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CASE STUDY ON PRICING POLICY ON LIVESTOCK, MEAT AND MEAT PRODUCTS IN HUNGARY

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Summary

In the last couple of years Hungarian economic policy has been concerned with reinforcing the transition to a market economy begun in 1989 as well as dealing with some of the consequences of transition. Despite the fact that Hungary was closer to a market economy than other centrally planned economies it still suffered the pains of transition, including: a sharp fall in output, high inflation and severe financial difficulties.

Following a difficult period, macroeconomic indicators in 1993 were beginning to show signs of a turnaround. The negative rate of economic growth of -12 percent in 1991 fell to -4.5 percent in 1992 and a growth rate around zero is expected for 1993. The rate of inflation, which peaked in 1991, declined to 23 percent in 1992 and is expected to remain the same level for 1993. The unemployment rate was around 13 percent in 1993.

The agriculture sector and food industry are important for the Hungarian economy. In general, agriculture and food accounts for approximately 20 percent of GDP, 19 percent of total employment and 25 percent of export. For example, in 1992, the agriculture sector accounted for 17 percent of GDP and employed 13 percent of the active population. The agricultural output increased in nominal terms in 1990 and 1991 but fell in 1992 and 1993 largely due to drought conditions. Input costs have been rising much more sharply that output prices. Because of this fact agriculture and food industries have been making losses in aggregate terms since 1991. This is reflected in the large number of bankruptcies occuring. The loss of the COMECOM markets was a major factor contributing to these difficulties. The financial situation of the agriculture and food industry is a serious constraint on the process of restructuring. The number of bankruptcies has increased sharply as dept has accumulated and a shortage of credit led to cash flow difficulties.

The livestock sector also declined in 1992 and 1993. Due to the rise in feed grain prices resulting from the 1992 and 1993 drought along with the continuing decline in both domestic and export market demand for livestock products over recent years, farmers have been decreasing the size of herds. Compared to 1991 pig numbers declined by 10.5 percent to 5.4 million head and pigs supplied for slaughter declined by 29 percent. Cattle stocks declined 18 percent to a total of 1.2 million head. Both production and consumption of milk declined, and the poultry industry contracted further.

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Structure of the livestock industry

The livestock population is dominated by pig and poultry production followed by cattle and sheep. Limited number of horses and goats are raised in Hungary. In relation to other European countries, the density of the cattle population per hectare is relatively low while pig and ship densities are medium and the poultry density is high. The value of animal products per hectare had until the recent years been close to the levels registered in Italy, France, Finland and the United Kingdom.

The industry is supported by some 4 million hectare of arable land and grassland production which provides feed grain, green fodder, hay and other crops required as inputs.

Cooperatives made a significant contribution to commercial livestock production including pig, dairy and poultry. They dominate beef and broiler production. State owned farms are important in both the breeding and fattening of pigs, in specialized dairy production and having nucleus herds of Hereford, Charolais and Limusine beef breeds. State farm participation in the poultry sector is small. Private producers, mainly small and household, account for the largest share of pig production, dominate sheep breeding and lamb production and also product most of the chickens, ducks and rabbits for the processing industry. During the recent crisis, the decline in cooperative outputs has been the most rapid of the three sectors.

Pig production

While the national pig herd has declined in the past few years it still dominates the livestock sector, in part a reflection of the historical consumer preference for prigmeat. Production of pigs account for 20 percent of agricultural output.

An estimated 780 000 mainly small scale and part time farmers, together with 750 large scale farms produced pigs in 1992. The small scale farmers account for 47 percent of output followed by cooperatives and states farms. In terms of concentration of production state farms had an average nearly 1000 sows and over 14 000 pigs, cooperatives averaged 400 sows and 40 700 pigs while the private farms scattered throughout the country averaged only 1.5 sow and 5.6 pigs. The cooperatives began to decline in relative importance after the transition of ownership commenced. During the latest period in reaction to lewer prices and smaller market demand an estimated 250 000 household either stopped producing or reduced the number held mainly to meet family consumption needs. State farms have tended to lower production less rapidly than the other sectors which reflects both the quality of their production facilities which were well maintained and the higher quality pigs produced.

Cattle production

While large scale production was being developed, there was a replacement of other dairy breeds with Friesians and also the gradual replacement of Simental and European Friesians with the American Holstein Friesian. As a consequence, dairty cattle dominate the Hungarian cattle herd. Because of this focus on milk production the quality and output of beef has declined.

