József Gráf

Financial reform in Hungary's agricultural economy

A Hungary's accession into the European Union on 1st May 2004 brought both long-term opportunities and enormous challenges to the country's agriculture.

With accession, we became part of the common agricultural policy of Europe which itself also went through a significant renewal in recent years. Subsidization shifted from the former production volume basis (which used to generate those well-known mountains of butter, beef and wheat) to a direction that is intended to propel into dominance efficient, market-oriented, environment friendly agricultural systems which provide better guarantees for food safety. This policy is not only supporting agriculture in the narrow sense. Instead, it provides for the long-term viability of the countryside. Agricultural producers in the new member states and thus in Hungary have been given a green light for taking their products to the single European market, profiting from relative price stability, direct payments and subsidies for rural development.

To a certain degree it is natural that a fast and radical change like accession to the EU is not only bringing benefits to the new entrants but temporary difficulties as well. Unfortunately, it was also the case for Hungary's agriculture. We spent years preparing for the adaptation of EU legislation and enabling its application in our country. We have reinforced our food safety, animal and plant health systems. We have established the institution that verifies eligibility for subsidies and makes support payments.

Still, these efforts to prepare our agriculture for EU accession ended up being controversial. Problems were caused in part by inherited weaknesses like gaps in technological development, low efficiency, lack of horizontal and vertical integration, underdeveloped logistical systems, unfavourable holding structure and belated political decisions, inappropriate training of farmers and the scarcity of national financing resources. What is more, even the European Union was late sometimes with taking a stance on certain matters or changed its strategy without prior warning.

It is a fact that all these mistakes caused tensions in the agricultural sector, especially in the year of our accession. After several delays, the local payment organisation, the Agricultural and Rural Development Agency could only verify and assess applications for subsidies and pay the due amounts by an extended deadline. This delay in the payment of direct production, market access and rural development support generated significant liquidity problems for producers. The lengthy buy-up of wheat offered for interventional buying and the inadequacy of storage capacities were additional sources of dissatisfaction in 2004. Thanks to extensive efforts by the Hungarian government and the contributing organisations, at least the immediate difficulties were eliminated and the foundations were laid for successful subsequent adaptation. These achievements from the years 2005 and 2006 were also proved by the relatively calm situation at the time.

As stated also in the report of the European Parliament's Committee on Agriculture and Rural Development: *practically, the agricultural integration of new member states into the single EU market is successfully completed.* Grain, sugar beet, beef and milk prices have been stabilized thanks to the regulatory mechanisms of the Common Agricultural Policy (CAP), and while expenditures increased after accession, revenues in the sector went up significantly due to larger subsidies and favourable yields. The foodstuffs market in Hungary has been characterized by lavish supply, an expanding selection of goods and a moderate price increase (6.5 per cent in 2004).

STRUCTURAL REFORMS NECESSITATED BY ACCESSION AND THEIR IMPACT

The application of the CAP in Hungary

In July, 2003 the mid-term review of the AGENDA 2000 programme (i.e. the reform's reform) led to yet another significant modification of the CAP. For there were legitimate fears that the CAP defined under the AGENDA 2000 would not be able to meet the challenges posed by ongoing globalization and liberalization and that it would be impossible to finance the programme due to the upcoming "eastward enlargement". The BSE crisis and a series of foodstuffs scandals also supplied arguments for the supporters of change.

The 2003 reform package known as the "Luxembourg resolution" consolidated several direct income subsidies into a *single (consolidated) payment scheme (SPS) that is mostly independent of production. This decoupling of subsidies from production volumes* means, first and foremost, that direct support is not linked to the quantity or nature of production. Instead, they are paid on a "historical entitlement" basis to eligible producers, using the production and subsidy volumes of a certain reference period as a basis of calculation. Access to the subsidy is subject to compliance with certain *environmental, animal welfare and food safety requirements* (Good Agricultural and Environmental Condition, Good Agricultural Practices).

Furthermore, the *common market organisation has been modified* in several sectors. Individual member states have substantial freedom (opportunity to make independent decisions) in the execution of specific reform measures. E.g. instead of full aid decoupling, a member state may decide to go for partial decoupling in the case of specific support payments and within certain limits.

For agricultural producers, the biggest change brought about by EU accession was the launch of direct support payments. New member states were given the opportunity to implement the *Single Area Payment Scheme, i.e. area-based flat rates fully decoupled from production* instead of the complicated SPS arrangement. Eight new member states, including Hungary, have chosen this method.

