AGRICULTURAL FINANCE : WHAT LIES AHEAD?

R Wilsnach
Senior Manager, Agricultural Department, Regional Banking, Standard Bank of South Africa

INTRODUCTION

The South African political environment has changed dramatically since the April 1994 elections. The agricultural sector has been affected in many different ways by these changes. South Africa saw not only the end of an era of international isolation but also a change of emphasis within South Africa.

THE CHANGING AGRICULTURAL ENVIRONMENT

The changing environment, both internationally and locally, has placed agricultural producers in South Africa under increased risk. These are not limited to increased price risks through deregulation of internal marketing, but also result from certain policy changes and increased international and regional competition.

Institutional Change

When a new government comes to power, policy is sure to change. South Africa is no exception and agricultural producers have already experienced some of the effects of change. For example, the current government places greater emphasis on the small farming sector and regards them as more consumer oriented. Commercial farmers are already experiencing the effects of less government intervention and support.

Deregulation of Marketing

In the past, most farmers concentrated mainly on production. If they kept costs down, managed the process well and had good weather, they were pretty sure of a good year. When it came to marketing they knew who would buy their produce and at what price.

However, deregulation has meant that producers must now find a buyer and negotiate a price in a market where little price transparency is evident. Prices are becoming increasingly volatile and more and more difficult to predict.

The good risk manager will ensure that he can sell to a market at a good price, even before he puts his plough into the ground. A producer can also make use of sales contracts or the agricultural commodities market to reduce or hedge his price risk.

South African Futures Exchange

Probably the most sophisticated instrument available in today's world to hedge price risk is futures contracts. Although futures contracts have been used worldwide for more than a century, South Africa introduced them with the founding of the South African Futures Exchange Agricultural Markets Division last year. Although by no means the only instrument to manage price risk, Standard Bank believes futures contracts have a place and a role to play in the free market environment.

Internationalisation

The internationalisation of South African agriculture will result in increased competition now that international prices are becoming an important factor in domestic pricing.

One of the conditions of GATT is the conversion of all quantitative restrictions to import tariffs. Low tariffs and cheap imports of agricultural products are often associated with cheaper food for the majority of South Africans. High import tariffs, on the other hand, are often seen as protecting white commercial farmers. Both of these points of view have merit.

What is clear is that the Ministry of Trade and Industry does not intend to give total protection but will rather increase competition via the tariff structure. This will affect agricultural producers and processors, especially in the areas where our producers are not internationally competitive.

Land Reform

The Department of Land Affairs will release a White Paper on land reform early this year. It will be a statement of government policy on land matters and will present a vision and a set of aims, as well as indications as to how these are to be attained. It will determine policy and act as a guide to the actions required to turn land policy into reality.

Current land policy is divided into three elements namely: land restitution, land redistribution and tenure reform. To date the following steps have been taken:

- The Restitution Act was passed.
- Land reform pilot programmes have been implemented in each province.
- The Presidential Commission of Inquiry into the Provision of Rural Financial Services (headed by Dr Conrad Strauss) has been established and its findings will be released soon.
- Land commissions have been appointed and the administrative network is now in place to commence with the restitution process (the Land Claims Court will become operative during April 1996).
- The Development Facilitation Act has been passed through parliament and is seen as a key step towards facilitating rapid land release.
- The development of a process to rationalise land administration in the former homelands has begun.
- A number of pieces of tenure legislation, including the Land Reform Labour Tenants Bill, was formulated and submitted to parliament during the current session.
- The Green Paper on Land Reform Policy was released on 1 February 1996.

