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THE NATIONAL LAND FUND



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I. INTRODUCTION

Historical background

Hungary has favourable geographical location for agriculture within the Carpathian Basin. The Hungarian agriculture has good growing conditions taking the soil quality, climate and terrain into consideration. The Hungarian agriculture has been always in focus of politically charged issues, especially as land ownership and structure of farming are concerned. Ownership and use of land went through dramatic changes in the second half of last century.

Before the end of World War II. the number of land properties exceeded 1 million in Hungary with large, medium and small scale farming patterns. Land reform of the period of 1945-1948 led to more small scale farming plots by the claims of individual farmers for land and the state farm sector emerged on the basis of confiscated large scale farms in the country.

Individual farmers were forced by the socialist regime to establish co-operative farms after 1948, and the so called second land reform had been completed by 1962. Ninety percent of the total agricultural land became covered by large scale co-operative and state farms by that time.

Recent land reform has started in the beginning of the last decade, after the change of political system. Due to the introduction of Compensation Act in 1992, at least 50 % of the country's total area was involved in the compensation process associated with the privatisation of land, cooperative farms, and the majority of state farms. Structure of land ownership and land use developed inadequately, as the result of land compensation and privatisation.

Hungarian agriculture and its characteristics

The share of agricultural area from the total area is high in Hungary compared to other European countries and similar to Denmark. Its percentage exceeds 60 % of the total area.

Distribution of land area by land use categories (2002)

Table 1

| LAND USE CATEGORY (Type of cultivation) | AREA (1000 ha) | AREA (%) | STATE OWNED AREA (1000 ha) | STATE OWNED OF Σ AREA (%)* |
|--|-------------------|---------------|-------------------------------|--------------------------------------|
| Arable land | 4 516 | 48,54 | 280 | 6,20 |
| Garden | 98 | 1,05 | 0 | 0 |
| Orchard | 97 | 1,04 | 9 | 9,28 |
| Vineyard | 93 | 1,00 | 4 | 4,30 |
| Grassland | 1 063 | 11,43 | 233 | 21,92 |
| Agricultural land together | 5 867 | 63,06 | 526 | 8,96 |
| Forest | 1 772 | 19,05 | 1 026 | 57,90 |
| Reed | 60 | 0,65 | 19 | 31,66 |
| Fish-pond | 33 | 0,35 | 9 | 27,27 |
| Productive land together | 7 732 | 83,11 | 1 580 | 20,43 |
| Uncultivated land | 1 571 | 16,89 | 453 | 28,84 |
| Total area | 9 303 | 100,00 | 2 033 | 21,85 |

Source: KSH, FVM.

* by land use category.

Due the recent land reform, the dominancy of state owned land had been eliminated except the forest area, vast majority of productive land now is in private ownership and cultivated by private entrepreneurs (farmers) corporate farms (companies) and co-operatives.

Privatisation of the Hungarian agriculture has been progress along land compensation since 1992, based on the two main pillars of land compensation and privatisation of state farms. Land compensation started in 1992 with the goal of partial restitution of agricultural land. First stage of state farm privatisation started by the transition of these large scale farms into business associations (companies limited by shares or limited liability companies) in the period of 1992-1996. Shares and business quotas of the companies have been sold without the agricultural land in the second stage. Privatised companies signed land leasing contracts with the Hungarian State for the right of further use of land.

Distribution of land use by type of agricultural holdings (2002)

Table 2

| Type of agricultural holding | 1996 (1000 ha) | 1996 (%) | 1997 (1000 ha) | 1998 (1000 ha) | 1999 (1000 ha) | 2000 (1000 ha) | 2001 (1000 ha) | 2002 (1000 ha) | 2002 (%) |
|------------------------------|-------------------|---------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|---------------|
| Companies | 2 615 | 28,11 | 2 538 | 2 410 | 2 620 | 2 560 | 2 785 | 3 040 | 32,68 |
| Co-operatives | 2 010 | 21,61 | 1 825 | 1 671 | 1 495 | 1 230 | 855 | 638 | 6,86 |
| Individual farmers | 4 192 | 45,06 | 4 627 | 4 745 | 4 689 | 3 983 | 4 196 | 4 339 | 46,64 |
| Other | 486 | 5,22 | 493 | 477 | 499 | 1 530 | 1 467 | 1 286 | 13,82 |
| Total area | 9 303 | 100,00 | 9 303 | 9303 | 9 303 | 9 303 | 9 303 | 9 303 | 100,00 |

Source: KSH, FVM.