The dominant standpoint which evolved during accession talks was that regardless of the payment scheme chosen, the level of direct *EU support paid to new member states should only reach the amount paid to old member states after a long (9 year) transition period* (the initial level was 25 per cent). This approach created an uneven competition playground in the singe EU market for the farmers of new member states. In order to reduce this gap, new member states were forced to apply *supplementary national aid (top-up)* by which they could supplement EU support up to a 30 per cent limit. This top-up was paid as a production-based aid and put a significant burden on national budgets: HUF 90 billion in the case of Hungary. Even with this supplementary subsidy, however, producers in new member states could only get 55 per cent compared to the payments received by their counterparts in old member states in 2004. Until 2007, the level of support increased by 5 percentage points annually. From this year on, the increase will be 10 percentage points per year thus the 100 per cent level will be reached in 2013.

In conjunction with the comprehensive reform of subsidies, *common market organizations (CMOs) have been modified as well* and have reduced intervention (by lowering intervention prices and decreasing/eliminating quantity limits on interventional buying). This is what happened on the grain and milk products market (butter, low-fat milk). On the latter market, direct milk support payment was launched as a partial compensation for the reduction of the intervention price. Effective 2007, direct milk support had to be integrated into the single decoupled support scheme on a mandatory basis. *The tobacco and sugar CMOs* were reshaped in the second wave of the reform process (beginning in 2004 and 2006 respectively). The changes relied on similar methods as with the aforementioned products and aimed at increasing competitiveness (abandoning of unprofitable production) and fulfilling the international commitments of the EU (elimination of barriers to international trade) while encouraging the necessary structural reforms through transitional measures. The *fruit and vegetable market* reform seems promising for us as most of the Hungarian proposals gained approval. The annual support payments to this sector can ensure opportunities for future development. The new reform will encourage producers to act rationally and accommodate to market demand. The new measures which relate to the Commission's *grape and wine sector* reform are expected to enter into effect in the middle of 2008. New regulations will prohibit the use of beet sugar for Hungary's winemakers. Furthermore, the calculation method of national envelopes and regressive grubbing-up premiums also convey disadvantages.

The amount and structure of support payments

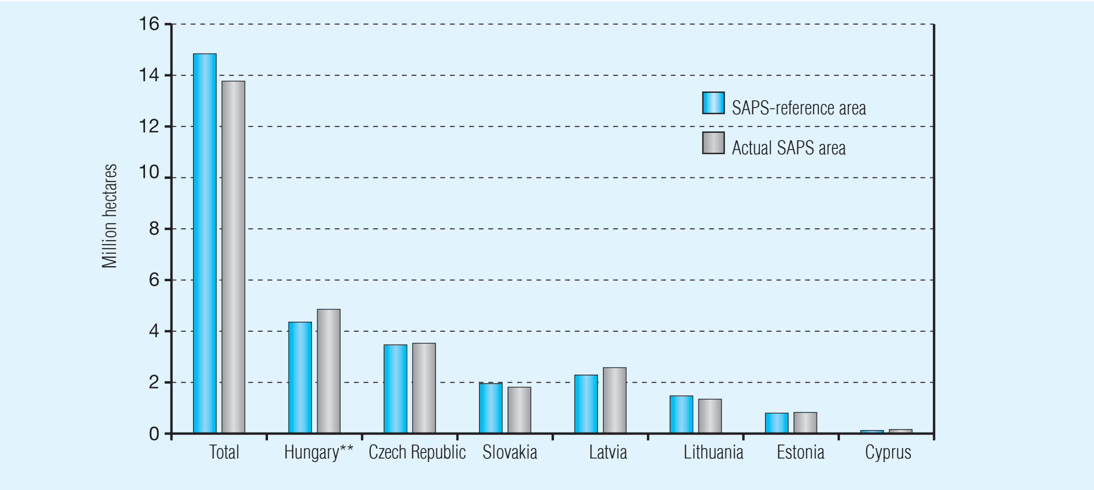
Hungary's *convergence programme* is targeted at the simultaneous improvement of the competitiveness of enterprises, the renewal of the economy's structure and the establishment of lasting general government balance. The best possible exploitation of agricultural support appropriations offered by the EU for Hungary serves each of these objectives. All this calls for a far-seeing approach, careful organising and strict control. It is fair to say that we have successfully avoided potential hazards in the case of the largest support item, the SAPS aid.

In new member states which employ the simplified payment scheme (SAPS), the maximum amount of flat-rate EU support per hectare is determined by the so-called reference area (defined in the applicable statutory provision as agricultural land kept in cultivated condition as of 30th June 2003). The payable amount is the quotient of the support budget and the reference area as declared in the applicable regulation. If the producers of a member state apply for simplified payments for an area smaller than the reference land, the amount of aid for the difference between the reference land and the actual SAPS area will remain in the Brussels budget. Contrary to some new member states (Poland, Slovakia and Lithuania), Hungary has not had this problem yet and has always been able to drawdown the full amount of direct EU support payments *(see Chart 1).*

The statement that *the Hungarian agricultural sector has been successful in utilising EU resources* is also true for rural development aid.

