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Is there a Way out?

Assessment of the Situation of the Hungarian Poultry Sector?

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Van-e kiút? – A baromfiágazat hazai helyzetének értékelése

Az előadás témája a hazai baromfi-szektor jelenlegi helyzetértékelésének bemutatása. Az Egyesült Államok Mezőgazdasági Minisztériumának (USDA) előrejelzése szerint a 2011-2020 közötti időszakban a baromfi-hús előállítására bővíthet a húsközül a legnagyobb mértékben. Van-e lehetősége Magyarországnak arra, hogy e kedvező helyzetet kihasználja? Felvázoljuk a baromfi-szektor rendszerváltás utáni történetét, az Európai Unióhoz való csatlakozás hatásait, valamint az ágazat jelenlegi helyzetét és problémáit. Kitérünk az ágazat versenyhátrányainak ismertetésére (exportcsökkenés, importnövekedés, technológiai lemaradás, ágazati stratégia hiánya, integráció fejletlensége stb.), valamint az ágazat helyzetét megnehezítő egyéb tényezők (energia-árak, takarmányárak, adórendszer, feketegazdaság stb.) bemutatására. Megvizsgáljuk, hogy milyen stratégiai lépésekkel lehetne javítani az ágazat helyzetét.

Kulcsszavak: baromfi-szektor története, helyzetértékelés, kilátások, stratégia, integráció

ABSTRACT

The topic of our presentation is the assessment of the current situation of the Hungarian poultry sector. According to a forecast issued by the United States Department of Agriculture (USDA), of all types of meat, poultry meat production may expand to the greatest extent over the period of 2011 to 2020. The question is whether it is possible for Hungary to take advantage of this favourable situation. We will outline the history of the poultry sector since the transition period, the impact of the accession to the European Union and the current situation and the problems of the sector. We will discuss the sector's competitive disadvantages (drop in exports, growth of imports, technological backwardness, lack of sector strategy, underdeveloped integration etc.). We will also include other factors that make the situation of the sector harder (energy prices, feed prices, tax system, black economy, etc.). Finally, we will examine the possible strategic steps to improve the situation of the sector.

Keywords: history of the poultry sector, assessment of the situation, prospects, strategy, integration

INTRODUCTION

According to a forecast issued by the United States Department of Agriculture (USDA, of all types of meat, poultry meat production may expand to the greatest extent) over the period of 2011 to 2020. According to this prognosis, prices are expected to increase together with the growth in demand, and feed prices will remain relatively high, too. Looking at the biggest exporters, we may expect an approximate 4% decrease in the EU exports. At the same time, poultry imports of the biggest importers are expected to grow by 15%, which translates into more than 1 million tonnes. (Source: AKI [Research Institute of Agricultural Economics, Hungary])

The questions are whether the economic situation forecast by the USDA may be

favourable for Hungary and whether it will be able to help the Hungarian poultry sector, which is in a critical situation at the moment. In order to answer these questions we will briefly outline the history of the poultry industry and we will discuss its current situation, its existing backwardness and problems.

THE HISTORY AND THE CURRENT SITUATION OF THE POULTRY SECTOR IN HUNGARY

Intensive poultry farming culture had become widespread in Hungary by the second half of the 20th century. Based on a centuries-old animal farming culture, modern, integrated poultry farming developed from the 1960s until the mid 1980s, which also resulted in the dynamic development of the Hungarian poultry sector (Kozák, 1999 Magda 1998). The growth in domestic demand and the expansion of export opportunities (mainly for the Soviet market) required a modernisation of existing plants and establishment of new ones (Orbáné, 1996 (Figure 1.)). The 1970s saw some really great achievements: world-class manufacturing capabilities were developed, production integrations were completed up to a national level and a high degree of vertical integration was created. (Kozák, 1999). In the 1980s poultry industry was one of the success sectors of Hungarian animal husbandry. The industry's performance reached its peak in 1988, when 466.3 thousand tonnes of poultry was processed and the export reached 237 thousand tonnes (Figure 1).

