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SCIENTIFIC PAPER

INTEGRATION EFFORTS IN AGRICULTURE IN HUNGARY AFTER THE REGIME CHANGE

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Abstract: *: The economic and political transition brought many challenges for the Hungarian agricultural sector. The break-up of large agricultural holdings had serious negative impacts on food production and on the export of agricultural products. Capital intensive profit-seeking intermediaries dominate the trading of agricultural goods that has injurious effects in terms of downward pressure on production prices and an increase in consumer prices. Cooperatives have a key role in effectively tackling the common challenges that small-scale producers have to face. More vertical integration along the food chain could contribute to providing rural employment and to an increase in living standards in rural areas. This study reviews the development, the specific features and the driving forces of modern cooperatives in Central Europe in general, and in Hungary in particular. The focus is on the integrator role of cooperatives and their future role in our globalised world.*

Keywords: *Cooperatives, Hungary, Integrators, Producer Organisations, Transition*
(JEL Classification: *Q10, Q13)*

Introduction

One of the unintended effects of the regime change (i.e. the process of the economic and political transition) was the fragmentation of land ownership, land use and production in Hungary. As a result of the privatisation process and the land reform in the early 1990s, the number of large-scale farms declined significantly and a highly fragmented land ownership structure characterised by small parcels and plots emerged in Hungary. Unlike large agricultural holdings, these small private farms could not participate in large-scale commercial production. To gain access to markets, it became necessary that at least processing should be concentrated. Processes related to the transition have revalorised the role of cooperatives, greater prominence was given to voluntary cooperation more importantly in the more labour-intensive fruit and vegetable sectors.

COOPERATIVE GONDOLA AND TRADITION IN HUNGARY

The widespread and diverse cooperative movement began as early as in the 19th century in Western Europe. The importance of cooperatives was different in different countries in Europe, however, cooperatives were founded to meet the needs of producers. Agricultural cooperatives play a crucial role in a country's economy and they generate income and rural employment. There are two main types of co-operatives: the entrepreneur co-operatives and the co-operatives that enable farmers to exercise countervailing power.

Basic values of cooperatives such as self-initiative, responsibility for social and economic well-being, justice and solidarity have always been unquestionable. Cooperatives are also active in the fields of production, transit, storage, trade, services, etc. However, there are some areas of activity, such as agriculture, where their presence is even more reasonable (Botos & Schlett, 2010). Cooperatives that were established in the second half of the 19th century had two main objectives: an economic one (to offer material advantages to their members) and a social one (to promote social progress in them).

The Rochdale principles - ideals that were established by the Rochdale Society of Equitable Pioneers in 1844 and that are the basis for the cooperative principles even today - are as follows: open membership, democratic control, reimbursement proportionate to contribution, payment of limited interest on capital (dividend), political and religious neutrality, cash trading and promotion of education in cooperatives. These principles were adapted to the changing socio-economic circumstances several times, but the core idea has remained unchanged throughout the years.

The Congress of the International Cooperative Alliance made the principle of religious neutrality optional in 1934, and later congresses made the same decision with regard to cash trading and religious neutrality. In 1966 two additional principles were set out: the obligation of transnational cooperation and the establishment of joint services (Csendes, 2004).

In 1995, the Congress of the International Cooperative Alliance (ICA) has defined the cooperative principles: Voluntary and Open Membership, Democratic Member Control, Member Economic Participation, Autonomy and Independence, Education, Training and Information, Co-operation among Co-operatives and Concern for Community. In 2002, the International Labour Organization (ILO) stated that "the promotion of cooperatives guided by the values and principles ... „should be considered as one of the pillars of national and international economic and social development" ... The European Commission, in 2004, found that the modernisation of the legal environment concerning cooperatives inevitable (Simko & Tarjanyi, 2011).

The history of the Hungarian cooperative movement can be traced back to the year of 1845, one year after the foundation of the Rochdale Cooperative. The first cooperatives in Hungary were established mainly in the credit and dairy sectors (Schilthuis & Bekkum, 2000). The commercial code which took effect in 1875 was the first code that regulated the cooperatives' commercial activity, and the term 'cooperative' appeared for the first time. Later, in 1898, the activity of economic and industrial credit unions was regulated. These laws were only subject to modification in 1920, when the general cooperative law entered into force and remained in force until the dawn of World War II.

