

#### 4. CREDIT AND RURAL FINANCIAL SYSTEMS

*“I found myself at the Land Bank while at the same time I am very sceptical about lending people money. I think that the less people borrow, the better off they will be”.<sup>1</sup>*

##### **Introduction**

Credit and financial support services in South Africa are characterised by the same inequitable nature as the agricultural sector. There is a modern and sophisticated system that serves the financial needs of the white agricultural sector and an informal micro-lending sector attempting to service the majority of the population.<sup>2</sup> By implication, the majority of South Africa’s rural population has no access to formal financial and credit services. At the same time, according to the 1997 White Paper on South African Land Policy<sup>3</sup>, the South African “government has the responsibility to provide assistance with farm credit”. Furthermore, based on empirical evidence from East Asia and Latin America<sup>4</sup>, it is the basic premise of this chapter that access to cheap credit is a crucial variable in the success or failure (short and long-term) of a land reform programme, as well as, for income-generating and/or profitable agricultural production.

The chapter starts by providing some evidence in support of the above-mentioned premise. The chapter then reviews a range of credit options that have been used in conjunction with reform programmes elsewhere in the world. The range of credit options reviewed include commercial financial and credit institutions, micro-credit schemes, credit unions, state-led rural finance, rotating credit and savings associations, moneylenders, self-finance, loan targeting and strategies to address default and loan repayments. Section 11 emphasises the importance of developing appropriate credit policies through a discussion of the negative consequences of inappropriate or ill-conceived credit programmes.

Section 12 attempts to explain why credit policies fail or succeed. Sections 13 and 14 discuss possible/suggested solutions, which include subsidised interest rates and savings mobilisation. Throughout this chapter there are references to, and discussions of, credit programmes in South Africa, with an emphasis on the “transformation” of the Land Bank of South Africa. (Some of the discussions and analysis of the South African material pre-empt arguments made in later chapters evaluating the South African National Land Reform Programme. I have nevertheless included these examples and discussions in this chapter, because although the Director of the Land Bank officially reports to the Minister of Agriculture and Land Affairs, the development and implementation of credit

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<sup>1</sup> Interview with Helena Dolny (Former Director of Land Bank & advisor to Derek Hanekom), June 22, 2001

<sup>2</sup> Coetzee G, Mbongwa M & Nhlapo K, “Restructuring rural finance and land reform financing mechanisms”, in Van Zyl J, Kirsten J & Binswanger H (Eds.), Agricultural Land Reform in South Africa, Oxford University Press, Cape Town, 1996, p. 515

<sup>3</sup> Department of Land Affairs, White Paper on South African Land Reform Policy, 1997, p. 24, 3.10

<sup>4</sup> There is also some South African empirical and anecdotal evidence to support this premise; as discussed throughout this chapter.

programmes is not essentially the function of the National Departments of Land Affairs or Agriculture.)

I draw extensively on my interview with the former Director of the Land Bank, Helena Dolny, and I have also included some observations based on my interviews with Isak Kuiper and other members of the Xhomi (Komani) San as well as various members of the Solane and Sheba Communities in Mpumalanga. In addition, I have drawn on workshops conducted among Western Cape land reform beneficiaries by Catling and Saaiman<sup>5</sup> as well as studies conducted in three redistribution projects, namely Labuschanneskraal and Daggakraal by Lyne<sup>6</sup> and Sibongile in the Free State<sup>7</sup>.

### ***Credit: a crucial variable***

Evidence from East Asia and Latin America suggests that access to cheap credit is a crucial variable in the success or failure of land reform programmes. Credit programmes in Bangladesh and Pakistan, for example, resulted in remarkable improvements in the living conditions of the rural poor.<sup>8</sup> Providing the poor with access to credit, is a method that can raise farm incomes, not through higher prices for agricultural goods, which transfer to consumers and have a negative impact on food security but, by reducing production costs.<sup>9</sup> In other words, providing poor/ emerging/ small-scale/ subsistence farmers with access to credit will enhance the ability of these farmers to access a combination of inputs. And, as Dolny<sup>10</sup> argues, one's capacity to exploit land resources fully depends on one's ability to access a combination of inputs. The paradox in South Africa's former bantustans, for example, where a shortage of land remains a problem in a context where relatively large land areas are unused, can, in part, be explained by a lack of access to financial resources/ credit.

Internationally, land reform beneficiaries in, for example, El Salvador<sup>11</sup> and Colombia<sup>12</sup> were unable to start agricultural production largely because they lacked access to credit and financial resources. In Mexico, land and agrarian reform policies failed to result in increased agricultural production partly because emerging small-scale farmers could not

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<sup>5</sup> Catling D & Saaiman B, "Small-scale farmers and growers in the Western Cape: The challenge of providing appropriate extension services", Land, Labour and Livelihoods, Volume One, Lipton M, Ellis F & Lipton M (Eds.), Indicator Press, Durban, 1996

<sup>6</sup> Lyne M & Lima Rural Development Foundation, "Options for Government's Settlement/ Land Acquisition Grant", Research Paper for the National Land Committee, July 1998

<sup>7</sup> NLC, "Tenure Reform Media Fact Sheet", not dated

<sup>8</sup> Muhumuza W, Credit and poverty alleviation in the context of Structural Adjustment Reforms in Uganda, PhD proposal submitted to the Department of Political Studies, University of the Witwatersrand, 2002 & Muhumuza W, Credit and Poverty Alleviation in the Context of Structural Adjustment Reforms in Uganda, Ph.D., University of the Witwatersrand, May 2002

<sup>9</sup> United Nations Food and Agriculture Organisation, An Enquiry into the problems of agricultural price stabilisation and support policies, Rome, 1960, p. 70 - 73

<sup>10</sup> Interview with Helena Dolny (Former Director of Land Bank & advisor to Derek Hanekom), June 22, 2001

<sup>11</sup> Sequira M, "Central America: Rural Workers say Land is Returning to the Rich", World News, April 9, 1998

<sup>12</sup> Barber S, "Colombia holds answers for Zimbabwe", Business Day, December 18, 1997

compete with large-scale farmers in terms of access to credit and other financial services. Between 1976 and 1982, the small-scale agricultural sector, which received 21% of agricultural credit but accounted for 44% of arable land, all but disintegrated.<sup>13</sup> Mexico's agricultural production went from providing ample foreign exchange to not even being able to meet the food security needs of its own population.<sup>14</sup> Increased agricultural productivity in Taiwan was partly the result of Taiwanese farmers' ability to diversify agricultural production. Diversification, in turn, required relatively large investments made possible by an efficient rural credit and financial system. In fact, virtually all the farmers in Taiwan deriving a substantial part of their income from farming, in the 1990s, have had easy access to credit.<sup>15</sup>

Land reform beneficiaries and small-scale farmers in South Africa, participating in a workshop conducted in the Western Cape, also argued that the absence of credit and financial services was a major constraint on agricultural production.<sup>16</sup> Community members at three redistribution projects - Labuschagneskraal, Daggakraal<sup>17</sup> and the Sibongile<sup>18</sup> community in the Free State - stated that agricultural production had not began (more than a year after the land was transferred) because they lacked access to credit and financial support. The same premise (i.e. that access to credit is a crucial variable in successful land reform and/ or farming) is contained in the Rural People's Charter, adopted in Bloemfontein in April 1999. According to the charter, "*Lack of access to credit is emerging as one of the greatest constraints to successful farming*".<sup>19</sup>

If the premise, that access to credit is a crucial variable in the success or failure of land reform programmes, is accepted, it stands to reason that appropriate rural financial and credit systems to service South Africa's emerging farmers and/or land reform beneficiaries must be developed. This raises questions around the types of rural financial programmes developed and implemented. As well as, the likelihood of such programmes reaching the poorest sectors of South African society, the parameters for post-apartheid credit policies in South Africa and the appropriateness of rural financial and credit institutions in the context of profound social, economic and political inequality.

A concept that emerges from the Latin American land reform debate is the distinction between reformism and (radical) social transformation. The parameters for post-apartheid South African credit policy was set by the constitutional protection of property

<sup>13</sup> Heath J.R, "Evaluating the Impact of Mexico's Land Reform on Agricultural Productivity", World Development, Vol.20, No.5 1992

<sup>14</sup> Otero G, "Agrarian Reform in Mexico: Capitalism and the State", Searching for Agrarian Reform in Latin America, Thiesenhusen W.C (Ed.), Unwin Hyman, 1989

<sup>15</sup> Adams D.W, Chen H.Y & Lamberte M.B, "Differences in Used Rural Financial Markets in Taiwan and the Philippines", World Development, 21 (4), 1993

<sup>16</sup> Catling D & Saaiman B, "Small-scale farmers and growers in the Western Cape: The challenge of providing appropriate extension services", Land, Labour and Livelihoods, Volume One, Lipton M, Ellis F & Lipton M (Eds.), Indicator Press, Durban, 1996

<sup>17</sup> Lyne M & Lima Rural Development Foundation, "Options for Government's Settlement/ Land Acquisition Grant", Research Paper for the National Land Committee, July 1998

<sup>18</sup> NLC, "Tenure Reform Media Fact Sheet", not dated

<sup>19</sup> The Rural People's Charter: Adopted at the Rural Development Initiative Convention, Bloemfontein, April, 25, 1999, p. 2

rights, the commitment to an essentially market-based land reform programme and the drafting of agricultural credit policy by commercial bankers (e.g. the Standard Bank's Conrad Strauss). In other words, credit policy in post-apartheid South Africa is reformist. It is particularly difficult for the rural poor to access credit within a system of market-based reform. Molino argues that if the rural poor borrow money to purchase land at a market price they will have to use the entire increase in their annual income from the land to pay for the interest charged on the loan.<sup>20</sup> Credit and financial institutions can be formal (i.e. commercial banks, micro-credit schemes, credit unions, government credit schemes or involvement in rural financial systems) or informal (i.e. moneylenders, rotating savings and credit associations, self-finance), or a combination of both.

### ***1) Commercial financial and credit institutions***

Coetzee et al<sup>21</sup> divide South African rural society into four main categories, each requiring different systems of financial service provision. These are large-scale commercial farmers (who normally have sufficient collateral and are generally serviced by commercial banks), small-scale commercial farmers (who generally have some collateral but not sufficient amounts to make them a viable investment for commercial banks), the bankable poor and the non-bankable poor. The bankable poor include subsistence farmers whose financial needs are generally serviced by informal lending practices characterised by small amounts and high interest rates. The non-bankable poor have no collateral and include the landless and impoverished female farmers. Formal financial institutions are unlikely to provide credit to the latter two categories.