The relative stability of the poultry industry, which could be seen until the 1990s, was due to the following three reasons: poultry, which was cheaper than the other types of meat made the demand increase; battery farming got spread and there was a shift of consumer preferences towards the healthier white meat (Tömpe, 2000). In the first third of the 1990s the poultry chain got into a crisis. The sector's performance fell to historic lows in 1993, when poultry production fell back to 308.8 thousand tonnes, and the export dropped back to 74.7

thousand tonnes (Figure 1). Between 1991 and 1993, Hungary lost two thirds of its foreign markets (the Soviet market), and the country could not enforce the increasing production costs and interest burden in its sale prices. Many companies went bankrupt or were liquidated. The process of privatisation was making its way slowly in the sector and foreign capital arrived late, too (Orbáné, 1996 and 1997). On 31 December 1995 the rate of foreign capital in the poultry industry was 32% (according to the statistics of the Department of Agriculture), which is a lot lower than the average of 53% in the food industry (Orbáné, 1997).

It was an additional problem that former close ties between the various phases of the poultry chain were fractured, because while in the 1980s poultry production on small farms was financed by cooperatives and state farms (the producers received the inputs in advance), from 1991 the integrator's role was transferred to the processors, which meant such additional burdens on them that was covered by taking up additional loans (Magda, 1998).

Compared to the 1993 lows, in the second half of the 1990s poultry production started to expand again with and poultry exports picked up again with fluctuations though. It was partly due to the fact that the majority of Western European countries had emerged from the crisis and their demand for poultry meat grew. On the other hand, the annual increase in the preferential quotas given by the Association Agreement with the EU and their efficient utilization also contributed to the recovery of exports (Orbáné, 1996 and 1997). After the years of crisis, investments picked up within the poultry processing industry: companies developed mainly dissecting, packing and further processing facilities (Orbáné, 1997).

However, the sector was adversely affected by the continued reduction in export subsidies (Hungary introduced the Agreement on Agriculture adopted at the GATT/WTO Uruguay Round from 1 January 1995). Further reductions of the former, low subsidies and the increase of input costs caused the conditions

of an economical export to cease (Nábrádi - Fáklya, 1997).

In the second third of the 1990s a strong concentration process took place, which involved the shareholding companies: Bábolnai Poultry Co. and Hajdúsági Poultry Farming Co.). In 1998, Bábolna Rt. gave 20% of domestic poultry processing, while Hajdú-Bét Rt. accounted for 35% of it, and these two companies' joint export market share reached 60% (Kozák, 1999). The production of the poultry sector was characterized by a high degree of integration.

Considering the state of the sector, we can see that the crisis of the Russian market meant another shock. Its effects could be felt already from the summer of 1998, when 35 tonnes of stock accumulated at the poultry processors. In the meanwhile, some producers' output was still growing, which was due to the investment support scheme (promoting capacity increase of producers and processors). The situation was worsened by the sudden saturation of Hungary's EU export markets and the drop in prices resulting from that. In order to solve the situation, the economic policy reacted by drastically decreasing subsidies (both direct subsidies and investment aids) instead of encouraging producers to move towards reasonable and coordinated production cuts. All this led to a general crisis in the sector (Tömpe, 2000).

Accession to the European Union made the situation of the sector even more difficult. Namely, after the accession, the poultry sector, being a "lightly regulated" sector ('lightly regulated' sector: basic regulations exclude all forms of market intervention measures. The support of the sector is possible only by adapting the supply to the demand. Tools to be used in order to achieve this are measures facilitating better organisation of production, processing and marketing, measures aiming at

quality improvement, the preparation of short term and long term production prognoses; follow-up in market prices), lost sector specific national subsidies it had previously received, and the producers in the sector had access only to very limited forms of assistance, e.g. within the framework of support for young farmers or within the framework of central contribution to investments aiming at environmental protection and animal welfare (but not at increasing the actual production). Due to the European animal husbandry requirements (animal welfare measures) and the more stringent animal health standards domestic poultry meat production decreased.