Károly Ihrig, key author of the literature on cooperatives, believes that the economic advantages of cooperatives stem from the fact that they offer a higher level of organisation to small and weak actors, while through disintermediation they also save some extra costs to their members. Cooperatives are able to evaluate needs of both supply and demand, as well as to organise and adapt the production process to their specific needs. Their social significance stems from fostering the economic success of their members and, through this, promote their social and material progress by concentrating disperse energies (Ihrig, 1937).

Trade plays an important role in cooperatives as consumer goods get involved in trade on several occasions before reaching their consumer. Different products entail a different composition of costs (remuneration and salary, office management costs, taxes and other charges, interest of capital in stocks, etc.), and how these costs relate to the retail price also varies in each case. As to farmers, important trade-related costs and price changes can have particularly negative effects on them. Farmers of different size classes buy and sell their products and consumer goods at different prices. Bigger farmers are in a more advantageous situation than smaller ones, since they dispose of bigger volumes which offer them the chance of disintermediation, and thus find themselves in the position of appropriating a bigger share of the sales price than small producers. Two main factors can thus decrease the profitability of small farms: small farmers sell their products considerably below the wholesale price, while they also purchase production assets above wholesale prices. Besides agricultural disparity, the profitability of small farms is further decreased by the fact that retail prices exceed/fall behind wholesale prices. When considering agricultural disparity, the wholesale price index for agricultural goods has to be recalculated by taking cheaper buying and more expensive selling prices into consideration. Difficulties stemming from agricultural disparity are further compounded by a trade disadvantage the harmful effect of which can be minimised through the strengthening of the cooperative movement (Schlett A. , 2009).

The most significant cooperative in Hungary, Hangya (Ant in English), was founded in 1889 with the main objective of tackling the negative effects of dumped wheat and corn imports on price change and of protecting the country from the plague of usurious trade. Speculators often withdrew their products from the market causing shortage before putting them back onto the market at usurer's price. The number of Hangya cooperative members has reached 700,000 by 1940, and has included 30 canneries and 400 shops as well (Hangya , 1923).

After the Second World War, following the takeover of the communist regime, Hungarian agriculture set a new course. After a sustained period of collectivisation (1948-1956), by the early 1960s the communist regime forced peasants to join collective farms and large, state owned farms. In the era of communism forcing farmers into Stalinist, soviet type of cooperatives ('kolkhozization'), which had nothing to do with earlier types of cooperatives, resulted in the fact that after the regime change in 1989 the most popular political slogan has become: 'Down with cooperatives!'

CHANGES IN HUNGARIAN AGRICULTURE AFTER THE POLITICAL AND ECONOMIC TRANSFORMATION

In the transition period, Hungarian agriculture changed radically. Its ownership structure, farm structure and even its production structure was transformed. As a result of these changes, production decreased by one third and employment in agriculture decreased drastically (Takács, 2008).

Processes related to the transition have revalorised the role of cooperatives. As a result of the Land Compensation Act a dualistic farm structure has emerged which had a negative impact on efficiency and competitiveness (Cseszka & Schlett, 2009). Individual farms accounting for the vast majority (99.1%) of all farms own no more than 40% of all the land. While the average farm size for agricultural enterprise is 504 hectares, the same figure for individual farms is barely above 3 hectares (3.3). If we focus onto individual farms' size, 72% of them own less than 1 hectare or no land at all (farmers involved in animal husbandry or providing services). In addition, if one takes all the individual farms under 5 hectares into consideration, one will find that 90% of individual farmers dispose of no more than 5 hectares of land (Lentner, 2010).

During the first decade of the transition two third of the food industry, and the entirety of some other sectors, were acquired by foreign companies. 90% of food trade is under the control of a small bunch of multinational companies. Very often foreign investment inflows entailed the closure of factories, which helped food processing companies to acquire new markets and offered the opportunity for them to gain superprofit. Companies that were acquired by international companies entered into a greater regional system of product development and specialization (vegetable oil, pasta and confectionary production) (Schlett, 2014).

