

HUNGARIAN CONSEQUENCES OF THE CAP DIRECT PAYMENT SYSTEMS

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ABSTRACT

As regards the experiences of the six-year-period from the accession of Hungary to the European Union in 2004, quite a few relevant and important conclusions can be drafted in connection with the implementation of the Common Agricultural Policy (CAP) in general and the CAP payment systems, in particular. In the frames of this examination, the situation of the agricultural sector should be analyzed in wider context, because the processes have been influenced by many important, natural and agro-political factors. The analysis of the first-pillar subsidy system functioning as the key element of the current CAP flows is also very important. The special features of operation, the efficiency and success analyses can significantly contribute to the better understanding of the current tendencies and enable us to thoroughly prepare for the changes of CAP from 2013.

The impact of membership can be more precisely evaluated after these few years from the integration into the European Union. The market-, regulation- and subsidy-related changes after the accession have had different impact on each sector and considerably affected the situation of producers. Many of the advantages that were expected from the implementation of the Common Agricultural Policy have not fulfilled the hopes. In case of CAP the predictability and programmability were basic features, but the extensive internal changes during the recent years (including the reform in 2003, the health supervision of CAP in 2008, restructuring of some market regulation measures, e.g. intervention) have had the opposite impact.

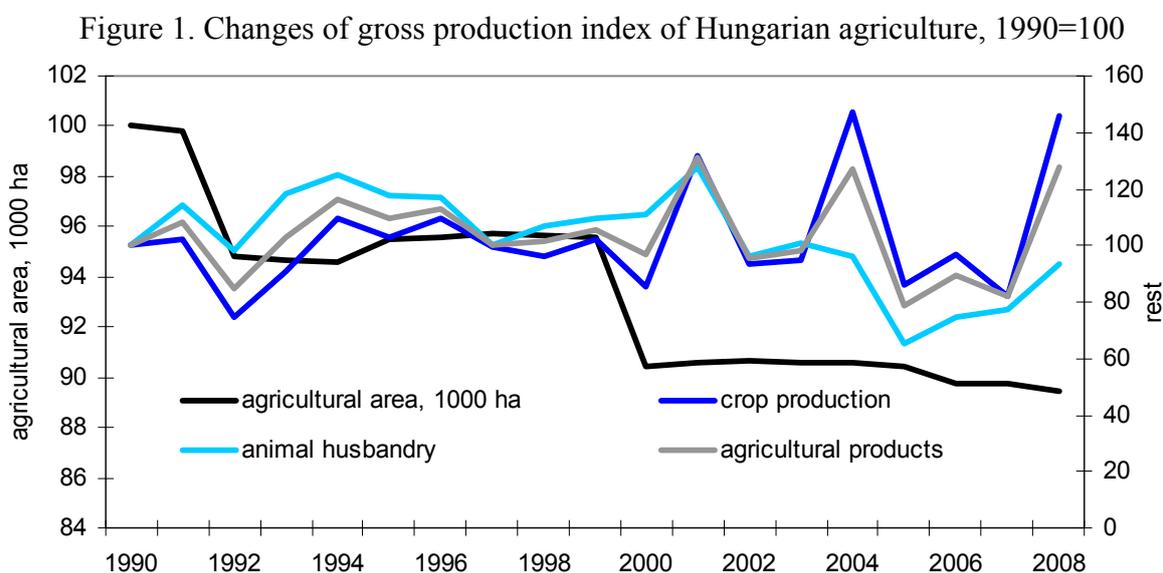
KEY WORDS

Common Agricultural Policy. Direct Payments. Market Income. Net Fixed Asset Accumulation.

INTRODUCTION - GENERAL EVALUATION OF HUNGARIAN AGRICULTURE IN THE PERIOD FOLLOWING THE ACCESSION

The role of agriculture within the national economy has further decreased – to some aspects rather quickly - since the accession to the European Union. The decline was greater in its share in employment and the GDP and moderate in investments and gross value added.

As regards the production value of agriculture – compared to the reference value of 1990 – the first ten years have resulted relative reduction and stagnating performance. As against to this, there has been more significant volatility after 2000 both in connection with crop production and animal husbandry. In case of crop production, the hectic can be mainly due to the climatic impacts, while the strong declining tendency was more clear in animal husbandry (see Figure 1).