Commercial banks tend to be unwilling to embark on rural credit programmes because of the particular difficulties encountered in rural financial markets. These include the difficulty of serving clients who are widely dispersed, administering a large number of relatively small transactions and operating in an industry (agriculture) that experiences unanticipated changes in prices, incomes and yields.<sup>22</sup> Other problems (particularly in developing countries) include poorly developed legal systems and information infrastructure, high transaction costs, lack of (or poor) credit and financial records of potential borrowers and collateral that is not secure. In Guatemala, for example, commercial banks in rural areas operate according to a centralised credit review process, “*which relies primarily on quantifiable, comparable information provided by loan applications, evaluations of collateral, enterprise records, project viability and individual credit records*”. Rural branch managers in Guatemala therefore “*acknowledge the limits this costly review process imposes on their capacity to make loans to lower wealth producers*”.<sup>23</sup>

<sup>20</sup> Molino J.C, "Land Credit for the Rural Poor: Review of Some Experiences, FAO Land Tenure Service SDAA, June 18, 1997

<sup>21</sup> Coetzee G, Mbongwa M & Nhlapo K, “Restructuring rural finance and land reform financing mechanisms”, in Van Zyl J, Kirsten J & Binswanger H (Eds.), Agricultural Land Reform in South Africa, Oxford University Press, Cape Town, 1996, p. 519

<sup>22</sup> Adams D. W & Vogel R. C, “Rural Financial Markets in Low-income Countries: Recent controversies and lessons”, World Development, 14 (4), 1986, p. 477 - 487

<sup>23</sup> Barham B. L, Boucher S & Carter M. R, “Credit Constraints, Credit Unions and Small-Scale producers in Guatemala”, World Development, 24 (5), 1996, p. 793 - 806

Furthermore, since adversities (i.e. drought) in rural areas tend to affect a large number of households at the same time, it is difficult for banks to diversify lending portfolios to cushion economic shocks. Coetzee<sup>24</sup> explains that specialisation in rural areas in a few economic activities linked to agriculture, expose rural clients to the vagaries of the climate, pests, diseases etc, leading to co-variance in their incomes. Furthermore, the seasonal nature of agricultural production results in expensive and administratively difficult fluctuations in the demand for credit and deposit services.

The poorest sectors of rural societies also tend to be excluded from access to commercial bank loans because they do not have access to the collateral required to qualify for loans. The collateral requirement for credit is seen by some as a “*method of redistributing income in favour of those who already own sufficient resources*”.<sup>25</sup> For example, in the South African land redistribution programme, the criteria that households earn a maximum of R1 500 per month to qualify for the Settlement/Land Acquisition Grant automatically means that they do not have the necessary collateral to qualify for credit from commercial institutions<sup>26</sup>. The 1997 United Nations World Development Report estimated that only 0.2% of global commercial lending reaches the poorest billion (20% of the world's population).<sup>27</sup> Research undertaken on micro-entrepreneurs in the informal sector in Kenya, Malawi and Ghana, further indicated that although many survey respondents had a relationship with the formal financial sector (i.e. commercial banks), this was nearly always in terms of savings deposits and not in terms of credit.<sup>28</sup> The incidence of formalised credit was very low in all three countries. Among the Kibera sub-sample in Kenya, for example, 96% of respondents had never applied for a loan from a commercial bank, usually because they had neither the skills nor the collateral to be taken seriously. In Malawi, none of the respondents (all micro-entrepreneurs) had obtained commercial bank loans. When the poor are able to obtain access to credit from commercial banks they often pay higher interest rates (as banks try to cover the potential costs of taking on “high-risk” clients). Apart from collateral, commercial banks also operated with other “wealth biases” that included the fact that these institutions often had better knowledge of, access to, and relationships with, wealthier borrowers.<sup>29</sup>

In some countries, governments have attempted to encourage commercial banks to operate in rural areas but these policies have not been very successful. In India and

<sup>24</sup> Coetzee G, Mbongwa M & Nhlapo K, “Restructuring rural finance and land reform financing mechanisms”, in Van Zyl J, Kirsten J & Binswanger H (Eds.), Agricultural Land Reform in South Africa, Oxford University Press, Cape Town, 1996, p. 516

<sup>25</sup> Letsoalo E. M, Land Reform in South Africa: A black perspective, Skotaville publishers, JHB, 1987

<sup>26</sup> This is a pre-emptive point, which is discussed in more detail in chapter 7 on the Land Redistribution Programme

<sup>27</sup> Muhumuza W, Credit and poverty alleviation in the context of Structural Adjustment Reforms in Uganda, PhD proposal submitted to the Department of Political Studies, University of the Witwatersrand, 2002 & Muhumuza W, Credit and Poverty Alleviation in the Context of Structural Adjustment Reforms in Uganda, Ph.D., University of the Witwatersrand, May 2002

<sup>28</sup> All reference to Kenya, Malawi and Ghana in this paragraph are from Buckley G, “Micro-finance in Africa: Is it either the problem or the solution”, World Development, 25 (7), 1997, p. 1081 - 1093

<sup>29</sup> Barham B. L, Boucher S & Carter M. R, “Credit Constraints, Credit Unions and Small-Scale producers in Guatemala”, World Development, 24 (5), 1996, p. 793 - 806

Bangladesh, commercial banks are forced to open a certain number of rural branches before they can open additional, more profitable, urban branches. In Vietnam, the Philippines and Ghana, donor or government funds have been used to induce the formation of private rural banks. Banks have responded to government pressure by building token offices in rural areas, which are either hardly operational or, which offer only a limited range of services.<sup>30</sup> In South Africa, in response to recommendations made by the Strauss Commission<sup>31</sup>, in September 1996, (i.e. to provide “appropriate financial services” to “release South African creativity” in rural areas as a “strategy for unlocking” the “development potential” of rural areas<sup>32</sup>) the Land Bank has expanded its rural branch network from 25 branches in 1997, to 80 outlets (including 20 mobile units) in 2003.

Despite the relative absence of commercial banks in rural areas, and the inability of these institutions to provide viable credit options to the poorest members of rural society, the number of respondents (in the Ghana, Kenya and Malawi study) with bank accounts, however, was surprisingly high – in Kenya, 88% of respondents in the regional survey had bank accounts (savings/ current accounts). The figures for Ghana were similar, while the number of account holders in Malawi was significantly lower. These accounts tended to be dormant or had very negligible sums in them. What this prevalence of savings/ current accounts suggests, is that although formal banking institutions “*are averse to extending credit*” to the rural poor (including small-scale producers and micro-entrepreneurs), formal banking institutions can effectively extend deposit facilities to the rural poor.<sup>33</sup> (Savings mobilisation is a crucial factor in rural financial systems and will be discussed below).

## 2. *Micro-credit Schemes*

Micro-credit schemes (implemented either by state agencies, commercial banks or development agencies) extend small, collateral free loans to poor members of rural societies in an attempt to promote self-employment and income generation.<sup>34</sup> During the 1990s, micro-finance programmes increased numerically as a result of perceived successes (mostly in Asia and Latin America) in providing the rural poor with access to credit. By 1997, 8 million poor people in developing countries were being served by micro-credit programmes.<sup>35</sup> The micro-financing industry also appears to be playing a stronger role “in the social and economic empowerment of the poor and disadvantaged”

<sup>30</sup> Adams D. W & Vogel R. C, “Rural Financial Markets in Low-income Countries: Recent controversies and lessons”, World Development, 14 (4), 1986, p. 477 - 487

<sup>31</sup> The Presidential Commission on Rural Financial Services (Strauss Commission), which made recommendations to improve rural financial services.

<sup>32</sup> From the Statement by the Minister of Agriculture and Land Affairs in the Land Bank, Annual Report, 2003, p. 7-9

<sup>33</sup> References to Kenya, Malawi and Ghana above are all from Buckley G, “Micro-finance in Africa: Is it either the problem or the solution”, World Development, 25 (7), 1997, p. 1081 - 1093

<sup>34</sup> Rahman A, “Micro-credit initiatives for equitable and sustainable development: Who pays”, World Development, 27 (1), 1999, p. 67 - 82

<sup>35</sup> Muhumuza W, Credit and poverty alleviation in the context of Structural Adjustment Reforms in Uganda, PhD proposal submitted to the Department of Political Studies, University of the Witwatersrand, 2002

in South Africa, and according to the South African Association of Micro-Lenders, micro-financiers have “played an enormous role in making millions of people part of the growing South Africa”.<sup>36</sup> Furthermore, the South African Land and Agricultural Bank has developed a micro-credit scheme, primarily to provide credit to impoverished women.<sup>37</sup> The Land Bank micro-credit programme, named “Step-up”, provides small loans to individuals who require credit for small-scale operations such as vegetable gardens, and can be regarded as successful.<sup>38</sup> Clients are awarded a maximum amount of R250, but qualify for a bigger loan on repayment. In 1998, 70% of the 32 000 Step-up clients were women<sup>39</sup>, and the repayment rate in 1999 was 87%.<sup>40</sup> By 2003, the Step-up” programme had made more than R300 million available to approximately 130 000 borrowers “who were previously regarded as unbankable”.<sup>41</sup>

Nevertheless, Rahman’s<sup>42</sup> study, on the “successes” of the micro-credit programme of the Grameen bank in Bangladesh, indicates that micro-credit schemes can lead to increases in the debt liability of individual households (i.e. impoverishing households) and increased tension within households and consequently, increased violence against women. Rahman provides the example of Dilu (and many others), who obtained a loan from the Grameen bank in order to increase agricultural production. However, low yields ensured that she could never generate enough profit to pay her instalments and consequently, borrowed money from moneylenders to do so. Dilu was rewarded for repayment by the bank with larger loans, which, in turn, were used to pay back the moneylenders. As a result, the household fell into perpetual debt without any increase in the overall household income. When Dilu finally failed to obtain access to a loan from the Grameen bank, she was forced to seek wage-labour in Malaysia to continue to repay the debts incurred. Rahman also cites evidence from Bangladesh and elsewhere, which indicates that the interest rates of micro-credit schemes are significantly higher (approximately 8% in Bangladesh) than commercial market rates.

This discrepancy in results can, in part, be explained by the criteria for success employed in assessing micro-credit schemes. Generally, micro-credit schemes are deemed successful if repayment rates are high. Repayment rates, however, do not reflect whether credit was used to meet household consumption needs or for productive purposes and does not take account of the manner in which funds for repayment are obtained. Rahman’s study, for example, indicated that individual members of households are sometimes forced into low-paying wage labour or, forced to obtain loans from other credit intermediaries (e.g. moneylenders) to pay back loans.