The rapid transformation of Hungary's commercial network starting in the 1990s also included the quick spread of foreign hyper and supermarkets (Árva, Katona, & Schlett, 2013). Concentration and vertical integration keeps strengthening retailers' bargaining power when negotiating with agricultural suppliers. The abundance of producers with no dominant position on a given market poses the risk of some retailers gaining monopsony power. Small agricultural producers depend more and more on collectors. Very often collectors tie producers to themselves opening up doors for the abuse of a dominant (customer) position. Cultivation contracts often offer unilateral advantages to well-capitalised collectors.

Concentration and vertical integration can strengthen the bargaining power of retailers against agricultural producers as well. If many producers are present in a market, retailers might enjoy some degree of monopsonic power (Seres, 2006). Information asymmetry between retailers and suppliers strengthen the bargaining power of retailers: retail chains have information about the market conditions, buying habits of customers, due to having direct contact with customers. Barcodes enable retailers to store data about consumer preferences, habits and behaviours and this information can be used against the competing suppliers which may have distorting effects on the retail market. Retailers have information about the economic situation of the suppliers as well. Suppliers, on the other hand, have information only about the marketing plans of their own products therefore, due to the information asymmetry they have less bargaining power (Balto, 1999).

In the case of agricultural products price is determined not only by supply and demand but by the linking of buyers and sellers on the market as well. Agricultural producers are usually price takers rather than price setters. Their prices are determined by the demand for their products. Producers (small-scale farmers) have access to fewer alternative large buyers and therefore they have less bargaining power. Small-scale producers often do not have access to working capital, and it is not unusual that they have to buy even the seeds and propagating material from the purchasers. Contracts (often at predetermined prices) can ensure a stable income and make a direct contribution to the producer's annual household income. Long-term contracts, however, reduce the financial uncertainty and small-scale producers can gain a reliable flow of income.

As a result of concentration and integration, agricultural producers become more dependent on food processing and food retailing companies. Most agricultural auction-type, perfectly competitive markets are replaced by vertical control through the use of long-term production and marketing contracts. Small-scale producers become strongly dependent on purchasers who exercise their dominant buyer power over the producers. Contracts may also be a device to consolidate the buyers' market power that may result in the hold-up problem (e.g. excessively long delays in payment for the delivered product, the producer is forced to accept disadvantageous terms later or ex post renegotiations of terms).

In addition to the traditional role of retailers as purchasers, retailers today have had a new role as they have advance information about the markets, in-depth knowledge of their customer base and they have acquired increasing market power (Consumers International Report). Branded goods are increasingly replaced by own-brand (private label) products. Compared to Western European countries, in Hungary the share of own-brand products in the daily consumption of households is relatively low, however, it is increasing significantly (Fertő, G. - Szabó, G. G., 2002).

On the basis of consumer needs and preferences, retailers explore the market and select a potential supplier that is able to produce and supply the goods efficiently at low prices. Suppliers of own-brand products often team up with retailers to design, develop and market-test new own-brand products (Guba, 2001). Own brands make retailers serious competitors to branded good suppliers and shift the market power to retailers. An imbalance of bargaining power between retailers and their suppliers may foster abusive buying practices, claim suppliers (e.g. slotting fees, late payments for products already delivered, squeezing out branded goods, etc.). As the profitability of smaller suppliers is decreasing, the production of own-brands or specialisation may increase their market power. Suppliers may build their own production or manufacturing capacities and provide store brand products for themselves. If they have enough buying power, they might be able to negotiate a reduction in the retailer price. Own-brand prices are on average 20% to 30% cheaper than branded prices because of the absence of brand development, packaging, and marketing costs. Own-brand products often surpass the performance of manufacturer brands, but they are often inconsistent quality and do not always meet the required quality standards (Hoch, 1996). The rate of sales of own-brand products versus branded products are influenced by the allocation of shelf space and in-store promotions as well. Some forms of brand positioning - i.e. different messages can be vested with the own-brand goods ("Tesco Economical", "Tesco Value") - are important tools for image creation. Brands provide identification of their products with unique associations to the stores, therefore retailers can make higher gross profit margins on own brands.