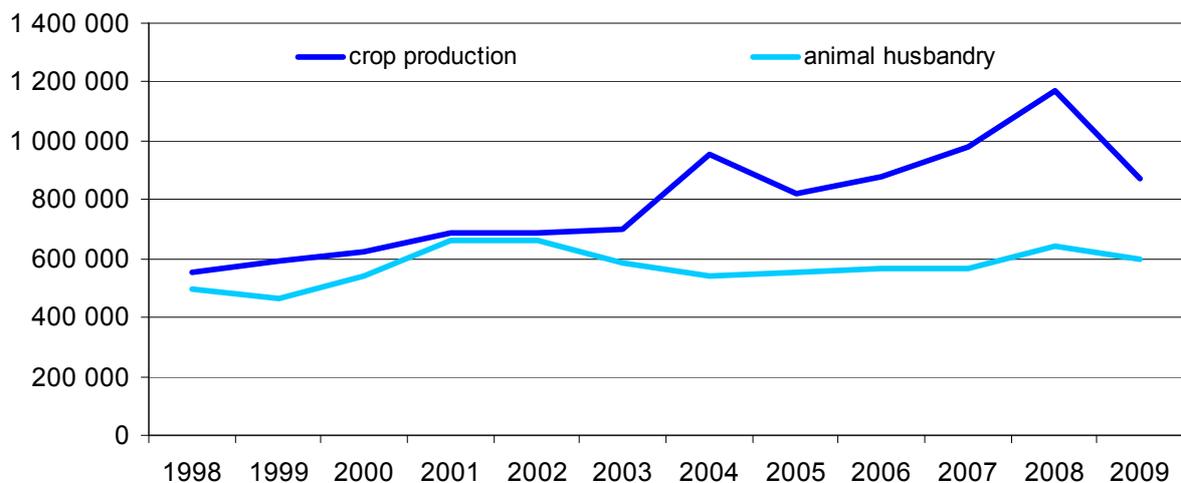


Source: own calculation on the basis of KSH 2010a

Following the accession to EU, the yield changes of cereals determined the performance of agriculture: it declined after the record high yield in 2004, but later grew again. The gross output and value added of agriculture continued the trend of the pre-accession period. According to this, the share of agriculture in gross output decreased to 4% by 2006, then it slowly increased from 2008. The added value had the similar tendency, in spite of the fact, that the gross value added grew by almost 162 billion HUF in 2004 – due to the positive impact of accession – and it corresponds to almost 70% increase during ten years (1999: 575 508 and 2009: 971 443 million HUF). [KSH, 2010a]

The extensive deformation of production structure went on after the integration: the share of crop production (including field crop production, mostly cereal production) grew, while the share of livestock farming decreased significantly. Due mainly to the direct subsidy and intervention measures, the structure of agricultural production moved towards simplification and production of mass products which could also utilize the intervention system. This process led to considerable distortion, heading towards further decline of maintaining ability of agriculture, permanent upset of market balance and instability of the role and operation of the sector. The share of animal husbandry in the gross output of agricultural products has been diminishing since the accession: the 45% share in 2003 decreased by almost 10% for six years, to 35%. Out of the main areas of animal husbandry, the pork section has declined the most: while there were 4,9 million pigs before the accession, it fell drastically in the year of accession, then dropped to 3,2 million by 2009 and there are 2,9 million pigs by today. It is more than 30% decline compared to the level before the integration.

Figure 2. The production value of crop production and animal husbandry between 1998 and 2009*, in million HUF



Source: on the basis of KSH 2010a, * estimated in January 2010

The narrowing positions after the accession can be clearly observed in the changes of the different production factors. The number of registered *enterprises* – both corporate and individual ones - has decreased gradually within the sector after the accession. In our days there are almost 7000 corporate farms and 600 thousand private farms in the sector. The average farm size of the previous is 46 ha, while of the latter one is only 4ha. While they share the agricultural land almost fifty-fifty, in case of animal stock, the ratio of corporate enterprises is 70% to 30%. So the private farms with an area below 1 ha, which make up almost 67% of all the farms, use only 4,1% of the

total agricultural land. The ratio of private farms with more than 50 hectares – which is above the critical point of ensuring livelihood – is hardly above 1,5%, but their share from the total area is almost 50%. [BARANYAI, 2010; TAKÁCS ET AL, 2005]