The Restitution Programme

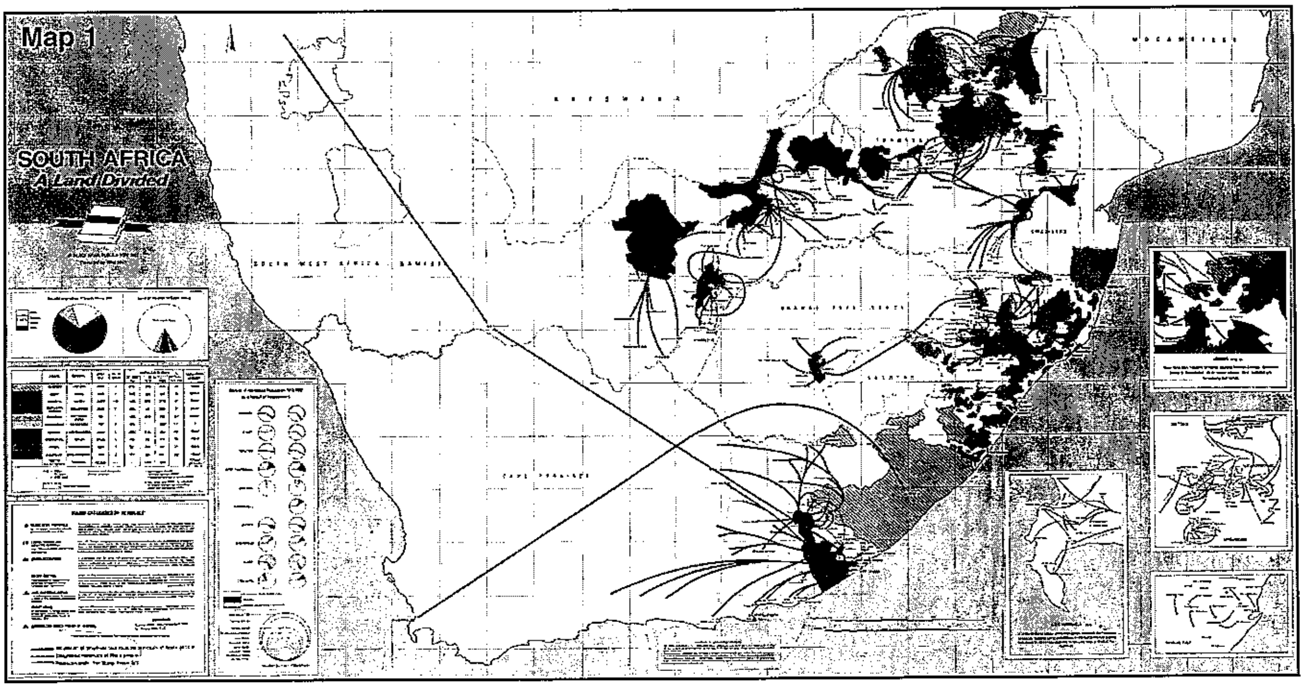
President Nelson Mandela started the restitution process by signing the Restitution of Land Rights Act on 17 November 1994. According to the Act, land claims for the restitution of land may be made by people who can prove that they were dispossessed of their land rights through racially discriminatory laws after 1913. The Department of Land Affairs estimates that more than 3,5 million people and their descendants lost their land due to racially based disposition and forced removals. (See map 1 indicating where most forced removals and dispossession took place.)