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<sup>36</sup> The Association of Micro-Lenders, info available at [www.mla.org.za](http://www.mla.org.za)

<sup>37</sup> See Chapter 10 for more detail & Dolny H, Banking on Change, Penguin Books, South Africa, 2001, p. 115 - 117

<sup>38</sup> If the criteria for success are a) percentage of women clients, and b) repayment rates

<sup>39</sup> Land Bank, Annual Report, Pretoria, 1998

<sup>40</sup> Land Bank, Annual Report, Pretoria, 1999

<sup>41</sup> Land Bank, Annual Report, Pretoria, 2003

<sup>42</sup> Rahman A, “Micro-credit initiatives for equitable and sustainable development: Who pays”, World Development, 27 (1), 1999, p. 67 - 82

In South Africa, the Micro-Finance Regulatory Council has (as its name implies) made several attempts to regulate the micro-lending industry (this includes investigations of micro-lenders not registered with the Council). In 2001, the Micro-Finance Regulatory Council established the National Loans Register and, in June 2002 introduced a rule to prohibit “reckless lending” (i.e. lending that exceed borrowers capacity to repay), and to curb increasing “over-indebtedness”. In terms of the National Loans Register, micro-lenders are compelled to submit all loans to the National Loans Register, thereby building-up a database of micro-loans. Thus far, 732 lenders are “fully engaged” in the National Loans Register, while 1 640 micro-lenders are registered with the Council.<sup>43</sup>

Many of the most successful micro-credit programmes have been built on extensive donor finance and this raises questions around future sustainability. In other words, can problems of profound poverty be solved by temporary capital injections or do solutions require a fundamental transformation of the social, economic and political power relationships in any given society?

### ***3. Credit Unions***

The success of agricultural/rural credit programmes depend, in part, on whether poorer producers or households gain access to credit. Barham collected survey data from 950 small-scale producer households, in areas of Guatemala in which market-orientated credit unions operate, in order to assess whether credit unions provide the poor with better access to credit than private or commercial banks.<sup>44</sup>

As a result of financial market liberalisation policies, state support for and involvement in credit services have been systematically reduced in Guatemala and, has resulted in the emergence of arguably more efficient financial systems and services, for example, credit unions. Barham argues that credit unions are of special interest, because they can be effective full-service intermediaries, which offer savings opportunities, make loans and provide other financial services to members. Savings mobilisation (drawn mainly from local funds) should contribute to lower default rates, since depositors’ interests are directly tied to repayment rates. Credit unions, which operate locally, will also be able to overcome the information problems experienced by private banking institutions. In the Guatemalan credit unions, loan applications are reviewed locally by a committee made up of union members who tend to have considerable knowledge of the risks and potential associated with individual applicants. For the same reasons and, because these unions operate within a community context (peer pressure), credit unions can be more efficient in monitoring and enforcing loan contracts (i.e. repayment rates should be higher than those for commercial banks). Better information also means lower transactions costs and greater overall efficiency. The local nature of credit unions also imply a greater level of participation in decision making and management for members and potential members, which enhances the legitimacy of these institutions.

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<sup>43</sup> Paragraph from Micro Finance Regulatory Council, Press Statement on Reckless Lending, not dated

<sup>44</sup> Barham B. L, Boucher S & Carter M. R, “Credit Constraints, Credit Unions and Small-Scale producers in Guatemala”, *World Development*, 24 (5), 1996, p. 793 - 806



On the other hand, the small areas in which credit unions operate coupled with the risks associated with lending in the agricultural sector (e.g. lack of diversification, sector-dependence) means that economic shocks such as crop failure due to bad weather, could lead to widespread loan default and deposit runs that can undermine the credibility and sustainability of these organisations.

Barham found that credit unions tend to relax credit constraints so that poorer households have better access to credit from credit unions than from commercial banks but, that the poorest households are still excluded from access to credit. Approximately 14% of respondents had improved access to credit from credit unions. Yet, credit union coverage did not reach the poorest sectors of rural society. Clearly, other types of finance or financial systems need to be developed if the poorest sectors of rural society are going to gain access to sufficient credit to enhance production and/or generate income and, thereby, improve their living conditions.<sup>45</sup>

#### ***4. Governments and rural finance***

Since formal financial institutions are unlikely to provide for the needs of the bankable and non-bankable poor and as a result of the persistent failure of market-based credit programmes, many governments have taken over the function of credit provision to poorer sectors of society. Notable examples include Kenya, Brazil, Taiwan and the Philippines. State credit provision (or intervention in financial systems) includes loan targeting, direct loans to farmers (often through parastatals or government agencies) and bank nationalisation.

State intervention in the provision of credit has not been particularly successful either. Scholars have argued that state-owned or directed financial institutions lack accountability, foster arbitrary practices and allocate credit more on political than economic grounds.<sup>46</sup> Governments/government agencies often lack the capacity to implement effective credit programmes. In Kenya, overworked staff members of the Agricultural Finance Corporation were unable to access individuals in the more remote rural areas. In the Philippines, the obstacle was resource constraints. The Taiwanese rural financial system, on the other hand, was hardly affected by capacity constraints because of the focus on deposit mobilisation and the large number of institutions involved in credit provision. These included the Land Bank, the Farmers' Bank, the Co-operative Bank, a number of commercial banks, savings companies and farmers' and fishermen's associations that provided 40% of the necessary funds.<sup>47</sup> Part of the answer may lie in government support for small-scale NGO and CBO based credit provision

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<sup>45</sup> This whole section is based on Barham B. L, Boucher S & Carter M. R, "Credit Constraints, Credit Unions and Small-Scale producers in Guatemala", *World Development*, 24 (5), 1996, p. 793 - 806

<sup>46</sup> Muhumuza W, State Dysfunctionalism, poverty and social capital, unpublished draft submitted for publication in *African Studies*, 2001

<sup>47</sup> Adams D.W, Chen H.Y & Lamberte M.B, "Differences in Used Rural Financial Markets in Taiwan and the Philippines", *World Development*, 21 (4), 1993

systems. In Bangladesh, a NGO, in collaboration with the government has managed a savings and credit scheme that provided 1 400 beneficiaries with \$130 000.<sup>48</sup>

In India and Thailand, farmers receive direct government loans through public or semi-public institutions. These loans have had a limited impact, however, because loans are generally only provided in times of drought or other emergencies.<sup>49</sup>

A number of developing countries have nationalised some or all of their commercial banks. These include Costa Rica, Mexico, India, Pakistan, Sudan and Bangladesh. Nationalised banks have been effective in increasing the number of bank branches in rural areas. *"It is less clear, however, if nationalised banks are more effective than other financial intermediaries in increasing the financial services available to the rural poor, in increasing the amounts of medium and long-term loans for farmers, in providing attractive deposit services, in lowering transactions costs associated with financial intermediation and in creating rural financial institutions that are innovative and self-sustaining"*.<sup>50</sup> And in Costa Rica, for example, the nationalised bank performance appears to be no better than that of the other developing countries where banks have not been nationalised.<sup>51</sup>

Nevertheless, in many cases, direct state intervention or assistance (based on appropriate targeting) may be the only means to provide the poorest sectors of society with access to credit. In this regard, Molino<sup>52</sup> argues that state provision of rural credit must meet a number of criteria for sustainability and success. These include: beneficiary participation in policy formulation, practical policies that are easy to implement, access to the necessary capacity, clear policy parameters and rules relating to default and a sound land price and market system.

### **5. Rotating credit and savings associations**

Firth argues that the concept of credit exists in all societies, including non-monetary systems - i.e. *"lending of goods and services without immediate return against the promise of future repayment. It involves an obligation by the borrower to make a return and confidence by the lender in the borrower's good faith and ability to repay"*.<sup>53</sup> For example, Rotating credit and savings associations, which are found in many African and Asian societies. Rotating savings and credit associations emerge in the absence of formal credit institutions or in cases where the poor are unable to access credit from other formal and informal credit institutions and intermediaries. These associations provide credit on a

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<sup>48</sup> Islam T, "Development Bangladesh: Land Rights Take Poor Out of Poverty Trap", World News, November 14, 1997

<sup>49</sup> United Nations Food and Agriculture Organisation, *An Enquiry into the problems of agricultural price stabilisation and support policies*, Rome, 1960, p. 72 & 73

<sup>50</sup> Adams D. W & Vogel R. C, "Rural Financial Markets in Low-income Countries: Recent controversies and lessons", World Development, 14 (4), 1986, p. 477 - 487

<sup>51</sup> Adams D. W & Vogel R. C, "Rural Financial Markets in Low-income Countries: Recent controversies and lessons", World Development, 14 (4), 1986, p. 477 - 487

<sup>52</sup> Molino J.C, "Land Credit for the Rural Poor: Review of Some Experiences, FAO Land Tenure Service SDAA, June 18, 1997

more impersonal level than credit from friends and relatives but at lower interest rates than, for example, moneylenders. Rotating savings and credit associations are relatively small, self-sufficient and voluntary-based organisations where members contribute fixed sums of money at fixed intervals to a collective pool.<sup>54</sup> The total amount is then paid to individual members on a rotational basis. Members of rotational credit and savings associations are therefore either creditors or debtors, depending on their position in the cycle. Members usually know each other and are bound by some common bond such as location, enterprise activity, gender<sup>55</sup> (Uganda) or income level.

Rotating savings and credit associations are popular sources of finance in rural communities. Buckley<sup>56</sup> found that rotating savings and credit associations were a common source of enterprise finance for micro-entrepreneurs in Malawi, Kenya and Ghana. In fact, over half of the micro-entrepreneurs that participated in Buckley's survey were members of Rotating savings and credit associations. The reasons for the popularity of these associations are varied. Firstly, because members of credit and savings associations are not accountable to the associations for use of funds - i.e. they are free to use their money as they wish. Secondly, because transaction costs are low and interest rates are low or absent.