Parallel with the decline of the number of farms, the number of employees also dropped: only 4,6% of 3 781,9 thousand persons, the total number of employees in Hungary, that is 175,8 thousand persons worked legally in agriculture. It means that more than 30 thousand jobs have been closed in the agricultural sector since the accession. The decline in the number of employees also mean that the share of grey economy and almost-grey activities has been increasing significantly in spite of the diminishing labour-intensive sectors. This process results increasing social tensions and strengthening uncertainties in the rural areas. The disadvantageous demographic conditions and the age distribution – which is more unfavourable in these regions than the national average – make the situation even worse.

Besides the impacts of common market, one of the key tools of CAP, the scheme of direct payments has contributed to these processes significantly.

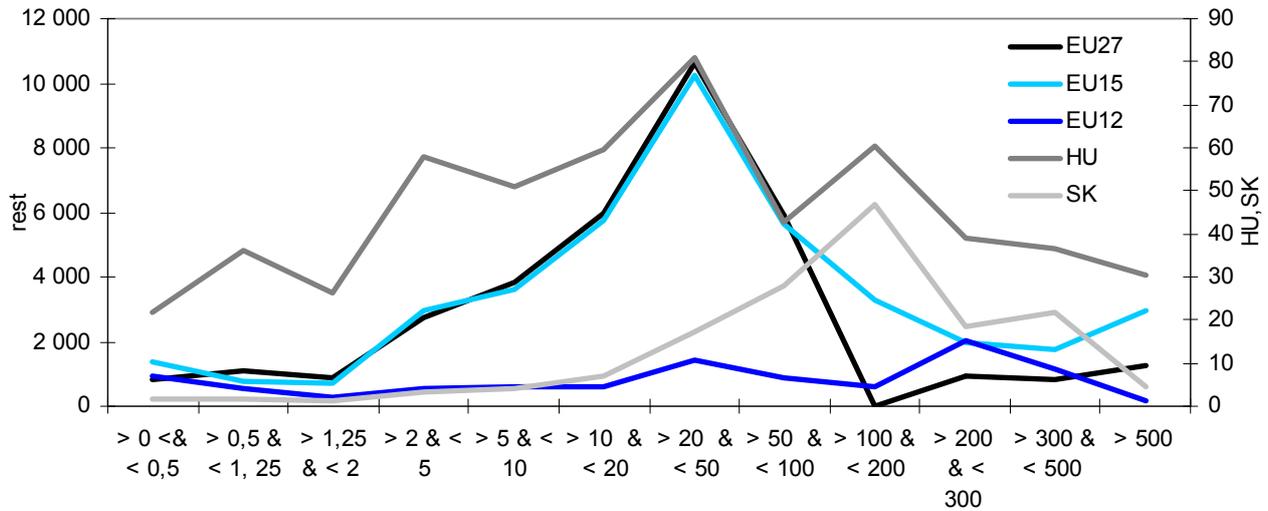
RESULTS AND DISCUSSION - ANALYSIS OF THE SYSTEM OF DIRECT PAYMENTS

If we compare the special features of payment systems in member states¹, we can see a lot of formerly existing factors.² On the basis of Figure 3 it is clear that the amount of payments between 20 and 50 thousand EUR is the greatest in the average of EU27. It is obvious that the specialities of the former member states are strong and closely follow the tendency of EU27. The only deviation from this tendency is in the higher payment categories. Within this, the performance of new member states related to the higher – 100.000 EUR – payment category is relatively low, in spite of the Czech and Slovakian values. The tendencies which can be set for the country groups coincide with Hungarian processes only to a small extent. More extensive similarities can be seen only in case of the above mentioned payment categories of 20-50 thousand EUR. Besides this, due to the Hungarian conditions, the peaks of 2-5 thousand EUR and 100-200 thousand EUR categories are different from the average EU values.