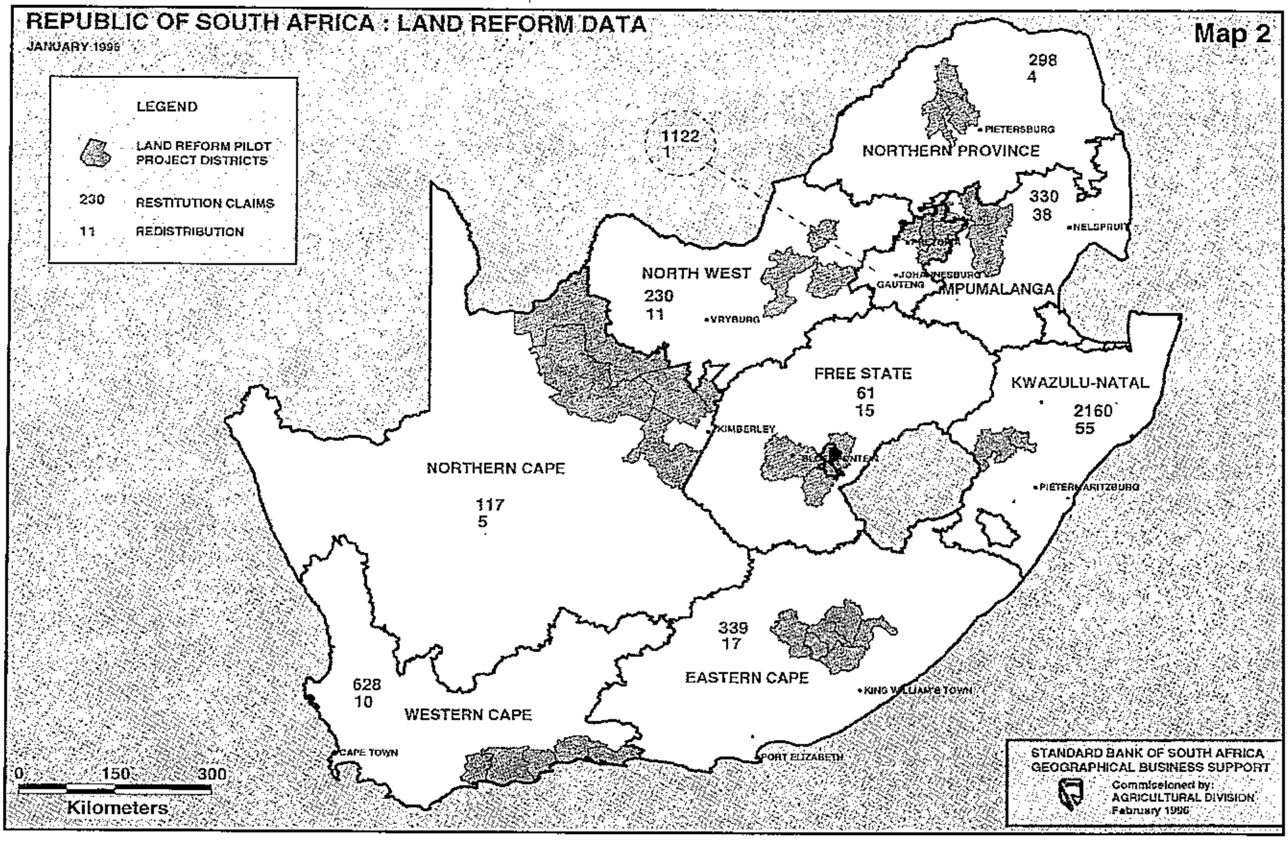
The Restitution Commission is already facing an immense and time-consuming task of registering, prioritising and investigating claims made thus far. The time frame is: three years to lodge claims; five years to finalise them; and 10 years for the implementation of court orders. As on 5 March 1996 a total of 6 894 claims have been received and the Department of Land Affairs is processing them.

According to the latest figures, most claims emanate from KwaZulu-Natal where a total of 2 484 claims have been received. Of these, 736 were over rural land. In the Western Cape there are 49 rural claims while there are 59 in the Free State (map 2).

Other rural land claims for the provinces are: Northern Cape (102), Eastern Cape (165), Mpumalanga (273), Northern Province (351), Gauteng (223) and North West (165). It is important to realise that:

- The majority of land claims are urban claims, with the majority of claims in KwaZulu-Natal, Western Cape and Gauteng.
- The given number includes all claims and does not distinguish between legitimate and illegitimate claims.
- A lot of duplication exists in the claims and in some





instances both the community and an individual member of the community submitted a claim for the same piece of land.

- A large percentage of land claimed is currently still owned by the state, private ownership is not involved.

The land claim process consists of the following steps:

In order to submit a claim the claimant submits the claim to the Land Commission. The claim is registered centrally and capture on the land claim database. The claim is then investigated superficially and if it seems to be legitimate, the fact that the claim will be investigated is published in the Government Gazette. Landowners are supposed to be informed of the claims before it is published. All interested parties are given 30 days to comment on the claim after which time an in-depth investigation is conducted by the Directorate of Restitution Research. It is envisaged that the investigation process will take a couple of months.

The Directorate will use this information and negotiations will commence to reach a negotiated settlement between the claimant and landowner. If a settlement is reached, the decision will be ratified by the Land Claims Court. If no agreement can be reached between the affected parties, claims will then go to the Land Claims Court for a decision. If one or both parties are dissatisfied with the Land Claims Court's decision, they have the right to appeal in the Appeal Court or the Constitutional Court (in the case of a constitutional matter).

It is important to note that the Registrar of Deeds will be informed of the pending claims at the time when the claim is published in the Government Gazette. A caveat (warning note) will then be registered against the title deed of the property and all transactions will be frozen.

The Redistribution Programme

A land redistribution programme aims to broaden the access of land to people who previously did not have access to land and decent living conditions, especially the landless poor and women. Where government policy previously stated that they aimed to redistribute 30% of agricultural land in five years, a clear shift in emphasis is evident in current policy.

Government presently advocates a "demand led" redistribution programme. That is, the amount of land to be redistributed cannot be dictated by a "top down approach" but will depend on the demand for redistribution of land at "grass roots level".

White commercial farmers own 85,6% (102,3 million hectares) of agricultural land and black farmers in the former "homelands" 14,4%.