Rotating savings and credit associations are not only a popular but also an efficient, source of finance. The fact that potential beneficiaries/members play an active role in the establishment and management of these institutions can, in part, explain the success of credit associations. Since members of associations tend to know each other, these associations are not plagued by the same risks (related to information constraints) as commercial banks. For the same reasons (easy access to information about members, the ability to screen members with a lot of precision as well as, monitoring and peer pressure by other members)<sup>57</sup>, members of associations are less likely to default. These associations, by definition, have simple and transparent management systems. *“Meetings are regular and members participate freely. Records are simple and understandable. The procedures for accessing loans were also simple and transparent. These associations were also flexible and occasionally rescheduled loans depending on circumstances where the borrower was unable to repay on time. Money is available within a week. It is therefore evident that the success and strengths of these associations is built on the easy accessibility of information about members, simplicity and*

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<sup>53</sup> Firth R, “Capital, Savings and Credit in Peasant Societies: A viewpoint from economic anthropology”, in Capital, Savings and Credit in Peasant Societies, Firth R & Yamey B. S (Eds.), George Allen and Unwin Ltd., London, 1964, p. 32

<sup>54</sup> Firth R, “Capital, Savings and Credit in Peasant Societies: A viewpoint from economic anthropology”, in Capital, Savings and Credit in Peasant Societies, Firth R & Yamey B. S (Eds.), George Allen and Unwin Ltd., London, 1964, p. 32

<sup>55</sup> Also see section on Women and Credit in chapter ten on this thesis

<sup>56</sup> Buckley G, “Micro-finance in Africa: Is it either the problem or the solution”, World Development, 25 (7), 1997, p. 1081 - 1093

<sup>57</sup> Muhumuza W, State Dysfunctionalism, poverty and social capital, unpublished draft submitted for publication in African Studies, 2001

*transparency of the institutions, high levels of participation, and simple procedures. There is also peer pressure to repay or to make the monthly contributions”.*<sup>58</sup>

Muhumuza’s study of six credit associations in Uganda revealed that these associations improved the welfare (social and economic) of members. Membership of Rotating savings and credit associations translated into increased political influence and access to substantial funding, which could be invested in income generating projects, including agriculture. With regard to household welfare, respondents said that the nutrition of children as well as, the ability to pay school and medical fees had improved since joining the associations. Respondents also indicated that they were able to accumulate assets such as land, animals and equipment. In addition, leadership skills were developed and, in some cases, participation in associations had empowered women and enhanced their status in society.<sup>59</sup>

Although membership in Rotating savings and credit associations have clear economic and social benefits, these associations are not likely to address problems such as structurally entrenched poverty or transform economic power relations in rural societies. These associations are affected by severe capacity constraints and can only provide limited resources and, as such, are “coping mechanisms” rather than “permanent solutions” to poverty.<sup>60</sup> The reason is that the total amount of resources available to a community does not increase significantly, even if payments are invested in income generating projects or capital accumulation.

## **6. Moneylenders**

Moneylenders are able to disburse short-term loans (at high interest rates) significantly faster than institutions do (the average time taken between first approaching the lender and getting the cash is 2.2 days).<sup>61</sup> Therefore, moneylenders are generally considered to be an important source of finance for the rural poor (and in some countries constitute the fourth most likely source of credit for the rural poor).<sup>62</sup> Yet, empirical evidence indicates that moneylenders are only used as a last resort – largely because of the stigmatised nature of money lending. Moneylender use was not prevalent among micro-entrepreneurs in Kenya, Malawi or Ghana.<sup>63</sup> In cases where individuals did obtain loans from moneylenders, it was for consumption and/or distress purposes (i.e. weddings, funerals, school fees) and not for productive purposes. In a study of 950 small-scale producer household areas in Guatemala, Barham found that “*moneylenders are generally*

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<sup>58</sup> Muhumuza W, State Dysfunctionalism, poverty and social capital, unpublished draft submitted for publication in *African Studies*, 2001

<sup>59</sup> For more detail see section on credit in chapter 10 of this thesis.

<sup>60</sup> Muhumuza W, State Dysfunctionalism, poverty and social capital, unpublished draft submitted for publication in *African Studies*, 2001

<sup>61</sup> Buckley G, “Micro-finance in Africa: Is it either the problem or the solution”, *World Development*, 25 (7), 1997, p. 1081 - 1093

<sup>62</sup> Southworth H. M & Jonhston B. F, *Agricultural Development and Economic Growth*, Cornell University Press, New York, 1967, p.126

<sup>63</sup> Buckley G, “Micro-finance in Africa: Is it either the problem or the solution”, *World Development*, 25 (7), 1997, p. 1081 - 1093

*viewed by borrowers as lenders of last resort, or for short-term loans at high contract rates but with low transaction costs, rather than as lenders of first resort for productive loans”.*<sup>64</sup>

Like all credit intermediaries, moneylenders provide loans only to individuals with some form of surety, hence excluding the poorest members of society from access to credit. On the other hand, it is normally the poorer sectors of rural communities who borrow from moneylenders, at often exorbitant rates of interest, because they cannot access credit on more reasonable terms from other credit institutions or intermediaries. The lack of regulation leaves those who access credit through moneylenders (and other informal credit systems) open to exploitation. Moneylenders are also affected by capacity constraints (e.g. lack of financial resources) that limit their ability to lend to more than a small group of individuals. In addition, informational problems and transaction costs are likely to raise as soon as moneylenders expand their scope of activity, hence negating the informational advantages they enjoy relative to formal institutions.<sup>65</sup>

## **7. Self-finance**

Although rural finance appears to be a crucial variable for sustainable land reform and increased agricultural productivity, it is not a panacea. In many cases, agricultural development has taken place without access to formal credit institutions. In the absence of effective formal credit systems, self-financing played a crucial role in agricultural development in Kenya.<sup>66</sup> Members of the Sheba community in Mpumalanga argued that historically they have always been involved in farming and that the crucial issue is access to land and not credit. *“In the past we had no credit but we managed to buy seeds with money borrowed from family members with jobs. We would pay them back after the harvest”.*<sup>67</sup>

Southworth & Johnston argue that in the agricultural sectors of developing countries, private informal sources of credit tend to be the most prevalent, with relatives and close neighbours dominating in the extension of credit.<sup>68</sup> Buckley’s<sup>69</sup> research among micro-entrepreneurs in the informal sector in Kenya, Malawi and Ghana also indicated that a common source of enterprise finance was from family and friends, while the major source of finance was self-generated funds. (By self-generated funds I mean any funds that are not borrowed from lending institutions, whether it is income from off-farm

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<sup>64</sup> Barham B. L, Boucher S & Carter M. R, “Credit Constraints, Credit Unions and Small-Scale producers in Guatemala”, *World Development*, 24 (5), 1996, p. 793 - 806

<sup>65</sup> Barham B. L, Boucher S & Carter M. R, “Credit Constraints, Credit Unions and Small-Scale producers in Guatemala”, *World Development*, 24 (5), 1996, p. 793 - 806

<sup>66</sup> Peterson S, “Neglecting the Poor: State Policy Toward the Smallholder in Kenya”, in Commins S.K, Lofchie M.F & Payne R (Eds.), *African Agrarian Crisis*, Lynne Rienner Publishers, Colorado, 1986

<sup>67</sup> Interview with Johannes Thivalo, Sheba Community, June 28, 2001

<sup>68</sup> Southworth H. M & Johnston B. F, *Agricultural Development and Economic Growth*, Cornell University Press, New York, 1967, p.126

<sup>69</sup> Buckley G, “Micro-finance in Africa: Is it either the problem or the solution”, *World Development*, 25 (7), 1997, p. 1081 - 1093

employment like migrant labour, small businesses, hawking, pensions or income from small-scale farming.)

Buckley points out that extending credit to those who are unable to generate own resources may not solve problems relating to poverty, income generation or employment, since, those who are unable to generate self-finance have already “*distinguished themselves as less entrepreneurial*”. Arguably, it might be more cost-effective to improve supporting infrastructure (marketing facilities, roads and input supply networks) and have farmers/rural entrepreneurs supply their own seasonal/start-up finance.<sup>70</sup>

### **8. Preliminary conclusion**

There are two major conclusions at this stage. Firstly, Adams and Vogel have pointed out that most institutional forms of providing financial services have failed in some developing countries, while in other developing countries virtually all institutional forms of providing financial services have been at least moderately successful.<sup>71</sup> This suggests that the particular institution is less important than the social, political and economic context in which they operate. Secondly, whether credit institutions are formal or informal (and independent of the type of formal or informal institution), the poorest sectors of society are unable to obtain access to credit. Accordingly, many governments, development agencies and credit institutions have designed credit programmes and projects that target specific groups, including the poorest sectors of societies.

### **9. Loan targeting**

Governments, developmental organisations and financial institutions often target particular constituencies in an attempt to steer credit programmes and subsequent development in a particular direction. The justification for targeted credit programmes is often the argument that the very poor cannot access conventional means of credit because they lack the necessary collateral. However, targeted programmes are not necessarily designed to meet the needs of the poorest sectors of society. The Brazilian government, for example, made US\$4 billion available for credit in 1997, but only US\$182 million of this went to needy small-scale farmers.<sup>72</sup> The Agricultural Finance Corporation in Kenya focussed on credit provision to large-scale farmers (excluding small-scale farmers) until the 1970s.<sup>73</sup>

Targeting can also be directed at specific activities, rather than specific groups i.e. loans for agricultural production only. Examples of policies targeting specific activities include portfolio requirements, rediscount facilities and loan and crop guarantees. These policies are all government attempts to influence lender behaviour. Loan portfolio requirements

<sup>70</sup> Peterson S, “Neglecting the Poor: State Policy Toward the Smallholder in Kenya”, in Commins S.K, Lofchie M.F & Payne R (Eds.), *African Agrarian Crisis*, Lynne Rienner Publishers, Colorado, 1986

<sup>71</sup> Adams D. W & Vogel R. C, “Rural Financial Markets in Low-income Countries: Recent controversies and lessons”, *World Development*, 14 (4), 1986, p. 477 - 487

<sup>72</sup> Servico Brasileiro de Justica e Paz, “Land Issues”, *News from Brazil*, Number 259, January 13, 1997

<sup>73</sup> Alila P.O, “Smallholder credit for rural development in Kenya”, in *African Perspectives on Development*, Himmelstand U, Kinyanjui K & Mburugu E (Eds.), James Currey Ltd, London, 1994

include stipulated levels of lending or restrictions on loan size (e.g. Dominican Republic). Banks may be required to make a certain percentage of their loans available for a specific activity (e.g. agriculture in the Philippines, India and Colombia).<sup>74</sup> Rediscount facilities involve concessionary interest rates or funds from the Central/Reserve Bank to lenders for targeted loans. Loan and crop guarantees are used in a number of countries (e.g. Mexico and Costa Rica) to lessen the lender's risk - i.e. the government guarantees to reimburse the lender for a certain percentage of loan defaults.<sup>75</sup>

The South African Land and Agricultural Bank, which operates in accordance with the Land Bank Act 13 of 1994 and is accountable to the Minister of Agriculture and Land Affairs (before December 1996 to the Minister of Finance<sup>76</sup>), has also embarked on programmes and introduced policies to target particular sectors of South African society. This followed the establishment of the Presidential Commission on Rural Financial Services (Strauss Commission), which made recommendations to improve rural financial services. The Commission's report was tabled and accepted in September 1996. The report contained 65 recommendations emphasising the role of the state and changes in Land Bank policies.<sup>77</sup> This was followed by the Department of Land Affairs' mid-term review on the Land Reform Pilot Programme, which highlighted the inadequacy of credit arrangements in the redistribution programme.<sup>78</sup>