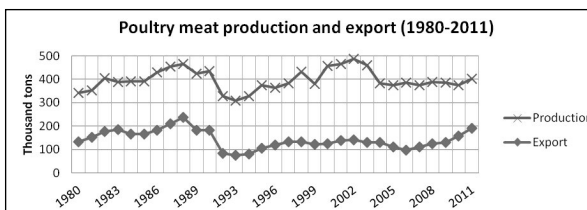
Popp (2007) compared changes induced by the accession to the EU to the ones of the transition period, because the state gradually withdrew from the support system, competition intensified for every participant of the product chain, cooperation among them was at a low level and they were slow to and unwilling to adapt to the market challenges. They were characterized by short-term survival strategies (instead of strategic cooperation), which was partly rooted in the mistrust among them. In addition, there was uncertainty on the market because of the extremely fluctuating prices.

Between 1999 and 2006 several significant participants of the poultry industry of the 1990s went bankrupt, one after another, including some integrated national company groups such as Carnex, Bábolna, Hajdú-Bét (Nyárs, 2008, Varga, 2007).

Misleading information about the bird flu epidemic in the autumn of 2005 deepened the poultry sector crisis in Hungary between 2006 and 2007, because there was a decrease in demand for poultry products due to the fear of consumers, and the purchase price was reduced, too. As a consequence, many farmers paused or stopped production. Processors had an opportunity to get rid of their unsalable

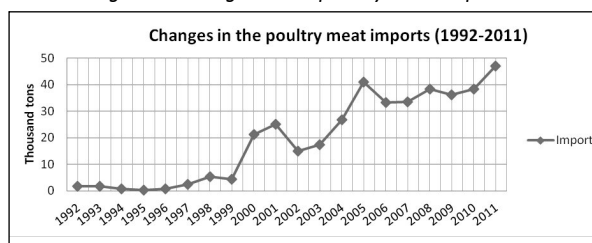
stocks only later and at low, depressed prices. The gap was filled up by importing cheap chicken meat from Brazil and Thailand. Because of precautionary animal health measures and the withdrawal of producers the poultry flock was reduced (Nyárs, 2008). Following this, poultry meat production experienced a stagnant period, while poultry meat export started to increase (Figure 1).

Figure 1: Poultry meat production and export



(Source: KSH [Hungarian Central Statistical Office] – carcass weight)

Figure 2: Changes in the poultry meat imports



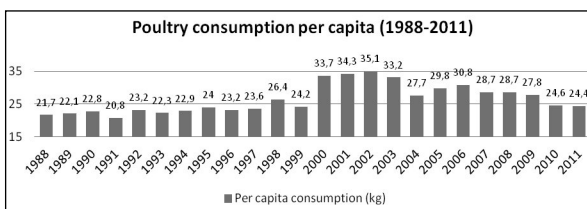
Source: KSH – carcass weight

The foreign market of Hungarian poultry products is rather concentrated, because since 1991 the vast majority of Hungarian poultry export has been going to the European Union. On the average of the period of 1991–1997, 70–80% of total exports were absorbed by EU countries, among which the most important ones were Germany, France, Austria and Switzerland (Orbán, 1997; Kozák, 1999). Even today (2012) the vast majority (81%) of our poultry meat export goes to the markets of EU-27 member states (source: KSH). Our most important importers are Germany, Austria, Romania, France, Slovakia and Ukraine.

Until 2000 the volume of imports was not significant in the poultry sector (Figure 2). But when domestic production fell back due to the Russian crisis, increasing domestic demand (Figure 3) was satisfied through imports, so the volume of imports surged. Due to the increase in domestic consumption (Figure 3) imports of poultry meat kept on rising also after the accession to the EU, and it has been on the increase ever since. By 2011, import share in consumption had almost reached 20%, compared with former 10–15% (Source: KSH, Az élelmiszerfogyasztás alakulása 2011, Statisztikai Tükör, vol. VI. issue 42. 2013.).