There has been a gradual shift in the structure of the industry. Cooperative production has declined over the past five years from 62 percent to 53 percent while private and small scale producers increased their position from 17 percent to 23 percent. The variation in size of herds follows a similar pattern to pigs. State farms herds averaged over 956 cows per farm, cooperatives average head per farms and the small scale farmers averaged 2.4 cows per farm.

The 70 percent of the cattle meat produced in Hungary come from the dairy herd and only 30 percent from the beef (and dual purpose) herds.

Poultry production

The fact that the Hungarian poultry sector has a share of about 8 percent of the total domestic gross production of agriculture and food industry shows the economic importance of the industry.

In 1980s, the poultry sector reached peak production and exports in 1988 amounted to 225 000 tonnes of meat and products. Hungary became the most important poultry supplier to the EC market.

Although small private (mainly part time) producers dominate production, this has been highly dependent on large scale operations with the producers receiving most of their inputs from the state and cooperative farms. The most important poultry hybrid lines and intensive feeding technologies were introduced by the state farms under the intensification programme and formed the basis of broiler and egg production systems.

Sheep and lamb production

Sheep are the traditional part of the Hungarian livestock industry. The ownership structure of the sector has gone through a major transition since 1989, when private farms increased their share buying out cooperative and state farms flocks. By 1992, almost 60 percent of ewes and lambs were owned by the private sector and further acceleration of this trend occurred in 1993.

Most of rearing, replacement flocks are kept indoor for overly long periods of the year. Located in remote areas, flocks ere attended by shepherds, and labour efficiency remains relatively low, with only 150 sheep looked after per person.

The overall performance of the sheep industry is not too high: the average output is about 20 kg live weight, 3 kg wool and 30 litres milk per ewe per year. The most common variety is the Merino, 95 percent of breeding females are from Merino breed.

Meat processing industry

The meat processing industry in Hungary is in a transitional phase and changing rapidly. During the past 30 years the state owned processing companies dominated the industry. Processing of livestocks started at the end of the 1970s by agricultural cooperatives and states farms, and in the 1980s this activity was strengthened when consumer cooperatives also began slaughtering and processing activities.

State meat processing companies

The 23 state meat processing companies were organized in each county under direct supervision of the Trust for Livestock Trade and Meat Industry. The trust decided on a weekly basis the number of slaughterings as well as the quantity of processed meat to be produced. The main plant of each company was usually developed with the aim to slaughter cattle and pigs, and process all the main types of processed meat products demanded by the domestic market.

The level of hygiene and equipment of the companies differ although most were improved in the past years with participation of the World Bank. The plants approved for EC and/or US export represent the most valuable part of the meat processing industry. Their slaughtering and processing capicities totalled 3.85 million pigs/year (9.4 million in Hungary), 251 thousands cattle/year (932 thousands in Hungary) and these accounted for a large proportion of the annual commercial slaughter.

Average utilization of state plant pig slaughter capacity has constantly decreased slaughtering declining from 75 percent of the capacity in 1991 to about 54 percent in 1992. Utilization of the cattle slaughter capacities which has always been low, further declined and now it is about 30 percent.

Medium scale plants

There has been a dramatic growth in private small scale plants which numbered about 300 and 400 in the early 1980s but now are estimated near 800. These plants provide about 40 percent of the total pig slaughtering capacity of Hungary. The cooperative companies were regarded as private in the past economic system. Activities of the cooperatives were based primarily on the slaughter of animals produced themselves. These companies offered direct markets for the pigs produced locally and satisfied local market demands. However in the earlier years most pigs continued to be sold to the mostly export oriented state companies which exported about 50 percent of their production.

Levels of hygiene in small and medium size plants do not meet the standards for export to the EC but a few have been permitted to export frozen pig and beef to the former Soviet union and other Eastern-European countries.

After liberalization of the market keen competition developed between state plants of large capacities and medium size or even small size private plants. The competition exists on the slaughter animal market and particularly on the consumer market.

New small scale plants

During the past few years private persons have invested in construction of small slaughter plants and meat processing plants which are now estimated at 100-150. Not all of the investors have strong financial positions. Many of the plant do not meet the Hungarian Regulation of Food Hygiene which represents a need for further improvement. These plants have markets for their own products at village and small town level. It is questionable how long these plants can remain competitive against big industrial competitors particularly when EC regulations must be applied.

