North-West region of Hungary, the second in the East. The research was part of a comparative study of the World Bank on the transformation of agricultural enterprises in Central- and East-Europe.

## **2. Critical factors**

The transformation of a cooperative into one or several viable agricultural enterprises or the set up of a new enterprise highly depend upon a number of conditions outside the direct influence of the management and the workers/members of the enterprise. We will discuss the most important conditions below. These are uncertainty, infra-structure, monopolies, markets and prices.

### **2.1 Uncertainty**

When talking to managers, members and workers of a cooperative the uncertainty about what will happen in the near future is mentioned as one of the biggest constraints for the development of the transforming cooperatives. Uncertainty is caused by the lack of legislation in the field of land ownership and the transfer of property, privatization and transformation, markets and land tenure. Sometimes already existing laws are adapted to cope with unexpected outcomes of the transformation. In Hungary the cooperatives to ease the transfer of shares. Outsiders, persons who left the cooperatives or their heirs, will get the possibility to take out their shares which will put many cooperatives under even more financial strains. As a result decisions on reorganization and new investments are postponed till the effect of this change is clear.

Uncertainty is created by the delays in the execution of the compensation due to complexity of the process. Several adaptations of the laws have been made to speed up the execution. Because of the delays the land assigned for compensation remains in a uncertain position which will have an adverse effect on the output and investments (OECD, 1993). It is expected that the compensation process will be finished at the end of 1993.

Lack of information is another factor contributing to the overall feeling of uncertainty. For producers main questions are: What to produce and where to sell. No adequate information systems are available to give answer to these questions.

### **2.2 Infrastructure**

A critical factor for the development of enterprises is the existence of an adequate infra-structure. The present infra-structure was made to meet the requirements of the large scale state farms and cooperatives. The rural infra-structure was also kept to a certain level to keep control over the rural population. It is astonishing to find out that in most villages only two telephones are available: one on the desk of the major, one in the office of the president of the cooperative.

For the operation of a free market system the present infra-structure is totally insufficient. Essential institutions are lacking like a network of rural banks, market information offices, quality control organizations, land registration offices. Also a new system for trade has to be developed. New market places to sell products have to be established like auctions and wholesale

markets esp. for products like vegetables. A group of small and medium size wholesalers and tradesmen is emerging but their impact is still small.

Especially for the set up of small private farms the necessary physical infra-structure is lacking: access roads to plots, electricity, gas, water, telephone lines. Construction of such a infra-structure will ask for enormous amounts of money.

Another aspect of the infra-structure is the availability of schools and training centers to provide education, training and extension services to farmers, managers of cooperatives and workers. The present system will have to be adapted to the needs of these people esp. in the field of management and marketing.

### **2.3 Monopolies, markets and prices**

In the former system the agricultural production chain was organized in monopolies which were mostly based at a regional level. One of the goals of the present Hungarian government is the break down of the monopolies and their privatization. But only privatization doesn't mean the end to a monopolistic situation. Most markets of supply of agricultural inputs and output (marketing and processing) still have a monopolistic character. A growing number of new enterprises are involved in these sectors but the largest market shares are still in hands of the still state owned or former state owned companies like AGRIMPEX (cereals), TERIMPEX (meat) and HUNGAFRUCT (fruit and vegetables).

The main bottleneck is the missing of a functioning production chain at present. The flow of goods from suppliers, primary producers towards processing and marketing enterprises is disrupted. The main disruption is between the primary producers and the processing industries. Processing companies went bankrupt or are near the point of bankruptcy due to the collapse of the internal market and old export markets. Because the marketing and processing of products is hampering primary producers are forced to cut production to reduce surplus production.

The privatization of the food industries is stagnating. A small group of enterprises is sold to mainly foreign investors. These enterprises include tobacco, sugar, beer, distilling and vegetable oil. The interest for other enterprises (meat, dairy, grain, canning) is low because of the collapse of the original export markets (CIS), the outdated technology, low quality of the products and the high level of indebtedness (OECD, 1993).

