

## **Broadening and deepening rural financial services and land banking**

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### **Introduction**

In this 9<sup>th</sup> of 12 articles, I address the need to broaden and deepen the rural financial services sector, so as to ratchet up seasonal and development finance for agriculture. I will offer a pathway to a vibrant rural banking and base this on establishing a regulated but active land market.

### **The need for broader and deeper rural financial services**

Zimbabwe's agricultural sector needs stronger financial markets: broader – reaching more customers – and deeper – offering more products. The role of financing for farmers, and especially for smallholders and family farms has not been given the attention it deserves. A few commercial agricultural commodities such as tobacco, cotton and soya beans have grown through contract farming as the main financing tool. While contract farming continues to offer opportunities, it has some challenges and the tool is not appropriate for many other commodities requiring finance. There is a need to scale up the successful contract farming models, and there is even more need for ambitious innovation, and for addressing the strategic issues girding the systemic and sustainable development of a vibrant rural financial services sector. The sector requires that breadth and depth to include micro-finance, commercial, merchant, investment and development banking, credit guarantee schemes, private equity funds, as well as social venture capital financing, among others.

I will argue for a Land Bank in this article and link this to the need to establish a Land Acquisition Compensation Fund that I alluded to in an earlier article, as an important step in rehabilitating the sector.

Before I go into that I just want to argue for 'catalytic' financing. Catalytic finance basically refers to targeted investment finance that leverages other investment finance, either because the initial investment removes an impediment or provides a missing infrastructure, or leads to desirable policy and/or regulatory reform.

Catalytic finance is possible across public, private, and donor investments and this type of finance is now required in Zimbabwe in order to unlock greater volumes of "patient" money from the commercial banks into various parts of the agriculture, food and manufacturing value chain. Such patient money is needed for investment of a medium to long-term nature which is currently missing. I believe that at this point in time, public funds and donor funds into the agricultural sector should take the more catalytic route, where these public investments are targeted at stimulating more private investment by commercial banks, farmers and agri-businesses.

### **Financing smallholders has special challenges**

The banking sector in Zimbabwe has limited understanding of smallholder farmers; and smallholder farmers have a limited history of dealing with large commercial banks. The traditional support to smallholders from state banks (Agribank) and parastatals has shrunk and that may be the case for some time. This means that in order for commercial banks to reach more rural clients, there is a lot of learning and education required on both sides. What is now needed is proper financial intermediation offering viable savings and lending products to the rural population. It can no longer be the traditional 'credit' supply models which have seen rural households with limited savings products that suit their situation. With dollarization, it is now feasible to increase domestic savings in rural areas. There is also anecdotal evidence that dollarization has also improved supply response for beef cattle by smallholder farmers. This is significant given the historical poor supply-response by the same clientele, and understandably so given that cattle continue to be one of the very reliable forms of savings in rural areas. With dollarization banks need to be more creative in offering competitive savings products to this discerning population. This should increase volumes of domestic savings and increase supply of loan finance.

### **The need for a full range of rural finance**

Traditionally, for the agricultural sector to enjoy the full range of financial products this requires 3 categories of finance:

1. Short-term (seasonal) finance for inputs and working capital;
2. Medium-term finance 2-5 years (for machinery, irrigation infrastructure, etc)
3. Long-term finance 6-25 years (for land acquisition, dams, etc.).

Today banks are struggling to provide support in all the 3 categories. By the late 1980s the financial sector was already providing very limited medium to long term financing for agriculture. Because medium to long term financing of agriculture is only viable at low levels of interest and low levels of inflation, this explains further why medium to long-term financing practically disappeared as the Zimbabwe dollar devalued and as inflation spiralled. Over the years, the macroeconomic instabilities eroded the capacity of banks to provide such capital. After dollarization in 2009, prospects for short term finance started improving, but the banking sector has been unable to attract low cost and longer term lines of credit.

The combination of the insecure land rights and poor liquidity in the market has compounded the challenges of farming as a business, for both small and large farmers. The Banking Act requires commercial banks to collect either collateral security for all commercial loans or, if the bank makes an unsecured loan, then the bank must set aside loan loss reserves equal to 100% of the loan. For the latter, Banks have no liquidity to make such provisions and in any case a bank is unlikely to go that route except for highly profitable deals. Currently farming is not that profitable anyway, mainly because of cheaper imports including illegal imports that dampen local prices. Zimbabwe's borders are too porous. And with no tradable land rights, farmers and banks have no way forward. The micro-finance sector which could possibly loan smallholder farmers has shrunk considerably and is unable to offer financial products to farmers. In conclusion, there is hardly a rural financial services sector to talk about, and this means that rehabilitating the land and agriculture sector will take a long time under the present scenario.

### **The need for a land bank**

Mine is one of several proposals out there trying to find a way of stimulating the re-growth of rural financial services. I have indicated what the end result ought to be in terms of institutions and products spanning short to long term. The strategic issue therefore is figuring out the pathway and steps to follow given that it is not possible to achieve all in the short term. The end result is vibrant rural banking and a vibrant agricultural land market. The starting point is to find ways of increasing investment into agricultural production and into land development. With the provision of a Land Commission in the new Constitution my suggestion is that the Commission embarks on establishing a Land Bank as well as a Land Acquisition Compensation Fund. The two have to be completely independent but strategically, the success of one depends on the other.