The first target group was small-scale farmers and, therefore, the Land Reform Credit Facility, managed by Khula Enterprise Finance, was established to provide credit to small-scale farmers. Khula Enterprise Finance is a parastatal owned by the Department of Trade and Industry. Khula's lending operations have been successful with regard to commercially orientated, mostly export crop, producers. There is a danger that Khula's policies will exclude the majority of redistribution beneficiaries because land reform beneficiaries tend to lack the resources required to operate in the more profitable agricultural sectors.<sup>79</sup>

The second target group would be those without access to sufficient collateral. One of the Strauss Commission's recommendations was that collateral rules should change. It was in this regard that the Land Bank introduced two new products - "silver" and "bronze" loans (as opposed to the standard "gold" loan). The former was designed to benefit emergent small-scale farmers by addressing the collateral obstacle. To qualify for a "silver" loan, assets that varied from 50% to 150% of the loan, depending on the amount borrowed, were required as security.<sup>80</sup> The "bronze" loans were intended to help

<sup>74</sup> Adams D. W & Vogel R. C, "Rural Financial Markets in Low-income Countries: Recent controversies and lessons", World Development, 14 (4), 1986, p. 477 - 487

<sup>75</sup> Adams D. W & Vogel R. C, "Rural Financial Markets in Low-income Countries: Recent controversies and lessons", World Development, 14 (4), 1986, p. 477 - 487

<sup>76</sup> Land Bank, Annual Report 1996, Pretoria, 1996

<sup>77</sup> Dolny H, Banking on Change, Penguin Books, South Africa, 2001, p. 55 - 58

<sup>78</sup> Turner S & Ibsen H, "Land and agrarian reform in South Africa: A Status Report", Occasional Paper Series, PLAAS, UWC, November, 2000, p. 24 - 25

<sup>79</sup> Turner S & Ibsen H, "Land and agrarian reform in South Africa: A Status Report", Occasional Paper Series, PLAAS, UWC, November, 2000, p. 24 - 25

<sup>80</sup> Dolny H, Banking on Change, Penguin Books, South Africa, 2001, p. 109 - 115

farmers obtain production loans to plant or to buy basic machinery. The security lay in the item purchased, a sound business plan, proof of access to land and a 20% deposit. In January 2001, the Land Bank extended the limit on the “bronze” product from R10 000 to R25 000 without security, thereby removing the requirement for a 20% deposit.<sup>81</sup> The products were relatively successful in terms of the increasing number of loans granted (3 348 in 1997 to 9 944 in the first six months of 1999) and the fact that 66% of the total number of loans went to the historically disadvantaged.<sup>82</sup> By 2003, the Land Bank had advanced R2 billion to developing farmers while maintaining its 50% market share of commercial agricultural debt. According to the Land Bank’s 2003 Annual Report, the total number of “development clients” stands at over 15 000 and “is increasing on an annual basis by approximately 80%”.<sup>83</sup>

The Bank also introduced measures that would arguably alleviate poverty and improve the living and working conditions on South Africa’s farms. The Strauss Commission’s Recommendation 51 stated that: “*The Land Bank must adopt a developmental approach to business, including attempts to influence the types of production loans financed. The development criteria for lending should include a good practice ethic in terms of clients applying the legally required health and safety standards of the Basic Conditions of Employment Act*”.<sup>84</sup> In this regard, the Bank’s Social Accountability Unit was set up in June 1999. In May 2000, the Bank introduced a discounted interest rate for farmers creating jobs, improving living conditions, building proper housing, schools and clinics on their farms and adopting environmentally sustainable farming methods.<sup>85</sup> The Land Bank also introduced a policy whereby the DLA had first option to purchase land going up for auction. Indications are that the DLA never utilised this opportunity.<sup>86</sup> Other structural changes included personnel changes, the appointment of the first black branch managers in 1998 and the establishment of a new information system.<sup>87</sup>

What emerges from the South African and international accounts, is the impression that target programmes are fraught with problems and do not have a particularly high success rate. Firstly, target programmes are problematic because it is difficult to define precisely who the target group is, it is difficult to reach target groups, data tends to be sketchy and target programmes are very expensive.

Secondly, and related to the targeting of specific activities, is the issue of fungibility or financial substitution. Fungibility, or financial substitution, refers to the fact that “*one unit of money, be it owned or borrowed is just like any other unit of money*”.<sup>88</sup>

<sup>81</sup> Business Day, October 24, 2001

<sup>82</sup> Land Bank, Annual Report 1999, Pretoria 1999 and Dolny H, Banking on Change, Penguin Books, South Africa, 2001, p. 109 - 115

<sup>83</sup> Land Bank, Annual Report, Pretoria, 2003

<sup>84</sup> Dolny H, Banking on Change, Penguin Books, South Africa, 2001, p. 55 - 58

<sup>85</sup> Land Bank, Annual Report 2003, Pretoria 2003 & Mail & Guardian, “Rewards for ethically correct farmers”, October 17, 1999

<sup>86</sup> Interview with Helena Dolny, June 22, 2001

<sup>87</sup> The Farmer, “Low-cost land bank loans for these farmers”, May 1999

<sup>88</sup> Adams D. W & Vogel R. C, “Rural Financial Markets in Low-income Countries: Recent controversies and lessons”, World Development, 14 (4), 1986, p. 477 - 487



Essentially, fungibility is a characteristic of all loans and involves the fact that households who access credit often do not utilise the funds for the purposes envisaged by the lenders - i.e. the household may use the money for consumption rather than for productive purposes. It is difficult for lenders to control credit utilisation, particularly in agriculture where borrowers are widely dispersed. It is, therefore, almost impossible for credit programmes to target specific activities. Similarly, loan portfolio requirements can easily be evaded by, for example, making a multiple number of smaller loans available to one borrower. While rediscount facilities and loan and crop guarantees are often very expensive methods and may be detrimental to lending institutions who may neglect savings mobilisation in a context where governments and/or development agencies provide funds.<sup>89</sup>

### ***10. Default and Repayment***

Where credit was made available to the rural poor, repayment has been minimal and default the norm. This was the case in Costa Rica, Indonesia, Zimbabwe, Kenya and the Philippines. In South Africa, banks are recovering only about 60% of the money they lend to farmers (as opposed to 100% ten years ago).<sup>90</sup> There are two possible explanations for this. First, that banks are lending to higher risk borrowers or, secondly, because farming has become less profitable. The Department of Agriculture found that there was generally a “lukewarm” commitment to repaying government.<sup>91</sup> This is confirmed by experiences in the Philippines where the Agricultural Credit and Co-operative Financing Administration relied heavily on government funds that borrowers felt little obligation to repay.<sup>92</sup>

Taiwan was able to avoid the “default disease” because credit policies placed emphasis on deposit mobilisation that allowed credit institutions to decrease their reliance on government funds and create more effective incentives for repayment.<sup>93</sup> Evidence from Indonesia suggests that land reform beneficiaries involved in commercial cash crop production and/or those with access to other sources of income have a better payback record.<sup>94</sup> In cases where beneficiaries lack alternative financial resources, there must be a substantial grant component to provide for the missing equity. Molino<sup>95</sup> argues that it is not reasonable to expect repayment from the non-bankable and bankable poor unless differentiated quotas designed around the ability of creditors to repay debt are designed. Examples include paying twice/four times per year instead of on a monthly basis. One of

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<sup>89</sup> Adams D. W & Vogel R. C, “Rural Financial Markets in Low-income Countries: Recent controversies and lessons”, *World Development*, 14 (4), 1986, p. 477 - 487

<sup>90</sup> *Business Day*, July 17, 2001

<sup>91</sup> Dolny H, *Banking on Change*, Penguin Books, South Africa, 2001

<sup>92</sup> Adams D.W, Chen H.Y & Lamberte M.B, “Differences in Used Rural Financial Markets in Taiwan and the Philippines”, *World Development*, 21 (4), 1993

<sup>93</sup> Adams D.W, Chen H.Y & Lamberte M.B, “Differences in Used Rural Financial Markets in Taiwan and the Philippines”, *World Development*, 21 (4), 1993

<sup>94</sup> Kinsey B.H & Binswanger H.P, “Characteristics and Performance of Resettlement Programmes: A review and some lessons from experience”, World Bank & LAPC Workshop Paper, Swaziland, November 1993

<sup>95</sup> Molino J.C, “Land Credit for the Rural Poor: Review of Some Experiences, FAO Land Tenure Service SDAA, June 18, 1997

the reasons for the success of the Cuban land reform programme was that beneficiaries did not have to pay for the land to which they obtained access. This reduced the need for further financial assistance and access to credit. The limited resources at their disposal could be invested in agriculture.

In an attempt to reduce the costs of default to the Land Bank in South Africa, the Land and Agricultural Development Bank Act 15 was passed in June 2002. The Act allows the Land Bank to claim all the income of any farmer who falls into arrears with it (arguably disadvantaging commercial banks and other credit agencies when a borrower defaults). Under the Act, commercial farmers would need to get written consent from the Land Bank before they disposed of produce it had financed. Farmers also may not transfer property encumbered with a loan for farm improvements without a certificate from the Land Bank.<sup>96</sup> However, the new Act also requires the Land Bank (like all other creditors) to seek judgements from a court of law and sell assets or rights in accordance with section 33 of the Act 15 of 2002.<sup>97</sup>

The success of these and other policy initiatives, depend on the reasons why borrowers default on loans. Reasons may include the fact that some borrowers are unable to repay loans, that some borrowers never intended to repay loans (as often happens when loans are provided by government agencies or developmental organisations) or because the techniques used to encourage repayment are defective. Adams and Vogel argue that recent experiences in Costa Rica suggest that the techniques lenders used to encourage payment, play a crucial role - i.e. there must be substantial costs for the borrower in case of default (appropriation of collateral) and significant benefits for repayment (possibility of bigger loans in the future, possibly at lower interest rates).<sup>98</sup>

### ***11. Negative consequences of credit programmes***

Inappropriate or ill-conceived credit policies can have negative consequences ranging from reduced income (impoverishment) and environmental destruction, to dispossession and overcrowding. The Solane Community Trust in Mpumalanga (where I conducted fieldwork), for example, consists of 200 beneficiary households who acquired portion one of the farm Uitsig in the Barberton district in February 1997. The community planned to utilise their property for commercial agricultural production and to provide employment and incomes for the beneficiary households. The community obtained a loan of just over R1 million from a commercial bank. The loan would be used to plant 80 hectares of sugarcane and 25 hectares of citrus and, for the construction of an irrigation system.<sup>99</sup> The first commercial harvest would take place in 2002. In early 2001, tragedy struck - a flood virtually destroyed the irrigation system. Loan repayments, however,

<sup>96</sup> Mail & Guardian, "Banks see red over new farms act", September 6 – 12, 2002

<sup>97</sup> This follows a challenge to the Bank's recovery mechanisms (i.e. the right to seize and sell the assets of a defaulting client without recourse to a court of law and without having to follow ordinary legal procedures) in the Constitutional Court in May 2000 where the Constitutional Court held that the Bank's recovery mechanisms were unconstitutional. See Land Bank Annual Report, Pretoria, 2003

<sup>98</sup> Adams D. W & Vogel R. C, "Rural Financial Markets in Low-income Countries: Recent controversies and lessons", World Development, 14 (4), 1986, p. 477 - 487

<sup>99</sup> Interviews with Solane Community, June 29, 2001

continue and fears exist that the community might lose their land. In addition, loan repayments have left the community with very little in terms of profit and/or income.<sup>100</sup>

In another local example, the Xhomani San, who received 65 000 hectares in the Kalahari on the border of the Kalagadi Transfrontier Park risk losing part of their land because of bad debt. Five members of the community's Communal Property Association's management committee, accumulated a R150 000 debt. Consequently, on March 20, 2002, the magistrate's court in Upington ordered that one of the community's farms (Erin farm) had to be sold to pay off the debt.<sup>101</sup> Indications are that questions around the legality of the actions of the members of the CPA will prevent the auction. Nevertheless, poor communities, who are given access to substantial amounts of credit, risk losing the meagre amounts of resources and assets that they may have.