¹ The comparison and analysis of payment systems within each member state cannot be done in the frames of this paper. The current study concentrates only on the conclusions that can be drawn on the basis of amounts of payments. As regards the systems within the member states further information can be collected from the systematic table on the following link: http://ec.europa.eu/agriculture/markets/sfp/pdf/ms_en.pdf

² The former specialities are also discussed in the related chapters of VÁSÁRY 2009

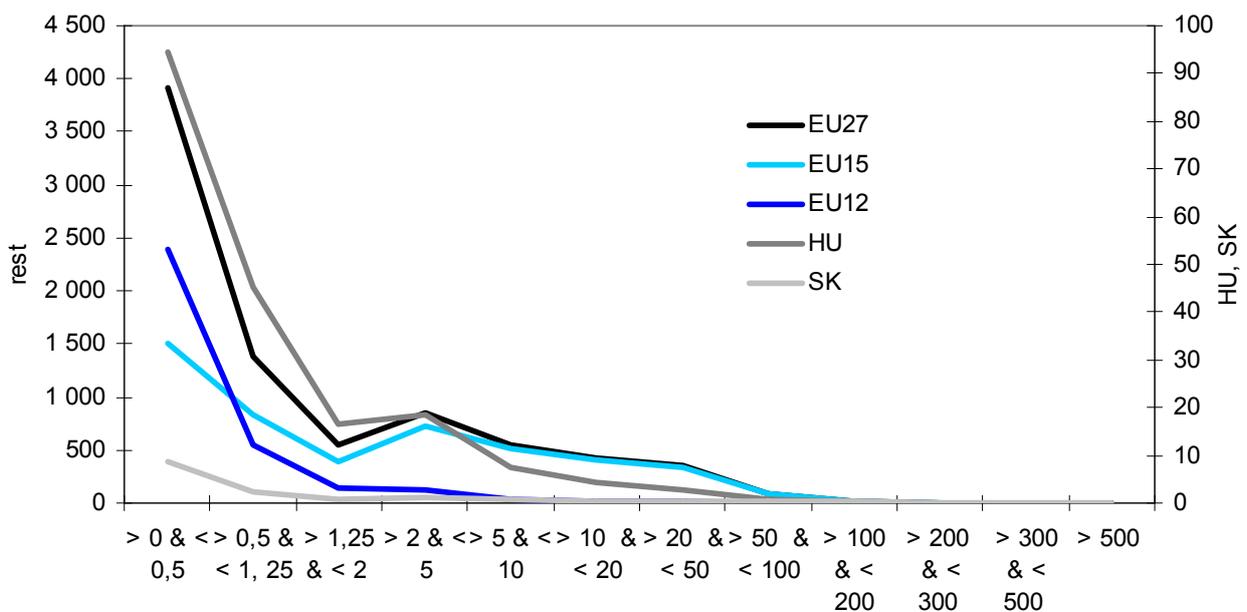
Figure 3. Distribution of payments in the EU on the basis of amount categories, 1000 EUR, 2008



Source: own construction on the basis of EB 2010

In case of those entitled for subsidies, there are no significant differences within distribution compared to the relations which give the basis for categorization. The national value, however, is rather strong in the lowest – below 500 EUR – payment category. This category makes up 50% of all the producers entitled for subsidies. The value of this category is 95% in case of Romania, 60% in Poland, 56% in Slovakia, 73% in EU12, but only 30% in case of the older member states.

Figure 4. Distribution of beneficiaries of subsidies within the EU on the basis of payment categories, 1000 capita, 2008



Source: own construction on the basis of EB 2010

Examining the changes of national specialities, it is obvious from Table 1, that the amount of agricultural subsidies has increased gradually for the years following the accession on the basis of the agreement. Parallel with this, a rationalization has started among the beneficiary farmers: the number of entitled farmers has decreased by almost 13 thousand. On the one hand, it was due to natural selection and giving up farming, on the other hand, to voluntary or necessary concentration, estate merger. The number of beneficiary farms decreased by 7% together with the falling number of those receiving the lowest payment category, that is less than 1250 EUR. The others increased significantly, by 4 or 5-fold in the highest category. There is a clear similar tendency in case of payment amounts.