Considering South Africa's limited availability of high potential agricultural land suitable for redistribution (map 3) and taking the lack of implementing capacity into account, land redistribution intentions might be regarded as optimistic. Land reform policy should focus on the income farmers could earn through farms rather than merely looking at redistributing a target amount of hectares.

A consideration is the cost of distributing land as high potential land has a higher value. South Africa has relatively little arable land which means there is a shortage of land of high potential land suitable for the successful establishment of redistribution. That is, of the 30% relatively high potential land (24,3 million hectares), only 15,9 million hectares is arable.

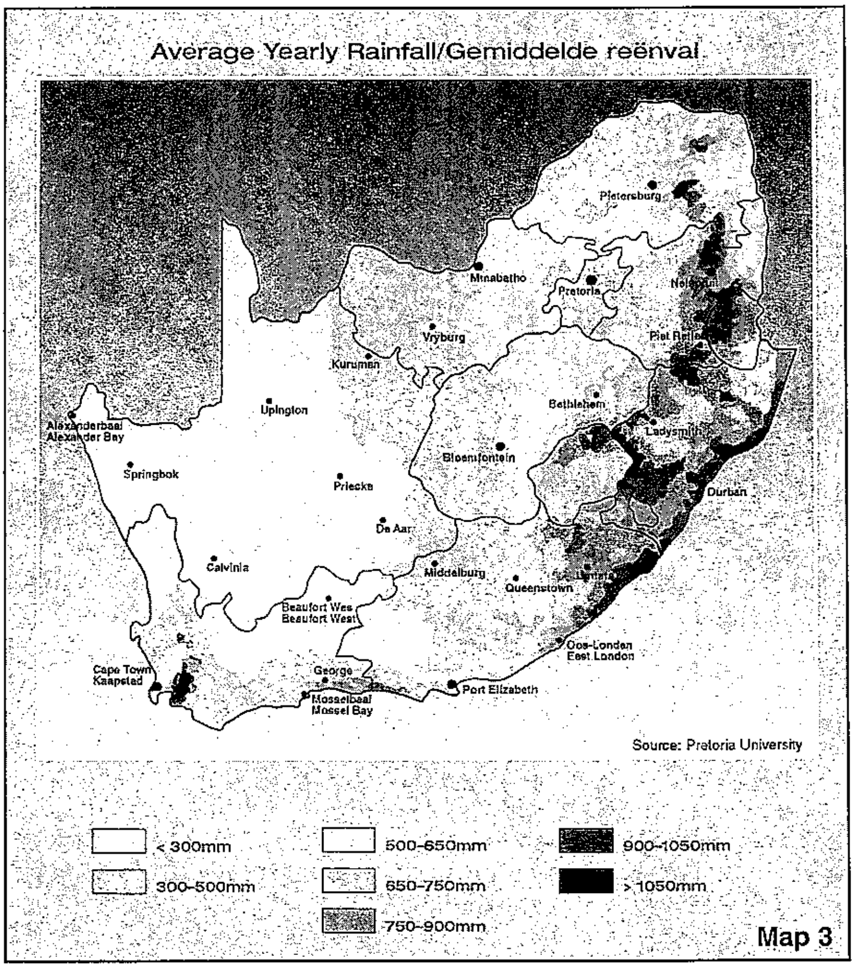
The cost of redistributing 30% relatively high potential land at market values, not including transaction cost, would amount to an estimated R28,3 billion compared to R1,9 billion for low potential land.

Redistributing high potential agricultural land would represent a huge government expenditure which would have to be justified by sustainable agricultural earnings and food security.

Fiscal limitations would prohibit a redistribution programme using only high potential land. Redistribution using only low potential land (R1,9 billion) could be fiscally possible but might not meet the goal of sustainable farming given certain technical limitations. Ultimately fiscal limitations and agricultural potential will determine the balance between the redistribution of high and low potential land.

According to the government, the land reform programme will have a "poverty focus". That is the land reform in general as well as land redistribution aims to provide the most needy with access to land. Priority will be given to the marginalised and women. Apart from restitution cases, it is envisaged that direct government intervention to acquire land will be limited and expropriation according to "just and equitable compensation"[1] criteria will be used as a last resort.

