Agriculture in Hungary

WHEN THE WORLD BANK APPROVED A $70 million loan in 1988 to help Hungary boost agricultural exports, Hungarian economy was expected to gradually become more liberal and open. But just two years after the start of the project, Hungary was swept by a “velvet revolution,” which radically transformed the economy. In response to the new conditions, the government and the Bank changed the loan’s objectives from supporting exports and providing term and working capital to new firms. Support for agroexporting institutions, however, continued.

The project was successful and provided a useful lesson for institutional development, according to an OED audit.* It showed that helping institutions not closely connected to a project can make the difference between success and failure. Some of the lessons from Hungary may be applied to agrarian economies, such as those in Sub-Saharan Africa.

A Shift in Focus
Most Bank loans operate on the assumption that the policies and institutional framework of a country will not change drastically while a project is being carried out. In this respect, the Bank-funded Agroprocessing Modernization Project in Hungary stands out as an exception. Approved in 1988, the project aimed to increase exports of processed agricultural products, mostly to countries of the former Soviet Union. At the time, the Hungarian economy was expected to gradually move toward market-oriented reforms.

The loan was intended to provide a US $60 million line of credit to commercial banks, which would grant subloans to exporting firms for improving product quality, management, and marketing. The remaining $10 million was earmarked for technical support to state institutions involved in agroexporting.

With the collapse of communism, the new government in 1990 launched a radical program of economic liberaliza-
tion. It privatized state-owned assets, liberalized foreign trade and prices, reduced subsidies, and removed legal restrictions to hiring and firing workers. As a result, the loan that had begun as an effort to reshape parastatal processing firms to allow increased exports and higher value added found itself responding to drastically changed circumstances. At the same time, Hungary’s export markets were rapidly disappearing.

Revised Sublending Objectives
In response, the government gradually (but radically) changed the loan’s objectives with five amendments approved between June 1989 and September 1993. Two of these effectively removed export assistance as a necessary condition for receiving subloans. Though the loan’s overriding objective of supporting exports was never formally revised, the amendments allowed banks to make subloans to private firms whose activities had nothing to do with exporting. The project became one with multiple objectives. Project funds were used to help the conversion of public enterprises into private firms and to provide term and working capital—both in short supply at the time—to new firms.

Results
The implicit new objectives were largely achieved. Over 80 percent of the 103 subloans are up-to-date on their debt service and about two-thirds of the borrowing firms are profitable.

Between 1989 and 1993 agricultural production fell by one-third and the number of people employed in agriculture was halved. However, production increased slightly from 1993 to 1996, and the food-crop yield index rose sharply from 68 to 89 (from a baseline index of 100 in 1986-90).

Institutional Development
Development activities, which aimed to eliminate information gaps in export markets, technology transfer, quality control, food industry research, and managerial and technical education in agroindustry were carried out as planned. The loan helped Hungary develop institutions that facilitate agroexporting. The early push in sublending has yielded increased exports, and many of the investments financed by the loan would not otherwise have had adequate economic rates of return.

Education and research. Training for enterprise managers was successful. Covering management, marketing, and inventory control issues, the courses continued through 1993. The project funded participation in conferences and study tours on food chemistry, agronomy, plant breeding and related disciplines; higher degrees for teachers responsible for management and engineering education; laboratory equipment; library materials; and pilots to test food-processing techniques.

Market information. The Food Quality Information Center was created to collect information on food quality regulations and legislation in Hungary and in the countries of the Organization for Economic Cooperation and Development (OECD). The center maintains a data bank, produces publications, and provides assistance to exporters. A planned “agromarketing office” intended to provide information on market opportunities and certify product quality, however, never materialized.

Quality control. The project increased the effectiveness of the National Food Inspection Institute. It funded a review of safety and quality standards, and of training and equipment to modernize quality-control laboratories. As a result, confidence in the standards of Hungarian food products has increased considerably among OECD and other importers.

Technology transfer. The project financed a study to improve the glass container industry, which at the time had four plants operating as a single state enterprise that produced high-cost and low-quality containers. Since privatizing, the industry used the study to invest in new production techniques. The project also financed a demonstration dairy goat farm.

Results. Partly as a result of this institutional buildup, agricultural exports rose 47 percent between 1993 and 1996, from $1.9 billion to $2.8 billion. This growth was a dramatic exception to the general contraction in the agricultural sector during the period.

A Lesson for Institutional Development
In designing agricultural projects, the Bank now routinely considers three factors: government commitment to a project, stakeholder participation, and the impact on the macroeconomic framework. More recently, however, there has been a growing awareness that institutions not obviously or closely connected to a project may make the difference between success and failure.

The agroindustrial project in Hungary took a broader perspective than most Bank operations in its approach to institutional development. The Bank supported a wide range of institutions to foster agroindustrial exporting. This allowed it to successfully address key institutional shortcomings—market intelligence, technology transfer, quality control, and managerial and technical education.
In agrarian economies, such as those of Sub-Saharan Africa and parts of the former Soviet Union, rapid expansion of agroindustrial exports is often feasible. For these economies, an approach similar to that of the project in Hungary appears worth considering when tackling institutional constraints.