Table 1. Changes of all direct payments and number of beneficiaries between 2005 and 2008

direct payments categories, 1000 EUR	direct payments, 1000 EUR				change 2008/2005 %	number of beneficiaries, 1000 capita				change 2008/2005 %
	2005	2006	2007	2008		2005	2006	2007	2008	
> 0 & < 1,25	57 407	58 474	59 121	57 916	100,89	170,28	163,72	151,79	139,57	81,96
> 1,25 & < 2	17 660	21 211	24 866	26 211	148,42	11,36	13,62	15,8	16,52	145,42
> 2 & < 5	37 913	43 691	51 522	57 829	152,53	12,22	14,04	16,6	18,69	152,95
> 5 & < 10	33 182	39 233	46 334	51 071	153,91	4,76	5,62	6,6	7,32	153,78
> 10 & < 20	45 530	46 508	52 714	59 792	131,32	3,11	3,27	3,76	4,3	138,26
> 20 & < 50	26 754	41 610	63 042	81 155	303,34	0,86	1,51	2,28	2,85	331,40
> 50 & < 100	31 288	35 041	36 712	42 909	137,14	0,43	0,49	0,52	0,61	141,86
> 100 & < 200	41 590	44 744	53 713	60 527	145,53	0,3	0,32	0,39	0,43	143,33
> 200 & < 300	11 971	19 591	27 318	39 122	326,81	0,05	0,08	0,12	0,16	320,00
> 300 & < 500	7 107	9 654	19 870	36 609	515,11	0,02	0,03	0,05	0,1	500,00
> 500	5 812	7 501	11 637	30 231	520,15	0,01	0,01	0,02	0,04	400,00
total	316 210	367 185	447 830	543 360	171,84	203,4	202,76	197,98	190,63	93,72

Source: own construction on the basis of EB 2010

The slowly decreasing number of those entitled for subsidies and partly the increasing demand for lower-categories can refer to the fact that the farmers in the less-profitable size categories have tried to utilize the changes within the system of direct subsidies, or at least to keep their position. Besides the improving intentions to do farming it is obvious in connection with subsidy entitlement that the land owners have got in better positions and greater access to subsidies in the short run: in order to keep their entitlement for subsidies and increase the value of land they cancelled the land rent contracts or did not extend them. It was enabled by the re-categorization drafted in the legal regulation about the modification of the historical basic entitlement connected with flat-rate scheme (SPS) planned from 2008.

On 20 October 2008 the Hungarian Parliament adopted the Law on the Introduction and Operation of the Single Payment Scheme to Agriculture, the so-called SPS and the Chairman of the

Parliament forwarded it to the office of the President of the Hungarian Republic on 28 October, 2008 for ratification. The President of the Republic, however, had some constitutional scruples about the Act so he did not sign it but initiated preliminary constitutional examination of SPS Act on November 12, 2008. The President found the provision of the new Law disquieting, which provision appoints the marketing year 2006 as a representative period as main rule for the calculation of the subsidy on the historical base. According to the resolution of July 12, 2010 of the Constitutional Court, the draft was declared anti-constitutional. On the basis of the justification of the resolution, not the quality and method of the base period was problematic, because not the implementation of the historical bases was against legal security. Furthermore, not the law of asset value, nor 2006 as basis year harm the rights of land owners. They rather objected the more volatile parts of the Act, which do not fix the ratio of historical and regional components and puts the decision about it into the authority of the minister, which is against the predictability. [MKA, 2010]