Furthermore, the Department aims to initiate programmes to provide people with finance and credit for land acquisition and basic needs, as well as for local



Map 3

1. Current indications are that a "just and equitable compensation, as stated in the constitution, can be equated to market value in most instances. Land owners who paid market value for their property will receive market value for their property if land is expropriated. If a current land owner, however, paid less than market value for his property at the time of purchase the current owner cannot expect compensation based on market value, but will receive market value less the advantage they enjoyed at the time.

capacity building support to enable people to plan, negotiate and implement settlement projects.

Although different opinions exist about land reform one fact remains undisputed, it is of critical importance that land redistribution and restitution is successfully implemented. The successful implementation of land reform will contribute towards political stability in South Africa.

Labour Tenants

The Labour Tenant Bill, passed by the Senate on 21 February 1996, aims to: *"provide for security of tenure of labour tenants and those persons occupying land as a result of their association with labour tenants; to provide for the acquisition of land rights by labour tenants; and to provide for matters connected therewith".*

According to the Bill, second generation labour tenants who are defined as "a labourer or family providing labour to a farmer in exchange for the use of farming land", have the right to acquire the part of the farmer's land that he has been cultivating with or without the farmer's agreement. In the first draft of the Bill, this law only applied to certain listed magisterial districts, now it applies throughout the country.

Both the labour tenant's right to acquire the land within three years following the commencement of the Act (in effect it is a three-year option to buy the land) and the security of tenure vested in labour tenants as they cannot be evicted, indicate the diminishing rights of the current owner. This can be regarded as being unconstitutional.

It is important to take note of the implications that the passing of the Labour Tenants Bill will have on farm land. As the owner will have to sell a part of this land to the labour tenant or tenants, the market value as well as the productive value (if calculated on a per hectare basis) of the property will decrease as the farm will become smaller. This could affect the security value of these farms especially in cases where more than one tenant family has a claim on the land.

Tenure Reform

Private land ownership is only one form of land tenure. Other forms in South Africa include communal tenure, trust land tenure, freehold and various forms of leasehold. Land tenure policy recognises that diverse forms of land tenure exist and that private land ownership is not the only way in which land reform can be accomplished.

The Department of Land Affairs envisages that the land tenure reform process should give people under all tenure systems, clear and well-defined land rights. All interested parties will be consulted, including those who have not traditionally been heard, such as the poor, women and those holding tenuous land rights.

Labour

Due to increased labour unionisation and new labour legislation, commercial agriculture is facing increased labour related risks. Although increased labour union activity in agriculture has been widely reported in the press, current statistics indicate that less than three per cent of the total labour force (1,1 million - 700 000 permanent and 400 000 seasonal workers) are currently unionised.

At present the COSATU-affiliated South African Plantation and Agricultural Allied Workers Union (SAPAWU) enjoys most support and claims about 30 000 farm worker members countrywide. The National Union of Farm Workers (a NACTU affiliate) can be regarded as the second most popular farm worker union. A further six unions have a fair amount of support on a regional basis with only one, the Vereeniging-based Municipal, State, Farm and Allied Workers' Union with 12 000 members, warranting comment as they organised the strikes in the Eastern Free State recently.

Labour Legislation

The agricultural sector's main reservation regarding the Labour Relations Act concerns the legalisation of strikes in sympathy with other union members. That is farm workers with no grievances may strike in sympathy with other workers belonging to the same union. This may happen even though labour practices on a specific farm may be regarded as being free and fair.

The employment of scab (temporary) labour remains legal and this could provide a measure of protection for farmers where timeous harvesting, milking or animal care is important.

The Labour Force and Minimum Wages

The South African Agricultural Union estimates that, on average, farmers employ between 20 and 30% more labour than is absolutely necessary. The much publicised decrease in the agricultural labour force is not necessarily an indication of increased mechanisation but rather the attrition of redundant workers.

The viability of the introduction of a minimum wage (a figure of R850,00 is being mentioned) is being investigated and the Labour Market Commission will probably release its results by mid-year. There is a strong argument in favour of the introduction of a minimum wage for agricultural and domestic workers in view of the fact that it is a very difficult sector of the labour force to mobilise and organise particularly because of logistic factors.

The following arguments are used against the enforcing of the minimum wage:

- High rural unemployment.
- Further marginalisation of unschooled labour.
- Practical application.
- The human rights issue which allows one the right to sell labour at the price at which it is accepted.