Privatisation in agriculture generated wide range of diversity in legal status, size and ownership of agricultural holdings. There are nearly 1 million private holdings with the average size of 4,5 ha. Small holders - private farmers - cultivate 47 % of the total agricultural area, medium- and large scale corporate farms (companies and co-operative farms shares 40 percent of cultivation.

Large numbers of individual farmers do not have available land to earn appropriate income for profitable sustainable farming, as the result of inadequate distribution of land use by agricultural holdings.

**Number of individual farms by land size
(Thousand)**

Table 3

| Land size (ha) | 1991 (Thousand) | 1994 (Thousand) | 2000 (Thousand) |
|----------------|--------------------|--------------------|--------------------|
| 0 - < 0,2 | 645 | 458 | 374 |
| 0,2 - < 0,5 | 412 | 345 | 204 |
| 0,5 - < 1,0 | 200 | 152 | 99 |
| 1,0 - < 10,0 | 138 | 225 | 232 |
| 10,0 - < 100,0 | 1 | 22 | 49 |
| > 100,0 | 0 | 0 | 2 |
| Total | 1396 | 1202 | 960 |

Source: KSH, FVM.

Owners of small parcels of land have been leaving the business by land leasing or offering their land for sale on the market or directly to the Hungarian State for the National Land Fund.

Profitability of agricultural production in most of the farming enterprises are very low. The net income per hectare of agricultural are is one third of the EU average due to the low input efficiency, low level of subsidy, poor machinery and last but not least the unfavourable farm structure. Share of agricultural sector in the nation's economy decreased significantly .

**Share of agricultural sectors in the Hungarian economy
(Percentage of GDP)**

Table 4

| Sectors | 1991 (%) | 1995 (%) | 1996 (%) | 1997 (%) | 1998 (%) | 1999 (%) | 2000 (%) |
|-------------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Nation's total economy | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 |
| Agriculture | 7,50 | 5,90 | 5,50 | 4,90 | 4,60 | 3,90 | 3,4 |
| Food industry | 4,60 | 3,50 | 3,50 | 3,30 | 3,10 | 2,80 | 3,00 |
| Agriculture + food industry | 12,1 | 9,40 | 9,00 | 8,20 | 7,70 | 6,70 | 6,40 |
| Forestry | 0,30 | 0,30 | 0,30 | 0,30 | 0,30 | 0,30 | 0,30 |
| Total agriculture + forestry | 12,40 | 9,70 | 9,30 | 8,50 | 8,00 | 7,00 | 6,70 |

Source: KSH.

About 239 thousand people - 6 % of the total civilian employment - worked in the agricultural sector in 2001. Unemployment has increased in the countryside.

The value of agricultural production and share of GDP declined in the transition and privatisation process. Number of land owners increased while agricultural land went through fragmentation. Large scale fields had been split between old-new compensated landowners. Large number of them were not able to start or continue cultivating their land due to the lack of working capital and knowledge (or in many cases of will). Large scale privatised farms having own and borrowed financial sources started leasing the land from those who were not able to cultivate it.

II. NATIONAL LAND FUND

Purposes of establishing National Land Fund

Improved agricultural holdings, ensured fair and stable farm-income within the constrains of environmental issues are the preliminary conditions of running sustainable farming. The preliminary conditions can not be achieved without land consolidation, with the goal of creating chances for the Hungarian agricultural enterprises within the enlarged European Union.

Despite the fact that land consolidation is basic interest of both land owners and land users, it can not be carried out without the active involvement of the Hungarian State.