Chart 1

SAPS REFERENCE AREA AND ACTUAL SAPS AREA IN THE NEW MEMBER STATES THAT JOINED THE EU IN 2004* (2004 DATA)



* Slovenia and Malta did not choose the simplified payment scheme.

** Effective 1 January, 2007, the revised SAPS reference area in Hungary has been 4.829 million hectares. This figure, however, is still lower than the actual SAPS area.

Source: European Commission

The budgets for the five operational programmes financed from structural funds were utilised as shown in *Table 1* below.

Based on data from the Standard Monitoring Information System (SMIS), within all Hungarian operational programmes, it was the Agricultural and Rural Development Operational Programme (ARDOP) which utilised the highest proportion of the available budget. Up to May 2007, 73 per cent of funds available for the entire programme period have been paid. The average utilisation rate of the other programmes is 55 per cent (HRDOP: 44 per cent, EDOP: 58 per cent, EIOP 62 per cent, ROP: 57 per cent). If we look at the utilisation of structural funds, we see that 73 per cent of the European Agricultural Guidance and Guarantee Fund budget has been drawn. The utilisation of European Social Fund (ESF) and European Regional and Development Fund (ERDF) budgets remained substantially below that level (ERDF: 64 per cent, ESF: 50 per cent).

Besides ARDOP support, NRDP aid financed from the Guarantee section of the EAGGF is also employed for improving the quality of life in rural regions, modernising agricultural production and for environment-friendly agricultural development. Similarly to ARDOP, the drawdown rate of NRDP resources (73 per cent) exceeded that of other operational programmes that relate to the structural funds.

With Hungary's accession to the EU, *support budgets available for agricultural producers have expanded significantly: the amount of subsidies increased by 31 per cent on the previous year in 2004* and grew by another 43 per cent until 2006. Still, the level of per-hectare support in Hungary is hardly over 70 per cent of the EU average.

Simultaneously to that, new financial resources opened up while former payment titles remained in effect. Area-based support financed from the Brussels budget (SAPS) amounted to HUF 78.1 billion in 2004 and increased by 5 percentage points in each subse-

Table 1

THE BUDGETS AND FUND UTILISATION OF OPERATIONAL PROGRAMMES

(May 2004–2007)

Operational programmes*	Budget (HUF billion)	Amount paid (HUF billion)	Utilisation rate (per cent)
ARDOP	107.81	78.26	73
EDOP	145.88	84.64	58
HRDOP	170.11	75.66	44
EIOP	112.30	70.00	62
ROP	111.74	64.22	57

* ARDOP – Agricultural and Rural Development; EDOP – Economic Development; HRDOP – Human Resources Development; EIOP – Environmental and Infrastructural; ROP – Regional Operational Programmes

Source: NDP financial table and SMIS data

quent year. This amount was supplemented with a HUF 90 billion top-up from the national budget in the year of accession. Players in the agricultural sector could apply for further subsidies offered in the form of co-financed rural development programmes (80 per cent EU, 20 per cent national financing) which were launched in 2004. The National Rural Development Plan and the Agricultural and Rural Development Operational Programme offered farmers a total support of HUF 141.5 billion and HUF 84.3 billion respectively in the three-year period of 2004–2006. Furthermore, producers could also apply for support under the SAPARD pre-accession programme, plus subsidies paid exclusively by national governments also remained in place. In combination, these resources provided dynamically expanding budgets for the sector *(see Chart 2)*.

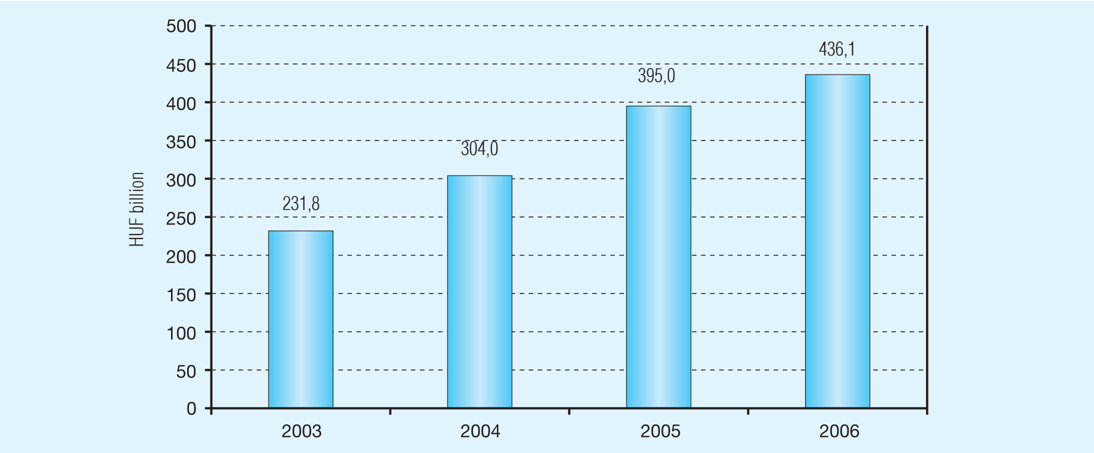
The adaptation of EU subsidy schemes brought about changes not only in the amount of subsidies but also in the composition of resources. Subsidies that used to be financed purely from national budgets have been funded from EU resources in part since 2004. As a result of the permanent increase of direct, area-based payments and the expansion of co-financed rural development programme budgets, a growing proportion of agricultural and rural development subsidies is coming from Brussels. *In 2006, nearly 60 per cent of total resources were funded from the EU budget.*