Empirical evidence from the Peruvian Amazon indicates that very effective credit and rural development programmes may result in increased conflict, dispossession and environmental degradation. The Peruvian government introduced a credit programme in 1987, which formed part of a broader macro-economic policy aimed at channelling resources from the urban to the rural areas. The credit and rural development programme *"sought to increase output from the agricultural sector, raise farm incomes and secure the supply of food crops for urban consumers"*.<sup>102</sup> In terms of the programme, peasants would form democratic and participatory Agrarian Associations. These associations would then receive secure access to land as well as the credit necessary to work and develop the land. Lending in the Peruvian agricultural sector increased dramatically. During the period 1986 – 1989, the average number of loans granted tripled and the land area worked with credit doubled over the average levels of the previous ten years.<sup>103</sup> The credit and rural development programme was so effective that it sparked a short, but intense, rush to acquire land in Peru's rural areas. Members of the urban middle classes (traders, teachers, students etc.) flocked to rural areas and joined Agrarian Associations in order to access land and credit, in the absence of more viable economic opportunities in the urban sector. Since members of the urban middle class tended to have more skills and resources than the rural poor, in a context of land scarcity, they took over land and poorer rural people were dispossessed, many becoming farm labourers. A 1989 survey revealed that 15.6% of the population in the agricultural sector consisted of new arrivals, compared to close to 0% in 1986. Partly because of these population changes, land conflicts over particular areas erupted between various local communities.

Furthermore, the availability of cheap credit allowed many households to clear more land than they were able to use (due to a lack of labour supply). This led to environmental degradation as former forest land was cleared and formerly environmentally sustainable rotation systems were abandoned in favour of cattle herding (which requires less labour)

<sup>100</sup> Interview with Jabulani Themba, June 30, 2001

<sup>101</sup> Weideman M, Interview with Isak Kuiper (Representative of the Komani San), Hartebeestpoortdam, September 8, 2002 and *Mail & Guardian*, "San risk losing their land", September 13 – 10, 2002

<sup>102</sup> Coomes O. T, "State Credit Programmes and the Peasantry under Popular Regimes: Lessons from the APRA experience in the Peruvian Amazon", *World Development*, 24 (8), 1996, p.1333 - 1346

<sup>103</sup> Coomes O. T, "State Credit Programmes and the Peasantry under Popular Regimes: Lessons from the APRA experience in the Peruvian Amazon", *World Development*, 24 (8), 1996, p.1333 - 1346

and charcoal production (which generates a cash income but destroys forests). In addition, much of the newly cleared land was not fertile enough and yields were too low to generate sufficient income to repay loans. Many households used their credit simply to maintain household consumption levels. In other cases, access to credit contributed to higher levels of food insecurity as farmers shifted from household subsistence production to the production of cash crops in order to raise cash to repay loans. As Coomes explains, credit programmes can undermine the welfare of the rural poor by shifting relative income and investment opportunities available between urban and rural areas.<sup>104</sup>

Empirical evidence also indicates that access to credit does not necessarily reduce the need for credit, nor does it necessarily translate into increased productivity or incomes. Buckley's study in Ghana, Malawi and Kenya found that a group of respondents, all of whom had in fact received one or more loans from specialist micro-enterprise lending institutions, still wanted credit. *"The inference being that despite having received credit, the demand for it appeared to remain fairly constant. There did not appear to be any movement towards self-sufficiency or graduation away from micro-finance programmes even for those who had received more than four credits. In fact, among those respondents from the Kenyan sample, there was a slightly greater number who needed more credit than among the random group where 97% of respondents had never received any type of formal credit. Furthermore, the impact of these credits on operations – measured in terms of increased sales, profitability or employment – was negligible and little different to the same set of variables recorded for those similar micro-enterprises which had not received credit"*.<sup>105</sup>

## **12. Why credit policies fail or do not have the intended results**

### **12.1. Structural nature of poverty**

Credit policies do not address the structural factors that maintain the marginalisation of the poor. As Southworth explains *"credit and income-generating programmes frame the problem of poverty as a temporary and easily remedied, cash-flow problem, instead of one which bears on relations of inequality and their institutionalisation in a broader economic policy"*.<sup>106</sup> Gendered social relationships, for example, often entrenches the poverty of women, in the sense that when women gain access to credit, the money is often controlled by male heads of households or male relatives.<sup>107</sup> Similarly, culture and societal values may contribute to continued marginalisation and poverty. For example, the rural poor are often conservative and reluctant to risk their only livelihood to borrow

<sup>104</sup> The whole paragraph on the Peruvian Amazon based on Coomes O. T, "State Credit Programmes and the Peasantry under Popular Regimes: Lessons from the APRA experience in the Peruvian Amazon", World Development, 24 (8), 1996, p.1333 - 1346

<sup>105</sup> Buckley G, "Micro-finance in Africa: Is it either the problem or the solution", World Development, 25 (7), 1997, p. 1081 - 1093

<sup>106</sup> Southworth H. M & Jonhston B. F, Agricultural Development and Economic Growth, Cornell University Press, New York, 1967, p.276

<sup>107</sup> Goetz A. M, "Who takes the credit: Gender, power and control over loan use in rural credit programmes in Bangladesh", World Development, 24 (1), 1996, p. 45 - 63

money from banks.<sup>108</sup> Similarly, societies that place low status on individualism are likely to discourage entrepreneurial activity.<sup>109</sup> Furthermore, different groups within a given society may be expected to engage in particular activities and not others, independent of economic reasons - i.e. women are engaged in household food production and men in cattle herding or, where women are excluded from decision-making structures. An individual's position within an extended family may also influence perceptions of, and successful use of, credit. Extended family and kinship networks create entitlements and obligations. For example, family labour may provide a producer with free or cheap labour to use credit successfully or, an individual may be forced by her status in the family to use newly acquired resources to meet obligations such as funeral costs or school fees.<sup>110</sup> In yet other societies, there are taboos against debt and as Southworth explains "*the taboo seldom prevents debt, but it tends to preserve attitudes that confine the use of credit to consumption purposes.*"<sup>111</sup>

Related to the above is peoples' or communities' understanding of or attitudes to debt, credit, repayment and default. When survey respondents in Ghana were asked whether they wanted debt, for example, over a third of respondents said that they never wanted to be in debt, while only 13% had stated that they did not want credit. Buckley argues that this suggests confusion regarding credit, which is seen as positive, and debt, which is seen as negative. According to Buckley, this also illustrates that credit concepts are not clear-cut. For example, many credit relationships in poorer societies occur in non-monetary forms, including lending labour and tools. In terms of attitudes to repayment and default, Buckley found that many of the Kenyan respondents were located in areas where donor and/or government credit programmes had operated, where many people had defaulted and where the lenders seemingly gave up trying to get the money back. "*So for many people, credit from outsiders (government, NGOs) was not greatly dissimilar to a gift*". This perception was clearly evident in cases where respondents said that they would like an "unconditional loan".<sup>112</sup>

## 12.2. Tenure security

It is frequently argued that access to credit is dependent on land ownership. This is certainly true with regard to South African credit institutions that remain tied to the requirement of land as collateral for loans. This argument has also often been a primary motivation for conversion to freehold tenure systems. However, international evidence suggests that land ownership is not a sufficient condition for access to credit. Firstly, commercial banks hesitate to lend to small-scale farmers and the rural poor for a variety

<sup>108</sup> Interview with Ben Cousins, Director PLAAS, July 2, 2002, also see the following section on tenure security.

<sup>109</sup> Buckley G, "Micro-finance in Africa: Is it either the problem or the solution", *World Development*, 25 (7), 1997, p. 1081 - 1093

<sup>110</sup> Buckley G, "Micro-finance in Africa: Is it either the problem or the solution", *World Development*, 25 (7), 1997, p. 1081 - 1093

<sup>111</sup> Southworth H. M & Jonhston B. F, *Agricultural Development and Economic Growth*, Cornell University Press, New York, 1967, p.276

<sup>112</sup> Buckley G, "Micro-finance in Africa: Is it either the problem or the solution", *World Development*, 25 (7), 1997, p. 1081 - 1093

of reasons. Banks consider factors, such as savings records and access to viable income streams, other than from farming, when they consider whether to lend to small-scale farmers.<sup>113</sup> What has emerged clearly from the redistribution programme, for example, is the fact that banks are not keen to go into ventures with Communal Property Associations. Communally owned land can hardly be used as collateral because banks look beyond the value of collateral pledged by the trust – they are concerned with quality of management and ability to control co-owned resources.<sup>114</sup> For example, in cases of default it is unclear whom to hold accountable. It will also be difficult to repossess land on which hundreds of people are resident. Furthermore, banks look for larger opportunities in which administrative costs are low in proportion to the size of the loans and in which capital can be recovered much faster.<sup>115</sup> As Dolny put it: *“Coming from a banking background, I thought that I would not lend money to a farmer with 20 or 30 hectares of dry-land, 400km away, because what am I going to repossess if the guy defaults on his loan?”*<sup>116</sup> The Land Redistribution for Agricultural Development Programme (discussed in chapter seven) arguably introduced a shift in the government’s thinking and implementation of land redistribution, placing far more emphasis on the development of a class of black commercial farmers. Predictably then, (based on the above discussion) the Land Bank has increased its lending to redistribution beneficiaries, and by 2003, the Bank had facilitated over R17 million in government grants in support of the Land Redistribution for Agricultural Development Programme.<sup>117</sup>