The Commission does not require loads of cash to establish a land bank, rather since all land settled under the land resettlement programmes is technically state land, it follows that all leases and permits for this land qualify to go on the Land Bank's balance sheet. Initially, all Offer Letters, Permits and 99-Year leases should be considered negotiable instruments, but only through the Land Bank which in turn will rely on the Commission to sanction and confirm that those individuals trading do qualify under the respective conditions of resettlement. For instance, anyone holding an Offer Letter and occupying A2 land and now wishes to go out of farming could offer to sell the Offer Letter to the Land Bank, then the Land Bank could sell and transfer the rights to another deserving and qualifying candidate. This is a win-win proposition since the value of the Offer Letter is expected to reflect the value of improvements since occupation. Similar provisions can be offered for A1 and Old Resettlement land permits. This regulated and restricted market allows for a 'learning by doing approach' by both government and farmers, and the process can be improved based on experience. The Land Bank will be able to raise some income by charging a commission and administration fees on these transactions. My guess is that once these transactions gather momentum, the Land Bank can start using its balance sheet to acquire appropriate lines of credit for medium to long term financing. The bank will be able to start lending for land and irrigation development, farm infrastructure, and machinery purchase.

Enter the Land Acquisition Compensation Fund. The initial target is to finance compensation for improvements for the land acquired from white farmers under the Fast Track Land Reform Programme. In a previous article I laid out in detail how Treasury could provide seed finance for the fund, say \$30 million dollars. The fund will then attract other funding. Holders of A2 land will contribute towards the purchase of farm improvements they acquired through annuity payments into the fund. The land bank will also be able to levy transactions on Offer Letters and 99-Year leases and transfer proceeds into the fund. Development Banks could support the process by investing in either the Land Bank or the Fund directly depending on how the deals are structured to meet the stated objectives. Donors could contribute to the fund directly by identifying land occupied by deserving A1 farmers and supporting these poor farmers to compensate for the acquired land.

The establishment of a Land Bank and a Compensation Fund is the initial step in resolving the outstanding compensation issue while at the same time leveraging medium to long-term finance for agriculture. Prospects for productivity and competitiveness will improve, other conditions being equal. This opens up prospects for commercial banks responding to short-term financial need of farmers and agri-business.

### **Need for pragmatism**

There is universal agreement that agricultural productivity and competitiveness has to grow again as the surest means for food security and growing the economy. What is not agreed in the political governmental discourse is how to rehabilitate the sector so that productivity grows again. Farmers need finance to produce and market. Those farmers or landholders who wish to leave farming and go into other businesses need a way of disposing the land to new farmers. These processes of a) mobilizing finance from the banks; b) farming productively and profitably; and c) processes allowing farmers to leave and some to come in, all add to increasing efficiency of the sector. These processes can be regulated either by: 1) the 'state' or 2) by the 'market'; and 3) there is always the third way of a 'regulated' market. I have argued for a regulated market to start with as a practical way of addressing the ideological divide and as a pragmatic process of learning by doing. There is need to be creative and innovative and do things that have not been done before.

The discourse so far has been a purely ideological one with no pragmatic offerings. The loudest voices are of the 'state fundamentalists' and the 'market fundamentalists'. The former arguing that giving more secure rights to individuals and families will not only result in the reversal of the land reform program, but also that the state needs more options to redistribute land in the future. The latter argue that privately negotiable land rights are the only way to rehabilitate the sector. In theory, and given the right investments and capabilities, both systems are workable in the long run. Unfortunately for Zimbabwe, both state administrative capabilities and market efficiencies are too low to solve the problem. For instance, the state has failed to manage the 8,000 odd leases comprising the Small Scale Commercial sector. Adding another 18,000 odd leases under A2 is an obvious administrative burden. On the other hand the banking sector is too limited in its capacity to finance this sector especially the predominant group of smallholder commercial farmers.

### **Conclusion**

A1 land, in my opinion, is where land policy should really open up to a regulated land market and this is good for the financial markets because the land is in small parcels, making it easier to transact and also making it a more competitive market. I believe that A1 landowners will be the most vibrant and most diverse commercial force in Zimbabwe's rural areas. The farmers are already more responsive to market signals than A2 and large scale farmers. These farmers won't be stuck inflexibly to a few commodities as with large-scale farmers. The A1 farmers will do much more if given a more conducive land rights regime. These farmers will form the new frontline commercial suppliers of manufacturing sector, especially raw materials for food, beverage, textile and other manufactured products. Given the chances that the financial services sector will also grow with a growing rural economy, it follows that these farmers will invest more in pre-processing, farm machinery, pre-processing facilities, and so on, as the sector creates more and better quality jobs, increasing household incomes—all adding up to family wealth creation, economic growth, employment creation, food security, and resilience against natural and man-made disasters.