The Hungarian State owns nearly 9 % of the total agricultural area and almost 60 % of the total forest area (Table 1). Obviously these productive lands can not be dedicated entirely to land consolidation. Certain parts of the state owned agricultural land are protected nature conservation areas, or parts of forest areas where the long term interest represented by the Hungarian State is necessary to kept.

National Land Fund (NLF) was established in 2002 basically to provide agricultural land for voluntary land-swap with the goal of helping the development of appropriate ownership and farming structure for sustainable farming. NLF has support the improvement of farm structure in accordance with the rural development objectives of the country.

Therefore its essential purpose to promote establishing operational family farms and supporting qualified entrepreneurs to obtain land for farming.

NLF has the role to influence land prices and land leasing fees on the market

Other main purpose is the swap of land in flood areas and land located in the flood protected areas.

NLF includes the majority of state owned agricultural land and forest areas. Beside the above mentioned purposes, it has to ensure proper use of the state owned agricultural land by land leasing contracts, and has to establish supportive conditions for sustainable forest management.

Providing land for special goals like social purposes or education is also one of the reasons of establishing NLF.

The assets of National Land Fund

The National Land Fund (NLF) itself is part of the treasury assets and it is the sum total of agricultural and other productive land of constantly changing quantity and location owned by the Hungarian State.

Distribution of land area by land use categories (2002)

Table 5

| LAND USE CATEGORY (Type of cultivation) | TOTAL AREA (1000 ha) | STATE OWNED AREA (1000 ha) | AREA OF NLF (1000 ha) | NLF SHARE IN TOTAL AREA* (%) | NLF SHARE IN STATE OWN. AREA* (%) |
|--|-------------------------|-------------------------------|--------------------------|---------------------------------|--------------------------------------|
| Arable land | 4 516 | 280 | 275 | 6,09 | 98,21 |
| Garden | 98 | 0 | 0 | 0 | 0 |
| Orchard | 97 | 9 | 9 | 9,28 | 100,00 |
| Vineyard | 93 | 4 | 4 | 4,30 | 100,00 |
| Grassland | 1 063 | 233 | 73 | 6,87 | 31,33 |
| Agricultural land together | 5 867 | 526 | 361 | 6,15 | 68,63 |
| Forest | 1 772 | 1 026 | 653 | 36,85 | 63,65 |
| Reed | 60 | 19 | 3 | 5,00 | 15,79 |
| Fish-pond | 33 | 9 | 3 | 9,09 | 33,33 |
| Productive land together | 7 732 | 1 580 | 1 020 | 13,19 | 64,56 |
| Uncultivated land | 1 571 | 453 | 271 | 17,25 | 59,82 |
| Total area | 9 303 | 2 033 | 1 291 | 13,88 | 63,50 |

Source: FVM, NFA

* by land use category.

As an exception, land removed from cultivation but being used for agricultural purposes is also included. Land areas under nature conservation protection are not included, regardless of the land use category.

NLF involves nearly 70 % of the state owned agricultural land representing slightly more than 6 % of the total agricultural land area of Hungary. NLF has considerable share of forest area, about 37 % percent of the total. Majority of the stated owned productive land belongs to this part of the treasury assets managed by the National Land Fund Management Organization as property administrator on behalf of the Minister of Agriculture and Rural Development.

The rest of state owned land belong to other part of the treasury assets and managed by property administrators dedicated for purposes other than as of NLF, for example protection of nature conservation areas or defence purposes.

Institutional background

The owner's right in respect of NLF exercised on behalf of the Hungarian State by the Minister of Agriculture and Rural Development (Minister) through property administrator.

Hungarian National Land Fund Public Benefit Company (Company) had been establish by the Minister on 1st of January 2002 with business quotas exclusively owned the Hungarian state and constituted as part of the treasures assets as well. The Company started to develop the managerial and property administration frame work of NLF in accordance with the relevant laws. It worked until 31st of July 2002. After the general election held in April of 2002, the new Government decided on the Company's closing settlements with final accounting.

The National Land Fund Management Organization (NLFMO) was established on 1st of August 2002 as the new property administrator and partial legal successor of the Company. NLFMO took over the land assets of NLF and the property administrator's duty, based on the amendment of relevant law.