Because of the collapse of the export markets in the former Soviet-Union and Eastern Europe there is an overproduction of most products. The overproduction together with the monopolistic and unclear market situation causes very low prices. Next to the collapse of the export markets there is a growing competition on the domestic market with good quality imports from EC (vegetables, dairy). Also consumers preferences for Western products play an important role.

As a result most agricultural enterprises have negative results and eat up their reserves or are facing bankruptcy (Szakal, 1992). The low prices make it impossible to save money for investments.

## **2.4 Credits**

Special attention will have to be given to the market of credits. To transform the present state farms and cooperatives into viable agricultural enterprises a lot of investments have to be done. In most enterprises buildings, sheds, store houses and equipment are in badly need for renovation or replacement. Money is lacking for long term investments as well as working capital to buy inputs and pay salaries. At present interest rates are very high (30 to 35%) although slightly coming down but still too high for agriculture with a profitability of almost 10 to 15%. Some governmental credit programs are set up but these are mainly focussed on short term credits (credits for seeds, fertilizers) to provide working capital for the coming season.

An overall problem is the lack of an adequate banking system to meet the financial needs of farmers and cooperatives. The development of an extensive network of rural credit agencies is a condition for any development.

The large, mainly Budapest based, banks have low interest in providing credits to agricultural producers because of the low profitability of agriculture.

3 Key points for the near future.

The process of transformation is complicated and it is difficult to get a full picture of what is happening and what next to do. It is important to realize that everything can not be done in a fortnight. A too high speed of privatization and transformation without an adequate assessment of the future potentials may lead to wasteful breakup of farms or close down of enterprises which are viable in the long run.(OECD, 1993).

To respond to the critical factors it is necessary to make a distinction between the short and long term. For the long run the development of the infra-structure and the reorganization of the agricultural education and training system are important. These factors are complex, ask for enormous investments and take time to implement and work out.

Next to this, in the short run, priority must be given to the reduction of uncertainty, the reorganization of markets and the development of a credit system.

An important aspect of the reduction of uncertainty is give confidence to entrepreneurs by securing property rights and regulation of property transfers. A great deal of uncertainty is caused by ignorance. To reduce the overall situation of ignorance the adequate provision of information is essential: market information, statistical data system etc. Specific organizations to provide this information have to be established or existing organizations have to be adapted.

The reorganization of markets and the development of a banking and credit system ask for government action and support. A market regulation system to guarantee at least a minimum price to producers has to be worked out as is happening at present. The break down of monopolies has to continue so producers have opportunities to choose between different suppliers and processing/marketing firms. Sometimes the establishment of physical market places is necessary. Financial support should be provided for those enterprises who reorganize themselves on the basis of a viable business plan as well as for newly established enterprises. Soft loans can encourage Hungarians to invest in those enterprises like meat-, dairy and canning industries with little interest of foreign investors. Some special investment schemes do already exist.

Special attention should be given to the situation of these processing industries. Failure to reorganize this sector will cause the break down of the whole sector. An answer can be the stimulation of small, regional based, supply and processing industries on the basis of a single, reorganized cooperative or the set up of joint processing, marketing and supply firms of small cooperatives and the growing number of small scale private producers.

Apart from long term aspects it should be realized that the people involved need time to adjust themselves to the new situation. They have to develop new ideas and perspectives on their position as a member and share holder of a newly established cooperative or as an independent farmer. One of the reason only a few people decided to leave the cooperatives was the fact that such a radical decision had to be taken within a very short time. People have to get used to take responsibilities and to make their own choices in stead of following the orders given by superiors or the party.

Next to the aspect of time there is a cultural aspect involved. With the collectivization the farming traditions have been destroyed. The development of a private farming sector will need revitalization of these traditions. At present small private producers partly return to old cultivation methods are still known from the pre-collectivization period. It will take time to regain something like a farming culture as in Western Europe (Van Engelen, De Groot, 1993).

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