Table 2. Agricultural subsidies between 2004 and 2010

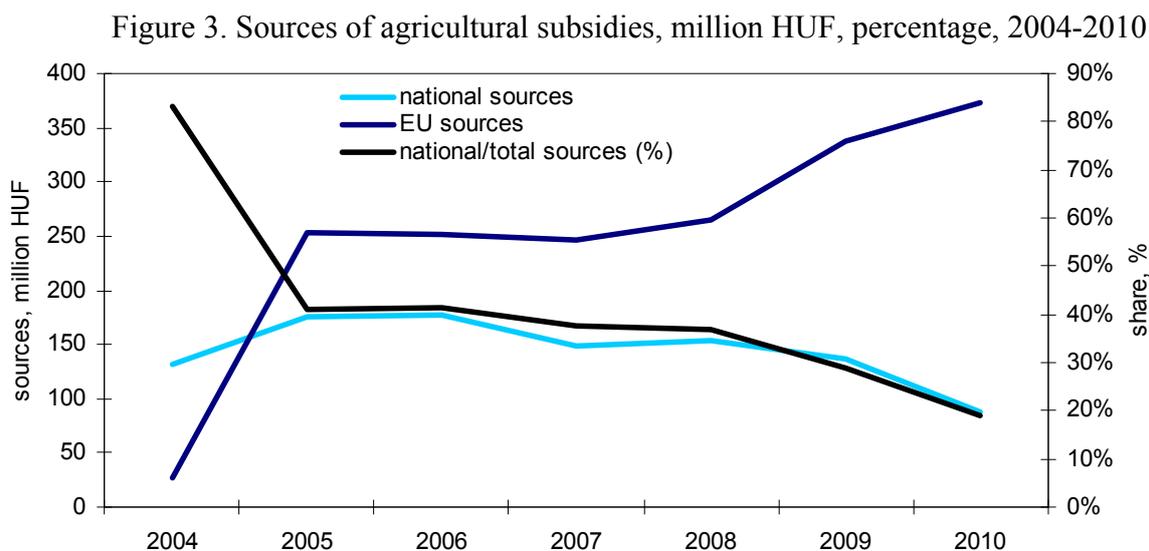
Title	2004		2005		2006		2007		2008		2009		2010	
	N.S.	EU s.												
"Former" development subsidies	27,5	-	15,3	-	7,8	-	3,0	-	1,3	-	0,9	-	-	-
Current expenses and income subsidy	90,9	-	131,5	-	125,4	-	98,7	-	101,6	-	83,0	-	42,8	-
Other national payments	8,8	-	9,8	-	14,1	-	10,1	-	9,9	-	3,8	-	7,3	-
Payments in EU co-financing	3,9	16,3	18,3	97,8	29,9	99,1	37,2	78,8	41,1	68,6	49,8	110,2	37,7	96,9
Ministry budget	131,1	16,3	174,9	97,8	177,2	99,1	149,0	78,8	153,9	68,6	137,5	110,2	87,8	96,9
SAPS	-	10,0	-	148,0	-	93,5	-	120,0	-	156,2	-	166,2	-	235,0
Export and internal market subsidies	-	-	-	6,6	-	59,7	-	48,0	-	39,6	-	61,9	-	41,8
Total payments	131,1	26,3	174,9	252,4	177,2	252,3	149,0	246,8	153,9	264,4	137,5	338,3	87,8	373,7
All total	157,4		427,3		429,5		395,8		418,3		475,8		461,5	
Share of national subsidies	83,29%		40,93%		41,26%		37,65%		36,79%		28,90%		19,02%	

Source: MOSZ, 2010 Note: N.s.= National source, EU s.= EU source

With this, however, one of the main advantages of SPS, that is the subsidization of livestock farming, has failed because the amount of top-up source, that used to be easily accessible for the branch, is gradually decreasing by 2013. The problem is not only the availability of sources from national or community sources – which are rather fragmented and will probably remain narrow due to the current financial situation – but also the limited group of titles, because only those payments can be provided that are separated from production. In this case, however, it is rather difficult to

support those sectors that are really in need and actually perform farming differently from the type of payment.

The implementation of the payment system is significantly affected by the fact that not too great sources can be spent from the budget on the spendings of the sector. Besides the macro-economic situation and the position of the national budget, the global economic crisis since 2008 have resulted drastic decline in nominal amounts of payments.



Source: own construction on the basis of MOSZ, 2010

Parallel with the narrowing budget sources, significant and clear tendencies could be observed in regards to net fixed assets stock, too. The introduction of production subsidies, more precisely, EU direct payments have resulted definite growth from 2004. It has resulted that 28.130 million HUF of 1998 and the 41.238 million HUF in 2003 increased to 303.465 million HUF. In spite of this, the accession was a breaking point, because the market income³ of farmers decreased and stagnated with declining tendency although the production subsidies increased significantly. There is strong negative correlation between production subsidies and market income: the value of correlation coefficient is -0,49. There is strong negative correlation between production subsidies and net fixed asset accumulation. Here the value of correlation coefficient is 0,75. So there is a conflicting picture between increasing volume of payments and volume of investments of accumulation purposes, which highlights again the permanent existence of subsidy-allocation tensions.