Between 2006 and 2011, the situation became even more difficult as a result of a significant increase in the feed and energy prices (the average increase of feed prices per

Figure 3: Changes in Hungarian poultry consumption per capita



Source: KSH

annum for chicken feed was 13%, while the price of electricity, natural gas and diesel oil went up by 22%, 99% and 50% respectively). Increasing purchase prices could only partially compensate the sector for such increase in expenses. Thus, the revenue position of poultry producers became worse. The profitability of processing decreased as a result of the increase in purchasing prices and stagnation in transportation prices. Raising the rate of VAT decreased the domestic consumption because of an increase in consumer prices and strengthened the black economy, which grew from 15–25% to 35% in the sector, based on the estimation of the Hungarian Poultry Product Council (BTT). In 2012, the drought further worsened the situation by increasing mortality, decreasing weight gain and there came a further increase in feed prices due to the heat (Aliczki, 2012).
 Overviewing the history of the poultry sector

amount of the 1980s. However, it is a positive development that duck and turkey flocks have more than doubled in amount compared to the average amount of the 1980s. The waterfowl product chain has proved to be more efficient, because here vertical integration has been successfully implemented with involving foreign capital (Popp, 2009).

In 2012, the Hungarian domestic poultry sector accounted for 3.83% of poultry meat production and 2.82% of broiler production in the EU-27 (Source: AVEC 2013 Annual Report). There has been a slight growth compared to the previous two years and hopefully this tendency will remain or even improve as a result of the implementation of the proposed industrial strategy measures in the sector.

The challenges of the poultry sector and possible solutions

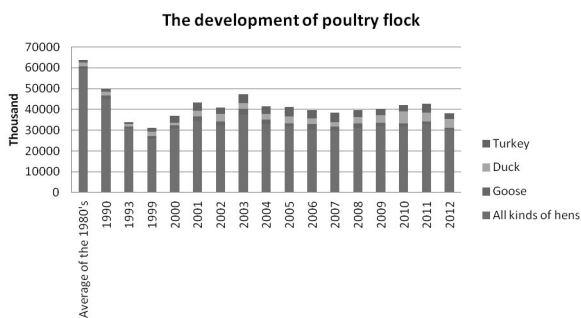
According to Nábrádi and Szöllösi (2008) the greatest challenge the poultry sector has to

face is the deterioration of its international competitiveness due to the increased domestic and international market vulnerability of the sector and some objective competitive disadvantages such as technological backwardness, the lack of industrial strategy, low profitability, the lack of up-to-date know-how.

It is also a problem that the integration of the poultry industry in Hungary has not reached the level of Western

Europe – 50% percent of the total broiler flock is produced in establishments with livestock of fewer than 50 000 animals (source: KSH-ÁMÖ [General Agricultural Census] 2010). However, production shows a greater extent of concentration (Aliczki, 2012). The lack of integration contributes to the growth of

Figure 4: The development of poultry flock



Source: KSH

we could see that although it was one of the success sectors of Hungarian animal husbandry in the 1980s, by now its position has become critical. As a result, the amount of livestock has decreased significantly (Figure 4) – by today the number of gallinaceous poultry has decreased by almost half compared to the average

market vulnerability through a low level of organisation and concentration. As the broilers distributed in Hungary are world-class some more appropriate technological equipment should be used to ensure their economic and competitive production. However, it could only be used economically in a large amount of livestock. Technological backwardness and small livestock sizes are also responsible for low natural efficiency indicators (Table 1).

to the seven-year development strategy developed by the Hungarian Poultry Product Council, 315 billion HUF should be invested in the sector over the period from 2014 to 2020, so that poultry market participants were able to improve their positions to a greater extent and Hungary was able to reach the first place in European poultry export per capita. The strategy should also reduce the increasing import rates.