Hungary's agricultural support system was aligned to EU schemes to a significant extent before accession already. In general, however, support typically went to development and investment projects. Within that, animal husbandry and plantation support was dominant. These subsidies were not simply an income premium for producers but also served certain production policy purposes. In current EU practice, this latter role rests mainly with the market and subsidies are required to cause as little distortion of market mechanisms as possible.

Hungary's accession to the EU was accompanied by a change in the role of *rural development* subsidies, i.e. aid aimed at assisting the sustainable development and competitiveness of rural areas along with environmental protection. Rural development was already an eligible objective in Hungary's agricultural support scheme before EU accession, although the weight of the related titles within total the support budget was insignificant. Besides income policy and market measures, i.e. the first pillar, rural development became the second pillar of the CAP in 2000 and has received a larger portion of the EU's agricultural budget since then. In 2006, nearly 30 per cent of subsidies to Hungary's agriculture were paid to farmers

Chart 2

BUDGET APPROPRIATIONS FOR AGRICULTURAL AND RURAL DEVELOPMENT



Source: Reports on the Agricultural Economy, 2003–2006 (amended appropriations)

through rural development programmes. In line with the intentions of the EU, second pillar subsidies will play an increasingly important role in the future, as they not only serve farmers but the entire rural community. The ratio of such subsidies in Hungary is already significantly above the EU average.

The adaptation of the CAP and the related EU support schemes *affected individual sectors differently.* The CAP put crop producing sectors, especially grain, protein, oil crops and fibre plants in a favourable profitability situation. Among animal husbandry sectors, cattle and sheep breeding is also entitled to receive subsidies while pig and poultry farmers are not eligible for direct EU payments. While these two disadvantaged sectors are only allowed to receive limited subsidies from the national budget, they did get support for improving animal welfare, developing waste disposal facilities and for the financing of veterinary expenses.

The nature of support payments

EU support schemes differ from the earlier Hungarian arrangements also in the timing of payments. Before 2004, support payments from the national budget were mainly paid in the first half of the calendar year and thus the funds (at least in part) were already available for farmers when the related production expenditures arose. In the EU scheme, however, farmers can submit applications for direct support (SAPS, top-up) in the first half of the year but payments will only arrive in the following year. Payment usually starts in the last months of the calendar year and lasts until 30th June in the following year. This was a problem especially in the transition year of 2004, when payment was also delayed by other reasons. The Ministry of Agriculture and Rural Development (MARD) made an effort to resolve the liquidity problems of farmers by advance financing the national top up. Producers had access to more than half of the total budget amount before accession already, in the form of pre-financing (factoring). Furthermore, under the framework of the “Europe Plan” Agricultural Credit Programme, they could apply for medium and long-term loans on favourable interest rates. The purpose of this HUF 200 billion loan programme was to help replace existing short-term loans, offering a 1 or 2-year grace period before the start of repayment. While *only two thirds of support appropriations were paid in 2004, the ratio improved considerably in subsequent years.* In 2006, nearly the entire budget was used up.

Albeit 2005 already qualified as a full year in the EU for Hungary, it was still a transitional year regarding subsidy payments as we had to resolve several issues that had remained from the prior year and also eliminate a significant payment backlog. In 2006, however, payments were made as scheduled. The fact that farmers applied for direct support for an area that was 800,000 hectares larger than in 2004 was a sign that farmers successfully adapted to the new circumstances. *(See Table 2)*

The establishment of application procedures for co-financed rural development programmes was also part of the financial reform. Due to the late programme launch, the payment of actions announced in 2004 could only begin in 2005, after the evaluation of applications. Although farm machinery subsidies had been offered through an application scheme before EU accession already, the understanding of opportunities and the preparation of application materials to meet stricter requirements caused difficulties for producers in the beginning. What proved to be especially difficult was the preparation of business cases as part of the application materials.