Conversion to freehold tenure in Kenya, also did not increase access to credit. This failure was the result of the fact that new landowners were not willing to risk losing their land by mortgaging it. Land in Kenya (and in many African communities), has a cultural and religious significance (i.e. linked to the presence of ancestors), which discourages land mortgaging.<sup>118</sup>

Furthermore, conversion to freehold tenure and collateral requirements could deprive small-scale farmers and the rural poor of their land. Land may be lost to debtors or sold in emergencies. The 1997 White Paper on land reform, for example, argues that one of the advantages of communal tenure is that land cannot be sold in emergencies or foreclosed for debt. In the Eastern Cape, a number of farmers have been offered land title but are not willing to take it. The farmers have built up a combined debt of R20 million with the Ciskei Agricultural Bank and fear that they will lose their land to their debtors as soon as they receive ownership rights.<sup>119</sup> In El Salvador and Nicaragua, debt is forcing

<sup>113</sup> Bruce J.W, “Do Indigenous Tenure Systems Constrain Agricultural Development”, Land in African Agrarian Systems, Bassett T & Crummey D.E. (Eds.), University of Wisconsin Press, Wisconsin, 1993

<sup>114</sup> Lyne M & Lima Rural Development Foundation, “Options for Government’s Settlement/ Land Acquisition Grant”, Research Paper for the National Land Committee, July 1998

<sup>115</sup> Bruce J.W, “Do Indigenous Tenure Systems Constrain Agricultural Development”, Land in African Agrarian Systems, Bassett T & Crummey D.E. (Eds.), University of Wisconsin Press, Wisconsin, 1993

<sup>116</sup> Interview with Helena Dolny (Former Director of Land Bank & advisor to Derek Hanekom), June 22, 2001

<sup>117</sup> Land Bank, Annual Report, Pretoria, 2003

<sup>118</sup> Shipton P, “Debts and trespassers: Land, Mortgages and the ancestors in Western Kenya”, Africa, Vol.62, No.3, 1992

<sup>119</sup> Kretzman S, “Eastern Cape farmers: some big chances, some big parties, but no big plans”, Land and Rural Digest, 9, July/August, 2001

small-scale farmers to sell their land and, indications are that land is returning to former landowners.<sup>120</sup> As a DLA project officer, commenting on the South African land redistribution programme, asks, *“what happens 10 to 20 years from now, when people have lost or sold their properties and become a burden on the community? We do not want the land reform programme to cause destitution in the long run”*.<sup>121</sup>

Perhaps the answer lies in the fact that in many countries in Latin America, Asia and Africa, where tenancy is the dominant form of agricultural production, tenants still have access to credit. Credit institutions evaluate loan applications on the basis of farming track records and repayment potential - not land ownership.<sup>122</sup> The Land Redistribution for Agricultural Development Programme, however, assumes that commercial banks will provide the bulk of the finance for the emerging black commercial farmers that the programme will supposedly support.<sup>123</sup> Unless there is a radical change away from the South African fixation on “land as collateral”, this is not likely to happen.

Recent developments in Land Bank policy seem to be moving in the recommended direction. As mention above, the Strauss Commission recommended, in 1997, that lending criteria not based on freehold tenure should be developed. In response, the Land Bank has become an agency for the distribution of Land Redistribution for Agricultural Development Programme funds and has signed a Memorandum of Understanding with the National Development Agency and the Commission for the Restitution of Land Rights to “ensure the greater co-ordination of initiatives in support of land restitution”.<sup>124</sup> According to the Land Bank’s 2003 Annual Report, it has thus far advanced R780 000 to 155 beneficiaries of the Land Restitution Programme. It also states that the Bank begun to introduce non-collateralised products for “qualifying clients” (but does not specify what “qualifying clients” are).

### 12. 3. New technology and/or new techniques

As Southworth explains, new incentives to invest family labour may be of little value if the farmer has no new tools and processes with which to work.<sup>125</sup> In other words, access to credit will not result in increased agricultural production unless it is accompanied by investments and changes in the factors of production, which include the introduction and utilisation of new technology. For example, less than 10% of all respondents in Buckley’s study (Ghana, Kenya and Malawi), who had received formal credit, were able

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<sup>120</sup> Sequira M, "Central America: Rural Workers say Land is Returning to the Rich", World News, April 9, 1998

<sup>121</sup> Interview with David Manzini (DLA Project Officer, Mpumalanga), May 25, 2001

<sup>122</sup> Interview with Helena Dolny, June 22, 2001

<sup>123</sup> Turner S & Ibsen H, “Land and agrarian reform in South Africa: A Status Report”, Occasional Paper Series, PLAAS, UWC, November, 2000, p. 24 - 25

<sup>124</sup> Land Bank, Annual Report, Pretoria, 2003

<sup>125</sup> Southworth H. M & Jonhston B. F, Agricultural Development and Economic Growth, Cornell University Press, New York, 1967, p.276

to demonstrate any type of change in technique or technology since they had received their first loan.<sup>126</sup>

#### 12.4. Macro-economic policy

Related to the structural nature of poverty is the fact that credit policies do not operate in isolation and, the success or failure of credit policies need to be understood in relation to macro-economic policies and the rural environment. Coomes' study conducted in the Peruvian Amazon shows how a macro-economic (and credit) policy aimed at developing rural areas, by transferring resources from urban to rural areas, resulted in urban to rural migration and the dispossession of the rural poor.<sup>127</sup> Similarly, access to credit will be of little value if the macro-economic policy undermines the ability of small or emerging farmers to compete with established local or international producers due to, for example, lack of access to markets, infrastructure, social services, information, training and political power.

The nature of the state may also play a role, particularly in developing countries. As Buckley explains, *"the prevalence of weak, transitory or corrupt governments tends to result in inconsistent policy making, to generate macro-economic instability, discourage innovation and increase the risks of doing legitimate business"*.<sup>128</sup> Finally, access to credit cannot compensate for a weak agricultural sector or low returns on investments in agriculture. *"Cheap credit does not make an unprofitable investment profitable"*.<sup>129</sup> If agriculture were not profitable, people would be unlikely to use credit to invest in agriculture and if they did, would most likely be unable to repay loans.

#### 12.5. Managerial shortcomings

Sometimes lack of access to credit was not the problem in the first place. As suggested in Buckley's study, apparent problems of capital shortages may be the result of, rather than a cause of, managerial shortcomings - i.e. where more entrepreneurial individuals were able to self-finance micro-enterprises. Buckley's argument is that those who were unable to accumulate resources or, who were unable to obtain loans from family or friends, probably lack the entrepreneurial qualities required in order to succeed in micro-enterprise or small-scale commercial agricultural production.<sup>130</sup>

#### 12.6 *The realities of poverty and rural life*

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<sup>126</sup> Buckley G, "Micro-finance in Africa: Is it either the problem or the solution", World Development, 25 (7), 1997, p. 1081 - 1093

<sup>127</sup> Coomes O. T, "State Credit Programmes and the Peasantry under Popular Regimes: Lessons from the APRA experience in the Peruvian Amazon", World Development, 24 (8), 1996, p.1333 - 1346

<sup>128</sup> Buckley G, "Micro-finance in Africa: Is it either the problem or the solution", World Development, 25 (7), 1997, p. 1081 - 1093

<sup>129</sup> Adams D. W & Vogel R. C, "Rural Financial Markets in Low-income Countries: Recent controversies and lessons", World Development, 14 (4), 1986, p. 477 - 487

<sup>130</sup> Buckley G, "Micro-finance in Africa: Is it either the problem or the solution", World Development, 25 (7), 1997, p. 1081 - 1093



Related to the unwillingness of the rural poor to risk their only livelihoods, is the fact that poorer individuals often utilise credit to invest in less profitable, but more secure ventures - i.e. instead of investing in production, individuals purchase land. As Buckley explains, enterprise (agricultural production) is “often seen as ephemeral, being tied into the life of its creator unlike land and real estate, which may be perceived as a more secure . . . form of investment. These latter forms of investment act as insurance in the absence of state provision for retirement or ill health and their ownership is likely to bestow more status than the ownership of an enterprise. Land and real estate is durable and can be worked by kin to produce consumption and income”.<sup>131</sup> In cases of extreme poverty, therefore, individuals are not likely to risk losing the meagre resources that they may have.

### ***13. Subsidised interest rates: a possible solution?***

Initially (early 1990s) in the South African debate, some land reform policy drafters argued that since access to cheap subsidised credit is partly what kept successive generations of white farmers on the land, agricultural credit policies should be used as a redistributive mechanism and to correct some of the imbalances created by previous political policies.<sup>132</sup> This argument is, however, not reflected in credit policies drafted in the late 1990s. Experiences in Taiwan and the Philippines appear to support the later policy development. Taiwan, which achieved impressive economic growth and a successful land reform programme, avoided using credit policies as income redistributing mechanisms. In contrast, the Philippines effected major income transfers to borrowers through concessionary rates and loan defaults, leading to extensive rent seeking behaviour and dramatic economic decline by the 1980s.<sup>133</sup>

There were also extensive debates in the South African Land Bank and the agricultural sector around the introduction of subsidised interest rates. Black farmers' unions were arguing that since white farmers had survived partly because of generous subsidies, the same privileges should be available to black farmers.<sup>134</sup> Authors opposed to the introduction of subsidised interest rates have argued that it encourages corruption, capital flight and unproductive investment, while at the same time discouraging savings mobilisation.<sup>135</sup> The argument against the introduction of subsidies is that it increases the demand for inputs, resulting in price increases – especially land price increases. The introduction of subsidies to increase the profitability of wheat production in Europe, for example, pushed up prices of inputs such as land. Within 12 years, the extra profit originally derived from growing subsidised crops was absorbed into the price of land

<sup>131</sup> Buckley G, “Micro-finance in Africa: Is it either the problem or the solution”, *World Development*, 25 (7), 1997, p. 1081 - 1093

<sup>132</sup> Van Zyl J, Binswanger H, “Market-assisted rural land reform: how will it work”, *Agricultural Land Reform in South Africa*, Van Zyl J, Kirsten J & Binswanger H (Eds.), Oxford University Press, Cape Town, 1996

<sup>133</sup> Adams D.W, Chen H.Y & Lamberte M.B, “Differences in Used Rural Financial Markets in Taiwan and the Philippines”, *World Development*, 21 (4), 1993

<sup>134</sup> Interview with Helena Dolny, June 22, 2001

<sup>135</sup> Muhumuza W, Credit and poverty alleviation in the context of Structural Adjustment Reforms in Uganda, PhD proposal submitted to the Department of Political Studies, University of the Witwatersrand, 2002 & Muhumuza W, Credit and Poverty Alleviation in the Context of Structural Adjustment Reforms in Uganda, Ph.D., University of the Witwatersrand, May 2002

used for wheat growing.<sup>136</sup> In Indonesia and Panama, governments tried to place ceilings on interest rates but were unable to enforce the legislation.<sup>137</sup> Experiences in the Philippines indicate that subsidised credit makes it impossible for credit agencies to cover the real costs of their lending.<sup>138</sup> Following a comprehensive comparative analysis, Adams and Vogel found that subsidised interest rate policies generally failed to promote agricultural production or the adoption of new technology and have discouraged savings and undermined the financial viability of the financial institutions involved.<sup>139</sup>

Nevertheless, in September 1998, the South African Land Bank did embark on a special development fund to subsidise mortgage bonds for previously disadvantaged emerging farmers at an interest rate of 15% (at a time when commercial banks' rates were well over 20%).<sup>140</sup> The new bonds, at the subsidised rate, would have a ceiling of R250 000. The rationale was that the percentage of such transactions, in terms of annual land transactions, would be too small to affect overall land prices.<sup>141</sup> This policy initiative may be successful if interest rates are high enough to encourage savings as well as cover the costs to the Land Bank.