THE EXPERIENCE LEARNED FROM PRODUCER ORGANISATIONS IN HUNGARY

It becomes now evident that a key contributor to productivity and effectiveness is the adaptation to market demands which includes a uniform, high quality production, an increased degree of processing and the access to consumers, i.e. the development and management of vertical coordination in agriculture (Németi, 2003).

were interested in making fast profit rather than investing in long-term cooperation.

The high number of cooperatives results in a strong price competition, as big multinationals can deal with large quantities of goods every day, acquired below market prices. This brings cooperatives, normally interested in long-term cooperation, into a difficult situation. Depressed prices take their toll in cooperatives as a consequence of which their members are only offered sales prices below market levels.

Strict EU regulations – indebtedness: Substantial investments (cold stores, sorting and packaging machines, refrigerated trucks, etc.) have to be made in order to obtain a EURO GAP specification which allows for selling to chain stores. This is partly financed by credit.

Monopoly of large multinationals: As the market is dominated by supply, the above described situation is further aggravated by the lack of storage capacity, which makes farmers even more vulnerable. Only large multinationals can guarantee large quantity acquisitions, and this is why cooperatives are obliged to tolerate slotting fees, unfavourable payment deadlines, contractual penalties, etc. Multinationals tend to depress prices by making unverifiable quality complaints, and demand contractual penalties for insufficient quality or quantities.

COOPERATION AS A KEY TO SUCCESS

The cooperatives system can contribute to solving two major difficulties of the country. One of them is the low rate of employment, while the other is the limited ability of rural areas to attract workers. Farmers who normally would not survive individually can increase their competitiveness through cooperating with each other, and can thus prevent further concentration of properties and the decrease in employment possibilities. A first step would be to improve acquiring and selling cooperatives. Through the expansion of their services, these improving cooperatives could offer new jobs on the long run. Creating credit unions could help cooperatives in different agricultural sectors to make improvements. This all could even entail the rebirth of the processing industry, as it would increase the added value and shorten the distribution chain, making Hungarian food products competitive on the global market. In recent years, some promising initiatives have proved that, even at an early stage, cooperatives have business potentials. The beneficial effect of cooperation is self-evident, but stakeholders' interest in forming cooperatives can be further increased, as voluntary cooperation is a key to competitiveness on the global market. This would be all the more vital that, in the short run, agriculture in Hungary will be facing challenges such as the possible ceasing of the agricultural support in 2020.

Cooperation can be an effective response to these challenges. However, the integration of cooperatives can only bring success if they can also efficiently deal with acquisition, storage, transport, packaging, processing, distribution and exportation as well. This also requires warehouses, processing plants, logistics centres, etc. Even if cooperatives dispose of the required means and resources, it is hard to compete with large multinationals, to improve distribution performance and to sustain their level of competitiveness. This is why improving possibilities and finding and disseminating solutions and techniques of cooperation, which could integrate local communities into the network of cooperatives, are of utmost importance.

CONCLUSION

Family farms have large potential benefits in the cultivation of labour-intensive agricultural products, whereas the biggest advantage of large-scale farms is the better use of capital. Large-scale farms can make larger purchases while cooperatives offer small-scale farmers improved access to markets (Schlett, 2015).

In the food chain, the producers and the consumers have the weakest bargaining position and are most vulnerable since they do not have advance information and are not flexible. Retailers and food processors on the other hand have advance information, are often large, and flexible so that supply can match consumer needs quickly.

In Western Europe, most agricultural cooperatives are specialised and can improve the efficiency which is beneficial for each member of the cooperative. The cooperatives can provide a countervailing power to counteract monopolistic competitors, which can increase competition. Producers (farmers) gain big benefits from agricultural cooperatives as cooperatives can address the problems of small farm inefficiencies and have stronger bargaining power. In the agricultural market an efficient marketing system is vital – the competitiveness of cooperatives is ensured not only by the rate of sales of the products but by the efficiency of the institutions and loans facilities as well.

The future of cooperatives in Hungary will largely depend on the governments' intentions, state aids, effective cooperation between the members, credit facilities, acquiring a share in processing capacities in order to assert interest, as well as on harmonisation and cooperation with other agricultural cooperatives. Due to early difficulties that cooperatives of a new type had to face, developments requiring massive state subsidies and mistrust towards new cooperatives, it has become a widespread concern that companies, rather than cooperatives, should be favoured when it comes to agricultural production.

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