Privatization

The objectives of meat industry privatisation, in common with national food industrial privatisation objectives, include the reform of ownership, the creating of viable industry and strengthening the competitive position on world markets. The aim is also to break up formal and informal cartels and monopolies and prevent the formation of new monopolistic structures. There is no limit on the share of foreign ownership. In considering bids for privatisation, apart from the monetary value of the bid, other factors are considered. These include, the potential for the development of new or expanded international markets, the size of the investment and employment levels planned, compliance with environmental standards and the capacity to improve the quality of products and to introduce modern efficient technologies.

Unfortunately regarding to the meat industry only little progress has been made. In 1993 of the 23 state owned meat companies, 14 were transformed. Of these 14, three were privatised. Two other companies are being liquidated. The degree of vertical integration of these companies has created problems for their privatisation. Within the same company, slaughtering, cutting, deboning and processing take place. This structure does not allow for economies of scale to develop and contests with western practice which tends to greater specialisation. Debts are also a problem for this industry and state aid is being directed to help in the transformation of those plants producing mostly for EC and US markets. Of those companies which have gone bankrupt and are facing liquidation the State Property Agency plans to buy up the usable capacities and run them as viable units.

Price policy

The legal framework for the termination of administrative control over consumer and producer prices was provided by the Price Law enacted in November 1990. It became effective from 1st of January 1991.

The law affirmed that the most important price setting factors are the market and economic competition. Prices and commercial conditions are to be agreed by the transacting parties but the Act retains powers under which the government can determine sectors in which prices can be controlled by the state and mentions the method for the setting of such prices. Meat and meat products are not subject of price control. For some farm products minimum purchase prices were set. The government also retained power to order companies which have a dominant market position to give prior notification of intended price increases in order to prohibit anti-competitive business practices. By 1st of January 1991 the proportion of all market determined prices was 90 percent and by 1st of January 1992 all consumer prices were set free.

Agricultural producer prices were also liberalized by the Price Law in the sense that they are now intended to be determined by market forces.

Minimum prices

Under the Price Law set statutory minimum producer purchase prices for corn, wheat used for both bread and feed, çow's milk, and slaughter cattle and pigs. The minimum price was set at a level intended to cover the cost of the most efficient producers. This minimum price was not a guaranteed price in the sense that it was not supported by government mechanisms or government funds which could be used to maintain the price. Producers were by law not allowed to charge less than the minimum price and processors were not allowed to offer less. The minimum price was meant to create a safety net for the producers. But, in a situation of excess supply processors found ways to refuse to pay the minimum price and the producers were obliged to accept a lower price. For example, the processor could claim that the product was below of standard quality and was therefore not subject to the set minimum price. No intervention system existed to take supplies off the market. The system was therefore ineffective as a price support mechanism. In effect, the minimum price was a transitional measures on the way to some form of price support under The Agricultural Market Regulation Act which came into force on 1st of March 1993.

The Agricultural Market Regulation Act

The purpose of the Act is to alleviate extreme market fluctuations and to coordinate the interests of economic agents in the market. The policy model enshrined in the Act is broadly patterned on the EC Common Agricultural Policy and its common organisation on the market. This is in a line with Hungary's association status in the EC and is intended as a transition measure to create a basic structure in order to ease Hungary's entry into the EC.

Price regulation

As far as price regulation is concerned, a guide price may be set according to estimates of expected price developments. A threshold price is defined above the guide price for exported commodities and a sluice price is defined below the guide price. Variable levies may be applied to prices outside these limits. If prices deviate from the guide prices to an extent that causes a market disruption which endangers the supply demand balance, quantitative regulation, intervention purchases and storage may be applied. Intervention may take place on the basis of contracts with the Product Councils or on an ad hoc basis if the market is threatened by shortage or surplus.

Three types of markets are defined; directly regulated, indirectly regulated and influenced market. Wheat, fodder corn and cow's milk are to be directly regulated markets from the beginning, and pigmeat and beef became directly regulated market from 1st of January 1994.

Directly regulated markets will be those to which separate market regimes will apply and will be those in which guaranteed prices and quotas to which the guaranteed prices will be limited, will be applied. Guaranteed prices are minimum prices that are inextricably linked to quotas. Intervention purchase is authorised to maintain the guaranteed price and the quantity purchased is limited to the quota amount. This implies that from 1st of January 1994 pigmeat and beef will be subjected to guaranteed prices for quantities up to certain quota levels. Quality conditions also apply to the purchased products.

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