#### ***14. Savings Mobilisation: a possible solution***

*"It is, of course, not credit itself that levers the poor out of poverty, but their ability to save from income generated from the use made of credit".<sup>142</sup>*

Agricultural credit policies can only be successful if they lead to increased overall production and income - i.e. an increased asset base that includes savings, whether in monetary or non-monetary (cattle, land, jewellery) form. Agricultural credit programmes that stress lending at the expense of savings mobilisation are, therefore, not likely to meet the objectives of increased agricultural production and poverty alleviation. Failure to mobilise savings will also reduce the total amount available for lending in rural areas in the absence of substantial government or donor funding. These institutions are also likely to lack long-term viability/sustainability. The role of financial and credit institutions is, after all, not only to lend but, also to provide deposit facilities, so that institutions that neglect savings mobilisation are incomplete and make themselves vulnerable to high rates of loan default. This is because financial institutions that deal with clients only as borrowers forgo useful information on the savings behaviour of clients that could result in more accurate estimates of creditworthiness. Secondly, borrowers are more likely to repay loans and, lenders to take responsibility for repayment, when they know that the

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<sup>136</sup> Dolny H, Banking on Change, Penguin Books, South Africa, 2001, p. 106 - 109

<sup>137</sup> United Nations Food and Agriculture Organisation, An Enquiry into the problems of agricultural price stabilisation and support policies, Rome, 1960, p. 72 & 73

<sup>138</sup> Adams D.W, Chen H.Y & Lamberte M.B, "Differences in Used Rural Financial Markets in Taiwan and the Philippines", World Development, 21 (4), 1993

<sup>139</sup> Adams D. W & Vogel R. C, "Rural Financial Markets in Low-income Countries: Recent controversies and lessons", World Development, 14 (4), 1986, p. 477 - 487

<sup>140</sup> Land Bank, Annual Report 1998, Pretoria, 1998 and Business Day, September 3, 1998

<sup>141</sup> Interview with Helena Dolny, June 22, 2001

<sup>142</sup> Buckley G, "Micro-finance in Africa: Is it either the problem or the solution", World Development, 25 (7), 1997, p. 1081 - 1093

local community generated the funds. Furthermore, financial institutions that mobilise savings will have a constant flow of funds available, whereas those depending on donor and government funds will be subject to inconsistent funding cycles.<sup>143</sup>

The obvious question, therefore, is why financial or credit institutions in rural areas tend to neglect savings mobilisation. Often, this neglect is based on the belief that the rural poor are unable or unwilling to save. There is, however, empirical evidence to indicate the contrary. For example, the high number of respondents in the Ghana, Kenya and Malawi study with bank accounts, the prevalence of self-finance, high membership rates of Rotating credit and savings institutions and even the existence of moneylenders (who would not lend money if there was not some possibility of repayment).<sup>144</sup> It is also important to note that savings often take non-monetary forms such as land and cattle acquisition.

## 16. Conclusion

The 1997 White Paper on South African Land Policy identifies as a priority “*the need for major institutional, policy and legal reform in regard to land and rural financing*” and further states that the South African government has the “*responsibility to provide assistance with farm credit*” and that an increasing number of land reform beneficiaries “*have developed business plans whose successful implementation requires access to credit and other financial services in order that production and income generation on their newly acquired land can take place. . . . The majority of rural people still have very limited access to formal financial services*”.<sup>145</sup> The challenges outlined above, coupled with the accepted premise that access to cheap credit is a crucial variable in the success or failure (short and long-term) of a land reform programme, as well as for income-generating or profitable farming, constitutes the motivation for the inclusion of this chapter in the thesis.

This chapter reviewed a range of credit options that have been used in conjunction with land reform programmes elsewhere in the world. The review was undertaken because South Africa has to develop credit options that address the inequitable nature of the credit and financial support services sector in South Africa, and particularly, because credit must be extended to poorer people in rural areas, including land reform beneficiaries. Secondly, as the discussion in this chapter has indicated, inappropriate or ill-conceived credit policies can have negative consequences ranging from reduced income or impoverishment, to environmental destruction, to dispossession and to overcrowding. Of the range of credit options reviewed, micro-credit programmes and rotating credit associations seem to have the highest degree of success, in terms of reaching the poorer sectors of rural societies and in producing “sustainable” results (i.e. contribute to the development of a long-term income-generating activity).

<sup>143</sup> Whole paragraph on the viability of financial institutions with regard to savings mobilisation based on Adams D. W & Vogel R. C, “Rural Financial Markets in Low-income Countries: Recent controversies and lessons”, *World Development*, 14 (4), 1986, p. 477 - 487

<sup>144</sup> See section on Commercial Lending Institutions in this chapter for figures.

<sup>145</sup> Department of Land Affairs, *White Paper on South African Land Policy*, Pretoria, 1997, p. 24 & 25, Sections 3.10 and 3.11

However, most credit options/ institutions/ programmes (including micro-credit schemes) fail to reach the *poorest* sections of rural society. For example, poor people, small-scale farmers, emergent farmers and/or anybody lacking “proof” of land “ownership” will likely be unable to obtain credit from commercial banks. The South African Land Bank, for example, has managed to significantly increase its lending to “poorer” clients, but, by and large, these “poorer” clients are able to present “viable business plans” and “proof of rights to land”, which, by definition, excludes the *poorest* members of rural society. (Admittedly, the Land Bank has tried to provide for the *poorest* sectors through its Step-up programme, which to a certain extent has been successful). Credit unions (as a further example) tend to relax credit constraints so that poorer households have better access to credit from credit unions than commercial banks, but the poorest members of rural society are still excluded. State intervention in the provision of credit has not been particularly successful either. State-owned financial institutions tend to lack accountability and capacity, foster arbitrary practices and allocate credit more on political than economic grounds.

As noted, even the more “successful” programmes have limitations. With rotating credit associations, for example, members reported increased household welfare, improved nutrition and the ability to accumulate assets such as land, equipment and animals. Nevertheless, rotating credit associations are unlikely to provide access to resources on a sufficient scale to transform social or economic relations. In South Africa, the Land Bank’s Step-up micro-credit programme has been relatively successful, distributing R300 million to more than 130 000 people, 70% of whom are women, with an 87% repayment rate. Yet, micro-credit programmes (including the Step-up programme) often appear successful because of the criteria used to evaluate it (i.e. repayment rates, number of borrowers etc.). The discussion in this chapter has shown that repayment rates, for example, do not indicate whether the resources gained through credit programmes were spent to improve the economic positions of households, or rather to meet household subsistence needs, nor whether the money was used by the “targeted” person (e.g. wife) or appropriated by another, more powerful individual (e.g. husband). In this regard, the attempts made by the Micro Finance Regulatory Council in South Africa to regulate the micro-lending industry is commended.

A very likely source of finance for the rural poor is not credit from financial institutions, whether formal or informal, but rather self-generated funds (whether from on or off farm, formal/ informal/ self-employment, or remittances from migrant labour or pensions). This is because a) the poorest sectors of society cannot access credit institutions/ programmes and b) because access to credit is just a “temporary injection of capital”, which cannot solve the structural nature of rural poverty – this would require the transformation of social, economic and political power relationships in rural society. Therefore, (and this is the major conclusion drawn in this chapter as well as the most important policy recommendation to emerge from the material in this chapter) policies that enable self-finance are likely to be more cost-effective and more beneficial to the poorest members of rural society. Policies that facilitate self-finance, are also policies that contribute to changes in the relations of inequality in rural areas, and include improving the supporting

infrastructure in rural areas (i.e. marketing facilities, roads and input supply networks). Furthermore, access to credit will be of little value if the macro-economic policy undermines the ability of small or emerging farmers to compete with established local or international producers, for example, because they lack access to markets, infrastructure, social services, information, training and political power. In other words, credit provision should only be one aspect of a wider policy approach to rural development.

Further (subsidiary) policy recommendations include the following. Firstly, if state provision of credit to poor rural people is to have any chance of success, a number of criteria must be met a) beneficiaries must participate in policy formulation. b) Policies and programmes must be practical and easy to implement, c) the state must have the necessary capacity, d) there must be clear policy parameters and rules relating to default and e) there must be a sound land price and market system.

Secondly, the collateral requirement that forms part of so many credit programmes must be reconsidered. The credit programmes that have the most benign effects are those which have the capacity to evaluate borrowers intelligently on the basis of farming track records rather than the availability of collateral, but this requires more sophisticated institutional capacity in the credit sector than exists in most developing countries, including South Africa.

Thirdly, with regard to the financial institutions themselves, a strategy, which may contribute to greater success in rural areas, is savings mobilisation. An emphasis on savings not only increases the resources available to these institutions, but also gives them better knowledge of their clients. Savings mobilisation is important for the borrowers, because as Buckley argues, it is not “credit that levers the poor out of poverty, but their ability to save from the income generated from the use made of credit”. Again this suggests an institutional structure of credit provision that is itself extremely sophisticated and integrated in a wider strategy of rural development than is available in most modern liberal oriented political dispensations.

Fourth, although subsidised interest rates are popular among emerging farmers, and can sometimes have positive effects, they are usually unsustainable and tend to encourage unproductive investment and discourage savings mobilisation. Subsidised interest rates also tend to increase the demand for inputs, resulting in price increases – especially land price increases – and so decrease the profitability of farming in the long term.