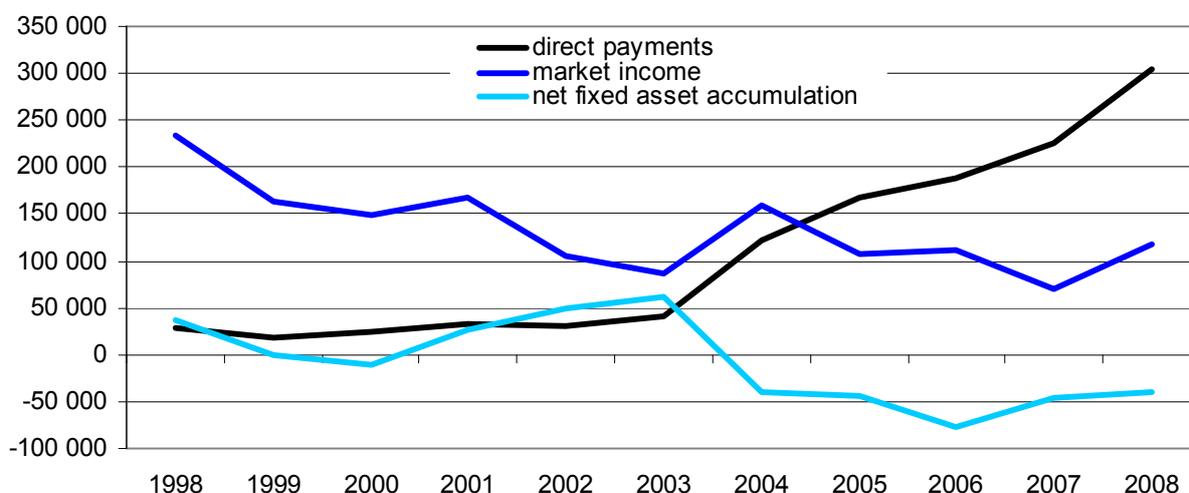
³ The market income means the difference between the net farming income and the production subsidies. The net farming income can be calculated by the decreasing of the income of production factors and by the amount of employees' income, land rent, considering also the result of interest rate operations.

The impact of rising income can be strongly felt in the increasing farm lease rents. (It is especially significant, because almost 60% of farmers use leased land.) It can be stated that the correlation coefficient of changes connected with farm lease rents and income since 2000 is very high, 0,92. It is much more obvious if examine only the situation from our integration into the European Union. The value of correlation coefficient in this is 0,96! Significant part of subsidies leak through land lease rents. Statistically it is difficult to quantify, but empirical sources prove that there are a lot of land lease contracts where the size of rent depends on the amount of subsidy, sometimes up to 100%.

In general, it can be concluded that the significant income growth after the accession has no impact on investments. Thus the expectations about the further, drastic run-down of Hungarian agriculture may become true, with special regard to the fact that the decline due to the cancelled investments is not a single phenomenon, it could have been observed since the 1980s, although the declining tendency has been stronger and more obvious since 2004. [HALMAI, 2010] The calculations have proved that the extra income from the direct subsidies does not definitely affect investments. The process of leaking is clearly obvious which raises further questions concerning the necessity of direct payments within the current system.

The correlation between net fixed asset accumulation and market income is more obvious, the value of the moderately weak relation is 0,25, which refer to the fact that there is a similar – decreasing – tendency in case of both factors. It also leads to the conclusion that the market income has greater impact on investments than the volume of subsidies.

Figure 5. Market income, production subsidies and net fixed asset accumulation between 1998 and 2008, million HUF



Source: KSH 2010b

In addition to this, the changes in the payment system, the access to EU sources, the introduction of the SAPS have some significant impact on the sector, but the financial transfers can be only partly blamed for the actual processes. They appear in the increasing income and land leasing rents, but do not explain e.g. the foreign trade relations. In other words, even the 100% share in the direct payment system could not really improve the efficiency, competitiveness and external market positions of the sector. The main causes of the general problems of agriculture can still be led back to the structural distortions, the special features of production and the historical determinations. The efficient operation of the payment system, however, could contribute to the consolidation of the macro-level finances of the sector. It would also require to enhance the efficient operation of the payment. The share of sources used within the sector should be increased and the income outflow should be moderated.