NLFMO is an independent budgetary institution operating under the Minister's supervision and managed by the President. The President of NLFMO is appointed and can be dismissed by the President of the Republic.

Activities of NLFMO are monitored by the Controlling Committee, its members can be appointed and dismissed by the Parliament's Agricultural Committee.

Local land assets utilisation committees can be formed in any settlements having land of NLF located within the settlements boundaries. The local land assets utilisation committee shall be involved with the right to comment in the evaluation of public tenders announced by NLFMO for leasing or sale of land belonging to NLF.

About 150 persons are employed by NLFMO as civil servants, but the organization itself is not an authority and it can not be taken as part of the public management with regards of its legal status. NLFMO organised into a Central Office and nine-teen local offices in each county. NFLMO performs the tasks arising locally with the

participation of the county (metropolitan) agricultural offices and the area land registry offices.

Financial requirements

As a budgetary institution, NLFMO is financed mainly from the state budget, but earns its own revenues from land leasing fees, sales of land and other contracts related to the land assets of NLF (e.g. easement, way-leave etc.).

The treasury land assets included by NLF and handed over to NLFMO for property administration, as well as revenues and expenditures related to the utilisation of this property has to be separated from the revenues and expenditures related to the own institutional assets of NLFMO.

Legal background

Due to the distinction between NLF as land assets of the treasury and the NLFMO as the property administrator, general laws and regulations had to be amended and new laws came into force during the last two years.

Specific legal background

Act CXVI of 2001 on National Land Fund (amended in August, 2002 by Act XXIV.) defines the legal framework of setting up NLF and establishing the institutional background. The Act sets the purpose of land assets included in NLF, and main rules of utilisation of the land-assets by sale, swap, or leasing.

Decree 254/2002 (XII.13.) of the Government on detailed regulations of registration, management and utilisation of National Land Fund's assets sets detailed rules of registration and valuation of land-assets. Regulates the utilisation (sale, tenure, swap) of land-assets in details and defines assessment methods of land-value for transactions.

Resolution No. 48/2002 (VII.19.) OGY of the Parliament on Land Policy Guidelines actually is not a law *◆▼ declares the most important land policy objectives of the country Provides fundamentals of land assets management and utilisation carried out by NLF.

Decree 255/2002. (XII.13.) of the Government on the purchase of cultivated land by State for life annuity. Particular regulation setting rules of purchasing lands for NLF from elderly people against paying life annuity.

General legal background

Act IV. of 1959 on Civil Code contains the basic rules of contracting, acquisition of ownership and tenure.

Act LV. of 1994 on Arable Land define the rules of acquisition land-ownership and land tenure, sets the pre-emptive rights of purchasing land and land-tenure, rules of utilisation and protection of agricultural land.

Decree 16/2002. (II.18.) of the Government on detailed rules of pre-emptive rights in regards of purchasing land and land-tenure. Adoption of this law aims to avoid land-purchase and land-tenure contracts unfavourable with regards to the land policy objectives of the country and to help tenants, local farmers having propriety rights on neighbouring land, local dwellers and NLF obtaining land.

III. LAND BANKING SCHEME OF NLFMO

It has been described that first of all NLFMO is in charge of handling NLF as the property administrator and it is not an authority (can not be considered as part of the public administration), therefore its land banking scheme fundamentally can be based on market instruments (purchase, sale, swap, leasing) used within the constraints of the relevant laws.

Basically NLFMO can not be taken as a land bank, because one of its main purpose is to be the property administrator of NLF.

Unfortunately, the land assets of NLF currently has no “liquidity”, since property administrators as legal predecessors handed over the land assets to NLFMO, since they had to utilise the land by land leasing contracts in accordance with the relevant law.

Almost 100 percent of the land included by NLF is under cultivation within the frame of fixed duration land leasing contracts. The first contracts will be expired in the second half of the decade around 2007-2008. It means, that NLFMO first of all needs to purchase land to improve the “liquidity” of NLF.