What made the use of development aid difficult for farmers is the post financing arrangement in the EU schemes. For in addition to the required own resources, farmers also had to advance the amount of support temporarily, which they could only get back upon financial settlement after project completion.

The backlog accumulated in the transition year was successfully eliminated in the rural development programmes as well. Agricultural producers became familiar with administrational EU procedures. Their liquidity problems were alleviated and more and more farmers are able to generate the required own resources for projects as their income situation is improving. By the end of 2006, the entire budget of the Agricultural and Rural Development Operational Programme was booked and agri-environmental action payments which made up the majority of the National Development Plan also caught up with the initial schedule.

As resources in the sector expanded, farmers faced a *stricter, two-phase control system* in the evaluation of applications. The first, administrational phase scrutinises eligibility by way of cross checks, while the second, physical check is

Table 2

AGRICULTURAL AND RURAL DEVELOPMENT SUPPORT PAID TO PRODUCERS SINCE HUNGARY'S ACCESSION TO THE EU

(HUF billion)

Description	2004	2005	2006	Until 30th June, 2007
Total agricultural and rural development support (appropriation)	304.0	395.0	436.1	
Total agricultural and rural development support (plan)	204.9	362.6	429.6	209.7
Of which:				
SAPS	10.0	148.0	93.5	59.5
National aid	178.2	109.3	147.9	105.1
Market subsidy	-	16.9	19.1	5.6
ARDOP	-	18.4	51.8	14.7
NRDP	1.8	49.7	65.9	12.4
SAPARD	14.9	29.7	9.2	1.4

Source: Reports on the Agricultural Economy 2005, 2006 intended to verify the submitted data. The latter covers 5 per cent of the applications and involves a check of utilisation and the verification of compliance with other conditions (e.g. Good Agricultural and Environmental Condition) by way of on-site inspections and remote sensing. Based on experience to date it is fair to say that Hungary has performed outstandingly in fulfilling aid utilisation rules and has not had to pay penalties for non-compliances.

The impact of accession on incomes and competitiveness

For the year 2004 (regardless of the time shift in actual payments), Hungarian agricultural producers received aid equalling 25 per cent of regular EU support *(SAPS) which was complemented with a nearly* 30 per cent national top up. Since the very beginning of our EU membership, Hungarian farmers could enjoy 100 per cent of the benefits of market subsidies (market, intervention, market stabilisation, export subvention) which represent a much smaller part within agricultural assistance forms. True, our farmers also have been fully exposed to all community burdens which relate to the single market and EU budget contribution. The disadvantages associated with smaller support were only moderately offset by the advantages which we have in certain cost factors (wages, land lease fees). This way, our producers started out with a disadvantage which occasionally led to a temporary loss of market share on the domestic markets as well.

For the new member states, it was clear right from the beginning that Hungarian agricultural producers would *receive more subsidies than in prior years* due to the applicable rules – a support scheme which bypasses the rules of a single market and which seems unfair in international comparison. While higher support meant a higher income for farmers, it has to be noted that these subsidy amounts did not go in full to producers. A part of them was "leaking" to other market players. The reason is that higher producer incomes generate demand for agricultural land and other resources of agricultural production which in turn triggers an increase in land lease fees. Consequently, a part of the subsidies ultimately ends up at entities that precede agriculture in the production process (i.e. material and machinery manufacturers, landowners). Then if increasing profitability leads to increased production volumes, larger supply may result in lower prices. Thus agricultural subsidies via this channel ultimately also benefit processing and trading enterprises and consumers of agricultural products.

The incomes of agricultural entities grew substantially since accession, as their profit before taxation almost tripled in the 2004–2006 period. Concerning the structure of revenues, proportions have evened out, with individual farms and partnerships making an equal contribution to total profits before taxation. *(See Chart 3)*

