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THE CHANGES IN THE ROLE OF PUBLIC WAREHOUSES IN HUNGARY

ZMIANY W ROLI PUBLICZNYCH MAGAZYNÓW NA WĘGRZECH

Key words: agriculture, finance, intervention, regulation, warehouses

Słowa kluczowe: rolnictwo, finanse, interwencja, regulacje, magazyny

Abstract. The role and significance of conventional loans secured by warehouse receipts is expected to stay unchanged due to the wider range of goods entering the scheme, which could balance negative outcomes.

Introduction

The greatest problem in financing agriculture is the seasonal variation of expenses and incomes: they fluctuate unevenly and sometimes unexpectedly during the year. External sources are often necessary to coordinate input and output. Financing is further complicated by the fact that due to the peculiarities of agriculture, high risks are involved; therefore, the usual means of financing widespread in other branches of economy cannot be applied here. These were the main reasons for setting up public warehouses and related financing schemes: the stored produce, and not the producer, serves as security for the loan.

As it is public interest to provide an acceptable level of income for agricultural producers, agrarian finance is always one of the central topics for governments.

Accession to the European Union meant significant changes in financing Hungarian agriculture, as since May 1, 2004, Hungary has been bound by the regulations of EU agricultural policies. How will accession affect the activities of public warehouses?

Materials and methods

The market of public warehouses

After the political and economic changes in the early 1990s, confidence was shaken in public warehouses. On one hand, several of the warehouses on the market did not have sufficient funds to pursue this activity; on the other hand, the relevant regulations were not immediately modified in the changing economic and legal context. In 1994, the activities of public warehouses were regulated by directives; in 1996, the Public Warehouses Act came into effect. The legal framework resulted in the stabilisation of public warehouses in the changed economic conditions; it also convinced producers of the safety of the scheme.

Owing to the legal framework, the market was also transformed: not all warehouses were able to meet the stricter requirements, and the smaller number of competitors had greater impact on shaping prices and finances. Risks also decreased as a result of the establishment of the relevant legal framework; as a result, more favourable loan schemes appeared, thus improving the situation of producers relying on public warehouses.

Public warehouses were first established to ease the financial difficulties in agriculture; however, the scheme is becoming more and more widespread in industry as well. At present, industry has a 30% share: the figure is expected to rise as both banks and warehouses are interested in involving industrial producers because of the smaller risk and less seasonal fluctuation. Overall increase is expected to be of greater value than increase in market volume, given the higher prices of industrial products.

Wheat, corn and wine are the most important agricultural products in warehouses. Among industrial products, food industry has the largest share: stocks are usually larger in order to deal with the fluctuations in production and market prices. [Halmosi 2001a]

Financing agriculture in the European Union

The EU Common Agricultural Policy (CAP) provides the economic and legal framework for Hungarian agriculture after the accession. Adapting to the new regulations is difficult enough in itself for the producers; in addition, the CAP 2003 reforms posed extra difficulties. Currently, Hungary is in a transitory period characterised by the coexistence of previous and future regulations, which results in a complicated system. The figure 1 demonstrates the complexity of the situation in recent years and the plans for the near future.

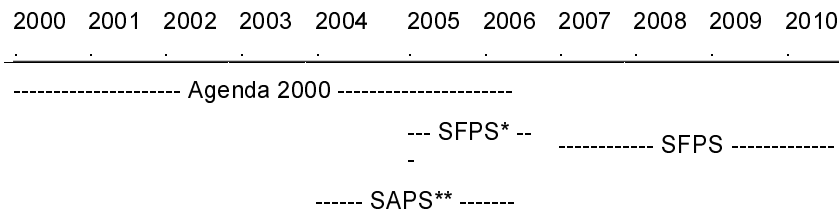


Figure 1. Financing agriculture in EU

* Single Farm Payment Scheme – a transitory period of introduction with modified regulations

** Simplified Agricultural Payment Scheme – for new EU members.

Source: own study.