Table 1: Comparison of the natural efficiency of broiler production

Natural efficiency indicators	EMSLAND (Germany) broiler integration average in 2012	Hungarian average in 2012
Mortality (%)	3.01	4.40
Average weight (kg)	2.43	2.35
Specific net feed consumption (kg/kg)	1.61	1.88
Average slaughter day	39.20	41.30
Average daily weight gain (g/day)	62.09	58.00

Source: BTT ágazati stratégiája 2014-2020 [Industrial Strategy of the Hungarian Poultry Product Council (BTT) form 2014 to 2020]

The production costs related to broiler production are high in Hungary, because the costs of protein sources, energy and labour are higher here than, e.g. in Brazil or in the USA. Due to the European Union there are stricter animal health and environmental requirements. Basic material production is also hindered by the fact that crop production and animal husbandry have separated and most farms do not own any cropland and cannot produce the necessary amount of feed. The disposal of manure is also a problem. Given the geographical situation of Hungary poultry meat export is more costly due to transport costs (Nyárs, 2008, Nábrádi-Szőllősi, 2008). The low level of interest advocacy in the sector is also a barrier to competitiveness (Nábrádi-Szőllősi, 2008, Aliczki, 2012).

Having gained an overview of the challenges of the sector, we can agree that it was time to develop an industrial strategy. According

Basic conditions of the strategy include a radical cut in VAT for meat and poultry industry products to 5%. This would contribute to an increased domestic demand of the sector's products and reduce the proportion of the existing black and grey economy that is a barrier to the concentration processes.

All this would improve competitiveness in the poultry sector. Another pillar of the strategy is raising animal welfare subsidies for poultry to 10 billion HUF and strengthening integrations in the sector. This is because the primary objective of the investment programme is to modernize commodity production (to reconstruct facilities and develop animal husbandry technologies) mainly in enterprises with an integration background. The establishment of a national export company with voluntary membership is also being considered as an option.

CONCLUSIONS AND SUMMARY

To sum up, the industrial strategy focuses on supporting integration and it is a very timely approach as integration is fundamental to a competitive and effectively operating economy. Supporting integrations should play a more important role as the development of vertical integrations would be essential to improve competitiveness, increase efficiency and the value add (Udovecz, Popp, Potori, 2009).

The industrial strategy is in line with the objectives of CAP 2014–2020 and the Hungarian National Rural Strategy. CAP 2014–2020 objectives also include support for horizontal and vertical cooperation (e.g. shortening the supply chain, developing new products and technologies) as long as they are included in the rural development programme of a Member State. In the current agricultural strategy vertical forms of integration covering the whole product path are encouraged in the framework of the association-development programme aiming at providing incentives for establishing and operating cooperative societies. Objectives include encouraging the cooperation of associations and forms of integration, supporting the establishment of secondary and tertiary cooperative societies and associative networks and the development of a bottom-up national cooperation system (Hungarian National Rural Strategy 2012–2020). However, the Ignác Darányi Plan (framework program for the implementation of the Hungarian National Strategy) fails to give

further details on the implementation method of the strategic objectives outlined in the Hungarian National Rural Strategy.

Encouraging vertical forms of integration is also an element of one of the preferential agricultural credit programmes, the Agricultural Working Capital Loan Programme of the Hungarian Development Bank (MFB). The programme was launched in May 2011 with a budget of 15 billion HUF and it aims at improving the competitiveness of agricultural production, particularly animal husbandry. The credit program benefits enterprises (individual enterprises, companies, cooperative societies, European public limited-liability companies, primary agricultural producers) that have their agricultural establishments on the territory of Hungary and pursue activities as integrators in the agricultural, fish-breeding, poultry, rabbit, cattle or pig sectors (www.mfb.hu).

It is definitely a positive development that finally an industrial strategy has been developed to address the challenges of the poultry sector. However, it could have taken place earlier. The situation of the sector could definitely be improved by implementing the strategic concepts, as the modernisation of facilities and technology and enhancing integration processes are all current problems. The Hungarian poultry sector can only benefit from the favourable economic situation forecast by the USDA for the period of 2011–2010 if the actions of the industrial strategy are reasonably implemented and the focus is put on the support of vertical integration processes.

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