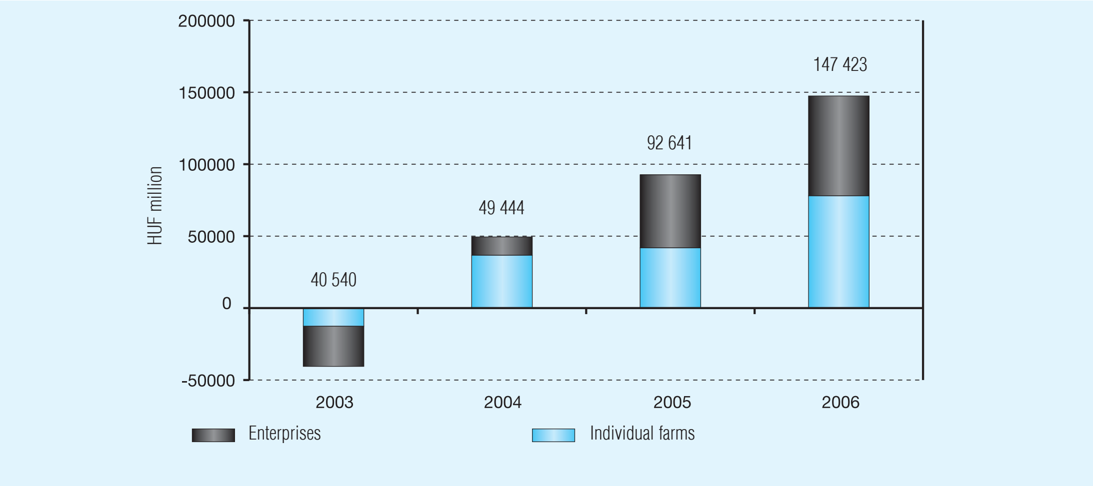
In 2006, per-hectare profit before taxation amounted to HUF 44,600 and the overall return on capital was 7.7 per cent. Perhaps the latter figure highlights that the profitability of Hungary's agriculture is still not satisfactory despite the impressive development in the sector. It is also evidenced by an international benchmarking of what is probably the most comparable indicator, gross operating incomes (which includes employee wages and the related charges). The per-hectare figure in the EU 15 countries is the double of that in Hungary.

Hungary has an interest in maintaining CAP subsidies for it helps us become net beneficiaries of EU membership. Naturally, we have to insist on equal standards for EU 15 countries and the new members regarding assistance to agricultural producers.

As Hungary is traditionally a net exporter of agricultural products, *agricultural* foreign trade is of special importance for us.

Chart 3

PROFIT/LOSS BEFORE TAXATION



Source: AKI pilot information system

Hungary's agricultural export was fluctuating in the years before accession and showed little growth only. After accession, our exports developed steadily. The average annual growth rate of our exports to the EU is 8 per cent, while the same figure for exports into third countries is 4 per cent.

At the same time, *the growth of imports also accelerated after accession,* with the annual growth rate of import volumes increasing to 21 per cent from the pre-accession level of 11 per cent. What we found surprising was that the growth rate of imports from other new EU member countries was even higher: 41 per cent as opposed to 19 per cent before accession.

Still, the *foreign trade balance of the sector has remained positive,* usually around 1 billion Euro. In 2006, the trends of the previous two years reversed: *the growth rate of imports dropped while that of exports went up.* This trend continued in 2007 as well. *(See Chart 4)*

In the future, we have to be even firmer in facing the reasons of weakening export performance which relate to competitiveness, quality and marketing. Furthermore, we have to prevent the growing popularity of low quality but cheap products by market protection measures and by ensuring fair competition.

THE ESTABLISHMENT OF A CUSTOMER FRIENDLY INSTITUTIONAL BACKGROUND

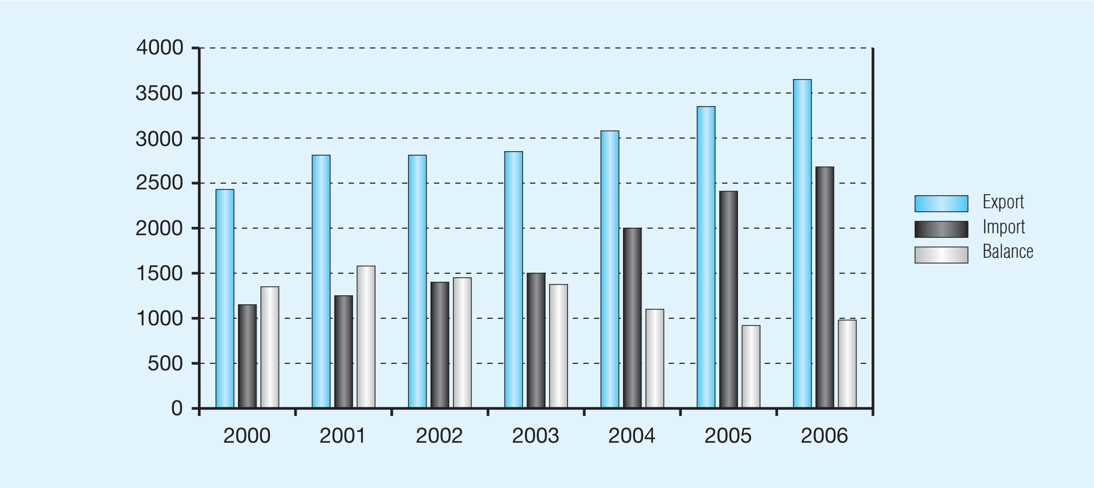
For the agricultural sector, accession to the EU inevitably called for the reshaping of our exiting institutions. The main reason of reorganisation, however, was not only to establish compliance with new EU requirements. While restructuring, we also had to keep in mind that the new institutions would be responsible for making support payments to farmers. Therefore, using the existing basis, we established a customer-friendly institutional background which involves a higher number of contact points for farmers but works with a smaller staff and on a lower budget than before. With this change, the emphasis shifted from the former control, authority and monitoring functions to technical counselling, assistance and information roles.