As part of the 2003 CAP reforms, the Single Farm Payment Scheme (SFPS) was drawn up, which is going to be introduced from January 1 2005. All EU members are expected to adopt the scheme by January 1, 2007. In the transitory period, member countries can choose freely between the previous and the new framework. New members were not provided with options: they must use the Simplified Agricultural Payment Scheme (SAPS), as regulated by the accession treaty, until 2006, and change to SFPS from then onwards.

In order to clarify the system, the difficulties that triggered reforms and the solutions proposed by CAP need to be discussed.

The main issue of the reforms is naturally the much-debated system of direct subsidies, as 45% of the EU-15 budget was taken up by CAP [Borszéki 2003].

The past: Agenda 2000 (Standard system)

This framework put emphasis on direct income subsidies based on base area and reference yield instead of the previous costly price subsidies [Popp et al. 2004].

The definition of base area serves as the limitation of the subsidies: sanctions apply if it is exceeded. Concrete sums are calculated based on reference yield (average yield of previous years). Land recreation periods are also mandatory: the EU decides yearly on the extent of lands to be withdrawn from cultivation, observing resources, stocks and consumption. Lands out of use are also entitled to receive direct subsidies.

As a result of Agenda 2000 and the direct product subsidies, overproduction occurred: as market mechanisms were blocked, prices did not decrease parallel with the increased supply, contributing to a tense atmosphere in the market. Increased production demanded even greater state intervention, which also involved increased costs in the form of storage and export subsidies. As a result of low prices in the world market, the EU export subsidies caused considerable tension.

The following reasons indicated the need for change [Popp et al 2004]:

1. EU internal reasons:

- overproduction, the resulting high export subsidies necessary for sale,
- increased demand from consumers in the field of quality, safety and environment protection,
- EU enlargement in 2004 (10 new members),
- market-oriented production.

2. Outside factors:

- WTO agreements in Uruguay and Doha,
- the 2002 Farm Security and Rural Investment Act in the USA.

The future: Single Farm Payment Scheme (SFPS)

The main aim of the modification in the support scheme is to make the amount of direct subsidies independent from actual production. Additional aims include better adaptation to market conditions and enhancing the role of rural development. [Halmosi 2001b]

Instead of production, the producer is going to be in the focus of subsidies; as a result, it is expected that the producer can adapt to the market in the following questions: What to produce? How much to produce? How to produce?

Expected benefits include the decrease of overproduction and better adaptation to market demand.

However, SFPS is not entirely independent of production, as on one hand, some of the product-specific subsidies will continue; and on the other hand, part of the subsidies may be received according to the rules and regulations of the Standard system owing to taking the advantages of derogation possibilities. In these cases, limitations also apply: there will be a maximum sum of subsidies available for certain purposes; in addition, subsidies in the Standard system will be deducted from the SFPS payments. A new requirement for subsidies is that producers must keep agricultural lands in appropriate condition at all times.

CAP market regulation in Hungary

The steps taken as part of CAP market regulation can be divided into four categories: (1) direct producer subsidies, (2) intervention, (3) internal market regulation, (4) external market regulation. The overall trend is to decrease the role of intervention and develop direct producer subsidies. Below is a summary of the most important changes.

Area-based subsidies

Among direct producer subsidies, this system, extending to almost all agricultural producers, has undergone the most significant changes. Subsidies can be applied for if area does not exceed a certain size, which varies across member countries. If the total sum of applications exceeds the base area, which is 3 487 792 hectares in Hungary, all applicants are entitled to proportionally decreased subsidy. Subsidies are calculated for area, at 63.00 EUR per reference yield. Only 25% of this subsidy is paid in 2004. The annual increase is 5% until 2008 and 10% from 2008. Thus, 100% subsidies will only be paid entirely by the EU from 2013 onwards. However, member countries can amend EU subsidies from the national budget, which could amount to a further 30%.