Labour Equity/Participation Schemes

The bank has recently received enquiries from farming customers wishing to finance equity or participation arrangements with their employees. Advantages of such schemes include:

- Equity/participation schemes are superior, in some respects, from a land reform point of view to mere settlement schemes. The latter require costly support services over and above the cost of land purchase.
- They are a form of empowering farm labourers who are more likely to have an interest in farming.
- Participation schemes arising from a pact between the farmer and workers "consensus farming" result in a retention of expertise on the land.
- Participation schemes also have potential to reach more people than mere settlement schemes (there are about 1,3 million farm workers in South Africa).
- Incentives resulting from participation schemes, if properly implemented, could improve productivity and labour relations.

The major requirements for the successful implementation of participation schemes include:

- Training of labourers.
- The farmer must be a shareholder who will stand to lose if the scheme is not managed correctly.
- The minority shareholders' interests must be protected.
- A stable, long-term relationship of trust between farmer and workers must have existed.
- Such schemes are more likely to succeed where workers' basic needs have already been satisfied.
- It would be advisable to make use of impartial intermediaries and valuators as well as other experts.
- Workers should contribute towards their shares.
- The scheme must benefit both the farmer and labourers.
- The original farm must be an economically viable unit.
- Legal structures should be kept as simple as possible.

THE FINANCIAL POSITION OF AGRICULTURE

Debt Position

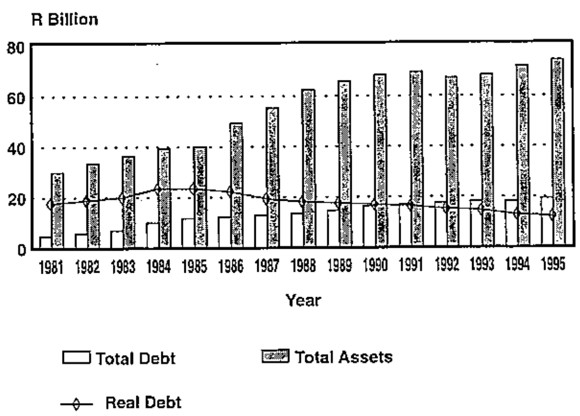
Most farmers are forced to borrow funds at some stage of the production process. Turning production inputs into saleable agricultural produce takes time. The time lag between expenditure incurred in order to produce, and income gained from the sale of produce is where credit comes in.

Agricultural output differs fundamentally from production or output in other sectors. Several factors, unique to agriculture, influence agricultural financing. Agricultural production is mainly seasonal and is often precarious because of erratic weather conditions. Thus, product prices fluctuate frequently. Farmers are compelled to invest money in production at the beginning of the season, while income at the end of the season cannot be estimated or assured with any certainty.

Agricultural finance is not only complicated but the sector also experiences difficulty in competing with other sectors for available finance.

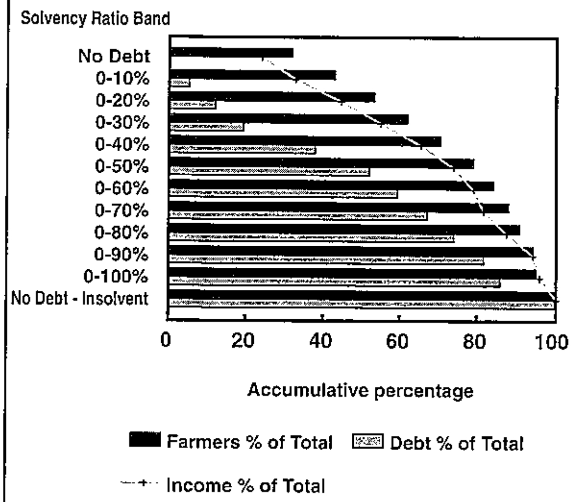
Debt position of the agricultural sector

Over the past few years, the debt position of farmers has frequently come under the spotlight. Difficult cli-



Source: Directorate of Agricultural Economic Trends

Fig.1. Total debt to total assets: 1981 - 1995



Figures are accumulative

Fig.2. Debt and income distribution of farmers (within ratio band)

matic conditions, coupled with high interest rates and inflation, have led to escalating farm debt. In the seventies farmers paid lower interest rates than those prevailing in the market. Farmers could borrow money from the Land Bank and agricultural co-operatives at interest rates below the commercial banks' prime lending rate. This, combined with negative real interest rates during the seventies and eighties made credit attractive to the agricultural sector. As a result farming debt increased from R2 billion in 1975 to an estimated R11 billion in 1985 (Figure 1).