When setting up the new structure, we had to keep in mind that competitiveness is highly dependant upon the performance and quality

Chart 4

HUNGARY'S AGRICULTURAL EXPORTS, IMPORTS AND FOREIGN TRADE BALANCE

(Euro million)



Source: AKI database and own calculations based on preliminary data from the Central Statistics Office (KSH)

of work of the related institutional network. As the responsibilities related to agriculture, food production and trading, research and development for the sector, (secondary) technical education, cartography, land matters, plant variety registration and so forth are traditionally handled by an extensive network of offices, the simultaneous implementation of a "cheaper government" and an efficient and customer friendly institution network has been a key issue indeed. The cutback of public roles, however, is often in conflict with the demand for multiple institutional services which frequently call for permanent on-site presence.

Concerning the individual elements of the institutional background, the establishment of the Integrated Administration and Control System (IACS), the agency for handling EU support applications and the related payments was already a major challenge for the sector's management. Luckily, the lengthy process of establishing and obtaining registration for the *Agricultural and Rural Development Office* (ARDO) is already a historical event and we have learnt the lessons. After the initial deficiencies, the operation of the institution has become stable by now and it appropriately fulfils its role. Yet it will face important new challenges with the implementation of the SPS support scheme and the establishment of the IT background.

The Central Agricultural Office (MgSzH/CAO), created with the consolidation of eight former organisations, has been in place since 1st January 2007. As a result, a two-tier model was implemented in the sector's directional and regulatory functions. Matters closely related to public administration like legislation, international relations and direct governmental activities will rest with the MARD. Technical direction over the sector will be performed by the new organisation for agricultural direction. At county level, the CAO integrates the functions of the Agricultural Office (FM), the animal and plant health service along with forestry and genetic resources related activities. Its key feature is *one-stop (electronic) administration,* where farmers can handle all matters important to them at a single place. Besides, 133 small regional branch offices will operate under the supervision of the CAO, offering farmers an opportunity to handle issues which can be settled locally at the district veterinary's office or at village management network sites.

In 2007, the new institution performed centralised control authority and technical direction functions on a HUF 3 billion smaller budget than the office's member institutions did on their own in 2006. Thus the budget of the CAO was around HUF 29 billion last year. The improved operational efficiency of the new institution does not only stem from integration. It is also a result of the further development of task allocation between the Agricultural and Rural Development Office and the various chambers (interest representation organisations).

The aforementioned small regional offices are part of the National Rural Development Network and will constitute a renewed and reinforced structure for the related efforts. In part, the new network is implemented on the basis of already existing infrastructure using EU funds. The network is established as a joint effort of the government, public administration institutions and representatives of social organisations and local communities involved in rural development programmes, e.g. the LEADER task forces. The creation of the network lays the basis of coordination and harmonisation between existing and future networks at the small region level.

Under the direction of the minister of agriculture and rural development, a *single food safety organisation* was set up in the middle of 2007, making Hungary the first country to have an organisation like that. The organisational structure, operational and legal redress procedures of the new unit had to be elaborated by 31 December 2007. Real and meaningful operations can only begin after the significant development of the organisation's IT and lab systems. With this new unit in place, the minister of agriculture and rural development will take over the food safety-related responsibilities of the minister of health, along with direction over the Hungarian Food Safety Office.

At the beginning of 2005 (the year after accession), technical direction of agriculture in the broader sense (farming, fishery, forestry, environment management) was performed by a staff of 17,084. Following a radical and extremely quick reorganisation, that number was reduced to 12,828 by the end of 2007. By the same date, the number of central administration staff at the MARD was decreased to 384 from the 2005 level of 548.

This in-depth restructuring was executed relatively smoothly and resulted in a truly customer friendly system. The coming years will need to be devoted to consolidation and development initiatives which will improve the conditions and quality of work (IT system, human resources). The safeguarding of the environment, improvement of food safety, compliance with professional standards will all call for real authority presence on the fields, in the forests, on the markets, at food processing plants and at food traders.