Payments are due between 16. November and 31. March. As this coincides with the intervention period and most of the autumn work has been completed by this time, it is unfavourable for producers from the point of view of liquidity if they are unable to sell their produce over the intervention price but before the intervention period.

Another problem is the risk involved in exchange rates: subsidies are determined in euros, but their current value in national currency cannot always be predicted.

Subsidies based on land area can be supplemented by further subsidies based on production; payment is done simultaneously.

Intervention

Intervention is open for all producers in the market: if they are unable to sell their own produce, they are entitled to offer it to the state from 1. November at 101.31 EUR intervention price. The period lasts until 31. May in the following year, during which price increases by 0.46 EUR per ton every month in order to compensate for storage costs. Therefore, intervention has become independent from fluctuations in market prices.

Another significant change is that intervention offers do not have to be made in advance, they may be done at any time during the period with the help of the relevant forms at the office in charge, and applications are answered within five days. Afterwards, the producer determines the timing of transportation, which the office coordinates with the warehouse. Payment is due within 30-35 days after delivery. The intervention price on the first day of delivery applies.

Table 1. The financing of public warehouses

	Conventional loan secured by warehouse receipt	Intervention loan secured by warehouse receipt	Mortgage
Fund provided by	bank	bank	public warehouse
Procedure	fast-track	fast-track	fast-track
Duration	before expiration of contract with warehouse	intervention period	before expiration of contract with warehouse
Sum of loan in ratio of value of produce serving as security	60-75%	100%	66%
Advantages, disadvantages		+ lower risk – risk of exchange rate modification – high quantity limitation	+ lower quantity limitation

Source: own study.

Results

The current situation favours the warehouses: producers are predicted to sell their produce later on in the period because of the higher price; however, this means that external finances are needed in order to ensure liquidity at least until November. External finances are promoted by the existence of public warehouses, as they provide guarantees in the form of warehouse receipts. In case the debtor does not pay the instalments, the bank confiscates the produce, and sells it to the state at a fixed price. The lower risks are reflected in the lower interest rates on loans covered by warehouse receipts, which is favourable for the producers as well, although the cost of storage is unchanged.

It is a further incentive for the producers that quality is also rewarded with premiums and additional discounts.

The most significant change is the appearance of intervention loans, which can be applied for in the possession of produce covered by the intervention regulations. This framework involves the lowest risk; as a result, interest rates are lower and loans amount to a higher proportion of the value of deposited produce. Despite the spread of this scheme, conventional loans are not expected to decrease in significance, as the range of goods in public warehouses is increasing. On the other hand, however, mortgages are losing ground, since such activities by warehouses are limited by national laws (maximum amount of loan) and EU regulations also had a negative impact (abolition of interest subsidies); thus decreasing their competitiveness.

Discussion

Accession to the EU and the changed system of subsidies provides more favourable conditions for agricultural producers, but public warehouses also continue to play an important role in ensuring their continuous liquidity. Warehouses are expected to gain significance, partly because banks are introducing intervention loans as a new type of financing scheme, and partly because the increased market share of warehouses (with the introduction of new products) means the appearance of new potential applicants for loans.

Given the present regulations, the share of intervention loans is expected to increase among all the loans secured by warehouse receipts, but their future largely depends on intervention regulations. As the EU intends to decrease intervention prices, the number of loans related to the scheme is expected to drop.

The role and significance of conventional loans secured by warehouse receipts is expected to stay unchanged due to the wider range of goods entering the scheme, which could balance negative outcomes.

Based on the less favourable market conditions, mortgages would be expected to lose ground; however, as they require the smallest minimum value of produce or goods as security, they are predicted to continue.

The only chance for smallholders to have access to the most favourable bank or intervention loans would be joint entry to the market, but their traditional resistance and lack of trust mean that such cooperation is not likely.

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Streszczenie

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