A Standard Bank study conducted in 1994 showed that 32% of the farmers participating in the survey had no debt at all (Figure 2), while 80% of the sample had a solvency ratio of 50% or less. They also generated almost 75% of the income. From this it is clear that farmers in the higher solvency bands produce proportionately less than farmers with a lower solvency.

In response to the De Kock Commission's recommendation in 1983, monetary policy became more market-orientated during the eighties and market-related interest rates were increasingly applied to agriculture.

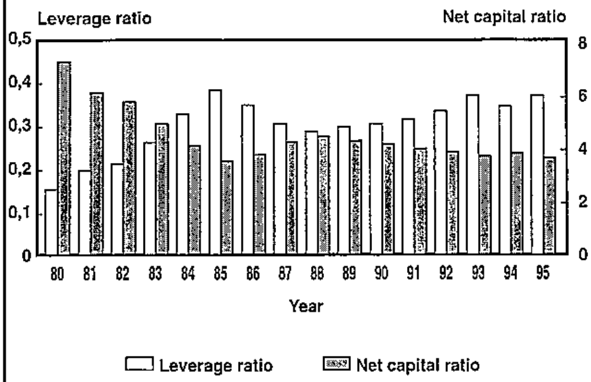
The agricultural sector has been shocked in recent years by a "double" increase in interest rates which has caused:

- a decline in subsidised interest rates for the sector; and
- the imposition of positive real interest rates for the economy as a whole.

Table 1:

Year	Percentage growth in net worth	Leverage ratio	Net Capital ratio	Debt as percentage of critical debt
1980		0,16	7,18	15,43
1981	4,19	0,20	6,11	20,92
1982	10,24	0,21	5,71	43,45
1983	5,80	0,26	4,89	121,28
1984	1,26	0,33	4,08	123,77
1985	(1,74)	0,39	3,58	84,24
1986	22,49	0,35	3,83	49,39
1987	17,80	0,31	4,22	32,05
1988	13,12	0,29	4,51	31,70
1989	6,78	0,30	4,36	42,51
1990	1,99	0,31	4,19	54,91
1991	0,84	0,32	4,00	50,47
1992	(5,45)	0,35	3,84	67,78
1993	1,13	0,37	3,69	41,14
1994	5,23	0,35	3,84	24,14
1995	1,94	0,37	3,72	34,40

Source: Directorate of Agricultural Economic Trends



Source: Directorate of Agricultural Economic Trends

Fig.3. Financial Ratio's: 1980 - 1995

The result has been that agricultural interest payments have increased dramatically, causing debt accumulation. Interest has become one of the largest single input cost items in agriculture.

In 1994, total farming debt was estimated at R18 184 million in contrast to R19 396 million estimated on December 1995, which marked an increase of 4,4%.

Assets

The value of farming assets increased by an average of 6,7% per annum from 1985 to 1995, while farming debt increased by 6,8% annually during the same period. It is clear from Table 1 that the farming sector experienced a period of low and even negative growth in net worth since 1990.

Solvency

The net capital ratio (assets/liabilities) decreased from a high of 7,18 (for every R7,18 invested in the business R1 outside capital is used) in 1980 to 3,72 in 1995 (Table 1 and Figure 3). A declining ratio over a period indicates a decrease in the capital position of the farming business as more use is made of outside capital.

The leverage ratio reflects the ratio of liabilities to own capital of a farm business. It gives an indication of the extent to which the farmer will be able to meet his total liabilities by using own capital. In 1980 a leverage ratio of 0,16 was present. That is, for every R0,16 of outside capital invested in the business R1 of own capital is contributed. This ratio increased steadily (except for slight drops in 1986 and 1988) to the current level of 0,37. Agricultural producers are therefore steadily making more use of outside finance.

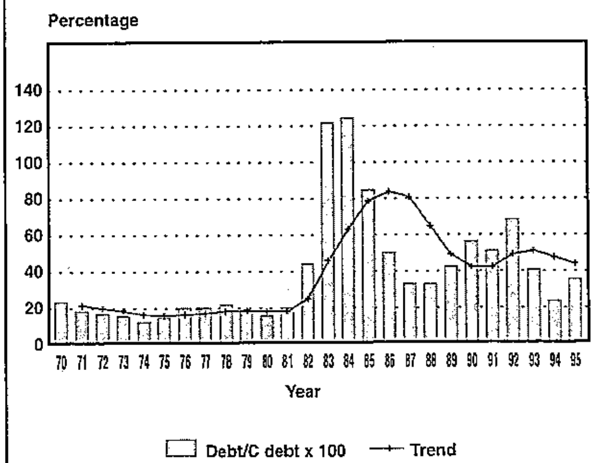
However, a leverage ratio of 0,37 is not considered unduly high for other sectors but reflects a substantial financial risk for the agricultural sector because of its lower profitability.