For this reasons, NLFMO has started to purchase agricultural land and forests against life annuity from people above 60 years of age. On the other hand, it is not an early retirement scheme, because there are not farmers on the selling side.

Utilisation of land assets

The ways of utilisation of land assets are defined by Act CXVI of 2001 on National Land Fund and Decree 254/2002 (XII.13.) of the Government on detailed regulations of registration, management and utilisation of National Land Fund’s assets.

NLFMO utilise the land assets by sale or lease within the frame of public tender process. Preference shall be given to persons eligible by force of Resolution No. 48/2002 (VII.19.) OGY of the Parliament on Land Policy Guidelines.

Based on the Land policy Guidelines, NLFMO has to take into consideration the main land assets policy objectives within the tenders as follows among others:

- to stabilize the situation and promote the development of land users in general;
- to establish and strength family farms;

- to promote environmentally friendly agricultural production in support of sustainable development;
- to promote the establishment of rational land property and lease structure;
- to facilitate the acquisition of land in support of livestock farming;
- to help the development of family or mid-sized corporate farming with upper limit of 300 ha of land used;
- to develop land parcel sizes eligible for EU subsidies;
- to provide preferential support for start-up farmers and qualified entrepreneurs with professional skills in agriculture or forestry.

The first public tenders for land leasing contract has been recently opened.

NLFMO can initiate land swap or can enter into agreement of ownership transfer with landowners. Land swapping transactions must ensure land consolidation, provide land for livestock farming or implement important objectives of public interest (e. g. flood prevention).

Utilisation activities (land leasing, sale of land, land swapping) have to be based on the land assets utilisation plan of NLFMO.

The contracts and agreements are subject of the Civil Code, there are not special rights assigned for NLFMO as the owner of the land on behalf of the Hungarian State. Pre-emptive rights of purchasing or leasing land have to be taken into consideration before the conclusion of contracts.

Local land assets utilisation committee has the right to make comment on the applications submitted before the decision making process of the tender.

IV. POTENTIALS, CONSTRAINTS

The NLFMO has just recently started its activity on the Hungarian land market with the announcement of purchasing land against life annuity and opening tenders for leasing state owned agricultural land, which has not been cultivated due to the bankruptcy of the former lessee.

Based on the high number of sale and leasing offers received, it can be projected that NLFMO has the potential to be significant on the land market in the country. NLF includes not more than 6,19 % of the agricultural land, but this size of land assets are large enough to be used as a land bank for land consolidation purposes.

This potential can be used, if constrains of the NLFMO operation can be reduced to the level of limitation implemented to ensure reliable use of the land assets of NLF, with the goals set in the Land Policy Guidelines. Achievements can be improved with the development of the following areas and constraints of operation:

- improvement of the “liquidity” of the land assets by purchasing and swapping agricultural land appropriate for the purpose of the NLF;
- improvement of the organization structure of NLFMO for being able to respond immediately both on the land market and within the frame of the

- existing land leasing contracts (e.g. approvals issued by NLFMO as landowner, etc.);
- improvement of the co-operation between the functional units of NLFMO and the government offices;
 - improvement of the market instruments used to achieve the goals and purposes of NLF;
 - obtaining higher level of pre-emption rights in purchasing land for NLF.

V. CO-OPERATION WITH COMMERCIAL BANKS

Both small- and large-scale farming enterprises are facing the lack of working capital in Hungary. Recently founded new bank institutions has started their operation on the market of mortgage secured credit-line facilities.

Act LV. of 1994 on Arable Land prohibits legal entities to own agricultural land, therefore large scale corporate farms are not able to access loans secured with mortgage registered on land.

On the other hand, individual farmers cultivate nearly 47 % of agricultural land and they are allowed to own the land up to 300 ha or 6000 Golden Crown (the official measure expressing the value of land reflecting its quality and type of cultivation). They are able to access mortgage loan facilities as much as their land accepted by the bank for security.

Banks are legal entities and can not own agricultural land in Hungary, even they can not keep the land against the debts. NLFMO has signed contracts of co-operation aiming this segment of the land market with commercial banks. The co-operation is based on the mutual interest of the farmer, the bank and the NLFMO.