CONCLUSION

On the basis of the examinations reviewing the processes of a few years, it can be declared that the volume of payments as well as the income of the sector increased significantly in nominal terms. There is a strong correlation between the growth of land leasing rents and direct payments. The extension of investments has been decreasing or has been falling very short of the expected level and there is a strong negative correlation as regards direct subsidies. The investments have not increased automatically in spite of the considerable growth of income that was realized due to the subsidies. The investments were mostly affected by the targeted development payments. Thus due to the decline of these incentives, the net fixed asset accumulation has been negative since the accession. The transfer efficiency of direct subsidies is low, the input and output leaking from the sector has been increasing, especially in regards to land owners. The structural distortions have not been solved. To sum it up, there is an obvious stagnation or regression at sectoral level. The export markets are clearly narrowing and the import is radically expanding.

In addition to the current organizational and market problems, there are many actual policy issues and measures which have had considerable negative impact further increasing the impact of market, climatic and other external factors. The incapability of making decisions in connection with SPS law and the rejection meant that the draft did not reach the desired goals of policy, damages the credibility, reliability and acceptance of politics, and it can have negative influence on current issues, too (e.g. land ownership of foreigners). During the implementation of CAP, the EU subsidies and the market measures together and/or separately are able to treat some segments of the sector's problems, but in total, they are unable to push the sector out of this slow-down tendency and to

launch an appropriate comprehensive restructuring and revitalization process according to the actual social expectations of competitiveness and environmental protection.

It is especially important if we consider that the CAP faces again some radical changes. The role of further adjustments is stronger, although the implementation of radical reforms is becoming more and more difficult within the 27-member community. Anyway, deep reforms can be expected in some areas. But both the total rejection and renationalization of CAP – when national competency and national financing replaces the common policy – is possible in theory. Although it is a fact, that only the reform processes can ensure sustainability, deepening of European integration and the maintenance of the community's achievements. The agricultural policy of the past cannot be continued in the future. The consequent progress in reforms will help to develop a sustainable Common Agricultural Policy which serves both the environmental values and the competitiveness.

On the basis of this, the demand for modifying the payment philosophy and realizing sustainable operation is increasing within the public of the member states. Therefore many suggestions can be drafted on the basis of wide-range analyses about both national and community payment systems. These suggestions can help to increase the efficiency of the payment system, increase its support within society and ensure the objectives of sustainable farming and preserving the environment.

Basically, agriculture still needs community transfers very much. New basis and/or arguments are necessary for this. In regards to this, the utilization of subsidies connected with agriculture should be increased, the definition of achievements that can be evaluated by the society should be clearly expressed.

The „European model” of agriculture is a value for the Hungarian society, too, and means the future for the Hungarian farmers, too. Therefore it is necessary to urge the development of more market-oriented CAP and underline the special features of multifunctional agriculture and the importance of agricultural policy measures serving them.

In connection with these changes, our national interests that should be represented during the talks about the next budget of CAP are the double-direction shift of disputable payment volumes based on former reference periods instead of maintaining the system which can hardly be justified for the taxpayers. On the one hand, the implementation of flat-rate scheme with equal payments per hectare across the whole EU, with lower amounts of payments than at present in order to ensure simplification and easier realization. On the other hand, the introduction of other targeted forms of payments that are adjusted to the special conditions of each region and that can be well justified for the taxpayers. At the same time, however, the planned drastic degeneration of direct subsidies in the future and the Hungarian farm structure would have very dangerous impacts, although the payments

that are reducing parallel with the increasing of farm sizes would harm the larger, more competitive farms. All these would endanger the principle of fair competition and unified market.

In order to maintain and develop national interests and values – also considering the above – it is necessary to set up efficient and successful representation of interests and cooperation within the sector as well as to draft and follow clear short- and medium-term objectives. These can help to face the actual social, environmental and economic challenges in a progressive and sustainable way. In order to realize this, such radical measures should be made like reduction of farm sizes or tightening of entitlement conditions, considering, of course, the long-term objectives and principles of the sector and following the principles of sustainability.

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