NEW CHALLENGES FOR THE AGRICULTURAL INDUSTRY

After handling the chores of forced, quick adaptation and institutional restructuring, the players of the agricultural economy are about to face new challenges. Although the current WTO round has not produced final decisions yet, the direction of endeavours is rather clear. The further liberalisation of the world trade of agricultural products seems to be unavoidable along with the cut of subsidies that directly impact competition and the differentiated reduction of customs duties. The Common Agricultural Policy of the European Union cannot be considered stable either as its alignment to the changing conditions of the world economy will continue to be a challenge in the coming years.

Just when Hungarian farmers have learnt the current rules of support applications and payments (SAPS + top-up), they are about to face yet another change: For the time of "transitional" membership operation is over. Effective 2009, Hungary intends to employ *the single payment scheme (SPS)* which is already in operation in the "old" EU countries. In this scheme, an even larger part of support is decoupled from production and reaches eligible applicants in the form payment based on the size of land or on historic performance data. In the future, only an insignificant proportion (3-4 per cent) of EU support will be linked to mandatory or optionally selected sectors. The new support scheme will require a lot of brainwork on the part of producers and the ministry alike, posing yet another challenge! The registration and consolidation of historic performance data (baseline values!) seem like an especially complex task, along with the evaluation of non-standard cases, the separation of entitlements and land utilisation rights, the regulation of the purchase and selling of such rights, and, last but not least, the domestic application of *cross compliance* rules.

Eligibility and the decoupling of entitlement trading from the purchase and selling of land will call for careful consideration on the part of farmers. While entitlement to support rests with land users, it can be sold or retained independently of the land itself. At the same time, it can only be capitalised together with the land worth. This new rule impacts the relation between land owners and lessees but it also requires careful national regulations in order to foster the formation of a desirable holding structure.

As far as administrational chores are concerned, the implementation and operation of the cross compliance scheme (a mandatory requirement from 2009 on) will be an even heavier burden. It will be a veritable reform! Cross compliance rules will require member states to comply with 19 community directives and regulations along with the requirements of Good Agricultural and Environmental Condition. The fulfilment of environmental, animal welfare, animal and plant health rules (on-site checks!) will mean that failure by farmers to respect the individual provisions can be sanctioned on its own and will be penalized in the future by deductions from or cancellation of direct payments! Preparation for these requirements will call for capital expenditures of billions of HUF on the part of farmers, especially stock breeders. Not to mention the burdens on the ARDO, the organisation to perform and coordinate monitoring.

The EU's Common Agricultural Policy consists of a series of reforms. While we were negotiating accession, the CAP was already under reform. Now when we are getting prepared for SPS implementation, a new revision of the CAP is on the way, this time referred to as a *health check.* While this round is not supposed to have a measurable impact on the conditions of operation until 2013, its consequences can be rather significant in the next financial cycle beyond 2013.

Although the next wave of changes has not taken shape yet, their direction is obvious. Overall objectives include the reduction (or at least freezing) *of the amount of agricultural aid; the full decoupling of support payment from production;* the internal *reallocation* of support *in favour of rural development* (modulation), the increase of the role of national financing (potentially co-financing!?) and the changing of the common market organisation of certain product ranges.

With a view to the characteristics and potential competitiveness of the Hungarian agricultural economy, we support all the policies which are intended to strengthen market orientation and eliminate exceptions and temporary rules that distort competition. In rural development, we seek more room for national decisions so that we can devote existing resources to alleviating our real, existing problems like water and landscape management, ecological carrying capacity and structural tensions.

The orientating role of Hungary's agricultural policy, the level of adaptation by the players of our agricultural economy are strongly affected by seemingly lasting world market trends that may also offer a solution to our existing structural issues. For every market forecast suggests that a turn has begun and the new trend involves an increasing demand for agricultural materials and foodstuffs.

It is a fact that Hungary's agri-ecological potential is underutilised, both in comparison to our historical performance and to old EU members. There are no market reasons for this situation. Our backlog mostly results from historical reasons, changes of markets and political systems, deficiencies in adaptation, organisation and cooperation and, last but not least, from technological disadvantages. These are changeable factors and we want to change them! Therefore, while respecting all EU requirements, *our decisive objective is to increase the output of Hungary's agricultural economy.* Needless to say, we mean efficient, competitive and sustainable development which also fixes the unhealthy ratios between specific sectors. In the long run, half of the output should come from animal husbandry and faster development could be enabled in the horticultural sector, too. Hungary has excellent conditions for grain and oil crop production which not only can help restore the weight of animal husbandry but also open up new opportunities for the better use of renewable energy resources and for bio-ethanol and bio-fuel production!

The chances of the agricultural economy should not be deemed based on the achievements (record harvest) or failures (frost, drought) of single years. Long-term perspectives are favourable: we are preparing for increasing demand and stabilising prices both on the foodstuffs and energy markets. It is worth investing in agricultural development, because the fruits of these investments will not only be enjoyed by farmers and traders but by consumers as well!