In case of bankruptcy of the farmer, the bank receives a purchase offer from NLFMO. The bank agreed with NLFMO on the purchase price before the loan-contract signed with the farmer. If there is not anyone having higher level of pre-emptive rights, the bank sells the land on behalf of the farmer (based on the loan-contract) to NLFMO and the land will be included by NLF. In case of higher pre-emptive right present, the land can be bought by that person strictly at the price offered by NLFMO. In both cases sales revenue is used to pay the debts.

NLFMO and the commercial banks involved in the co-operation inform each other regularly on the amount of loans issued and the debts expectedly recovered this way.

VI. CAP REFORM OF THE EUROPEAN UNION

Hungary will become member of the EU on 1st of May 2004. The membership to the EU probably will not have immediate dramatic influence on the land market of Hungary, due to the derogation agreed on opening the land market for foreigners.

However, the on going reform of CAP will affect the existing land leasing contracts signed for the use of state owned agricultural land. The so called decoupling of subsidies from the commodity production to the pillar of rural development and agri-

environment schemes will force the tenants to change their cultivation methods and set aside a certain part of land they use. As a consequence, there will be a need to adjust the existing land leasing contracts to the new conditions.

There are concerns, and unfortunately it is not seen yet, when the decoupling of the subsidies will start (there are several options), what situation will be faced with regards of the reference period, or in case of partial decoupling.

VII. MEDIUM AND LONG TERM PERSPECTIVES

As it has been explained, NLFMO as the property administrator of the state owned land assets of NLF started its operation in 2002. Within the circumstances of setting the organization up and the current status of the land assets involved, the following perspectives can be defined.

Medium term perspectives

Organization structure of NLFMO will be developed and improved with the goal of efficient land property administration can be carried out. On the other hand, “liquidity” of the land assets will be improved by purchasing and swapping land, creating the basic conditions for land banking.

Long term perspectives

Further adjustment of organization structure will be completed for shifting from a simply land property administrator operation to the land banking. NLFMO will be significant market player on the Hungarian land market as land bank and will have considerable role in land consolidation, using market instruments to achieve the purpose of National Land Fund.

Tonder, 18th of March 2004

Dr. Robert Sebestyén
NLFMO

BIOGRAPHY

Dr. Robert Sebestyén

Born in Budapest (Hungary) in 1955. Graduated from the University of Agricultural Sciences, Gödöllő as agricultural economist and started working for the state owned large scale agricultural sector in 1981.

Took part in a twelve-month on-farm-training programme in the USA and worked in Kansas from December 1983 to January 1985, attended courses at Kansas State University, collected data and materials for doctoral dissertation.

Appointed to be Deputy Director in charge of economic affairs at State Farm Hőgyész (Hungary) in 1985 to direct the farm-business management of the company. Company Commissioner in charge of the overall management and the transition of the company from state owned large-scale farm into company limited by shares in 1992-1993. The first CEO and Member of the Board at the legal successor company from 1994 to 1996 and took part of the privatisation in 1995.

Joined the Corporate Division of ÁB-AEGON Insurance Co. Ltd - the Hungarian insurance company of the AEGON Insurance Group - in 1997 as Business Manager-Agriculture.

He was appointed to establish the managerial and property administration frame of National Land Fund in Hungary as the managing director of Hungarian National Land Fund Public Benefit Company (MNFA Kht.) in January, 2002. He has been working as executive in charge of the company's final accounting to manage its closing settlements and has been Deputy Head of Main-department at National Land Fund Management Organization (NLFMO) in Budapest from August, 2002.

Participant of international conferences focusing on the agriculture in transition in Central-Europe (1992-1994) and agricultural insurance business (1999-2000). Dr. Sebestyén worked for an EC-PHARE Project (1994) and in association with UK professional consulting firms (1996-1998). He represented NLFMO on workshop and conference series organised by Europeans Land Owners' Organization (ELO, Brussels) in October-November, 2003.

Runs his small-scale crop production activity as part-time farmer, since 1992.