Repayment Ability

One method that may be used to determine whether total agricultural debt can be redeemed, is to examine the critical debt levels. Critical debt levels are calculated by dividing the net farm income (NFI) before tax, by the average interest rate. The critical debt levels of the agricultural sector give an indication of the maximum debt that farming concerns can service. Debt as a percentage of critical debt is calculated by dividing the total agricultural debt outstanding (on a year-on-year basis) by the critical debt ratio and expressing this as a percentage.

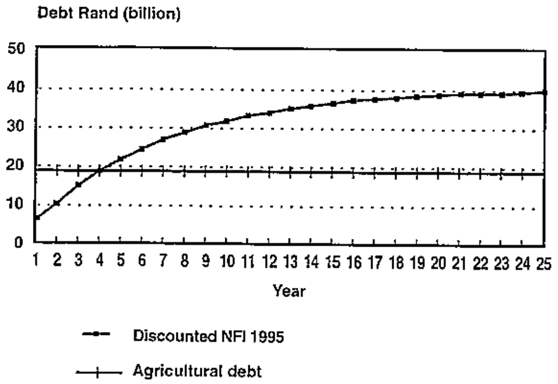
When total agricultural debt as a percentage of critical debt increases, real debt levels of the agricultural sector move closer to critical debt levels. This means that producers find it increasingly difficult to service their debt.

Several factors, such as an increase in total farming debt or average interest rate levels, a drop in farming income, or a combination of these, cause this percentage increase. The relative movement of these factors result in year-on-year percentage fluctuations.



Source: Directorate of Agricultural Economic Trends
** Estimates*

Fig.4. Debt as % of Critical Debt



Source: Directorate of Agric Econ Trend
Average interest rate: 17,14%
Fig.5. National Debt: Repayment Ability

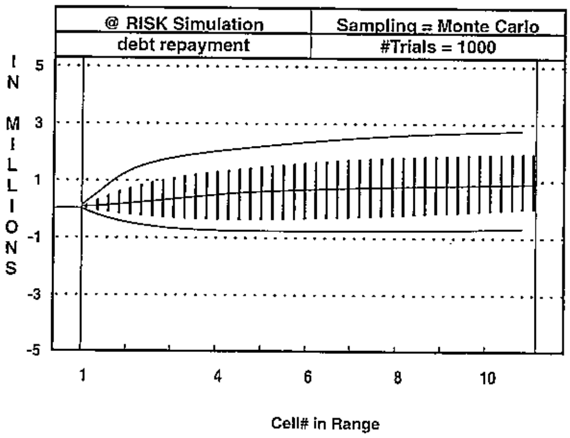


Fig.5A. Trend in Mean, 1Std. Dev., 5/95 Perc.

Table 1 and Figure 4 show that total debt as a percentage of critical debt during the seventies and up until 1981 amounted to an average of 17,25% of critical debt levels. During this period the agricultural sector could have incurred and serviced more debt.

During the early eighties, agriculture fell on hard times and this percentage increased rapidly. Total debt levels were at higher levels than critical debt levels, resulting in agriculture's weakest ever debt servicing capacity. This period can be considered abnormal and so it is important to examine the long-term trend rather than the absolute figures.

Usually, when total debt is less than 25% of critical

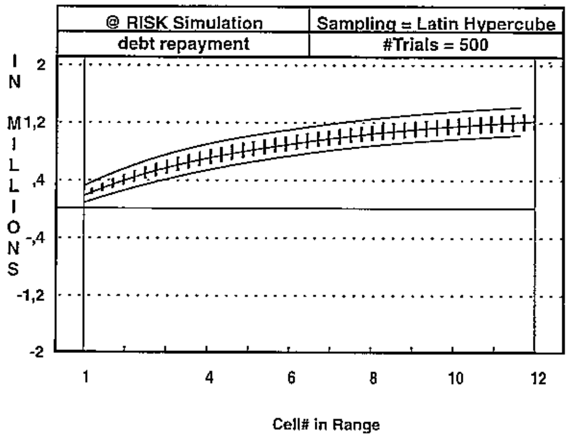


Fig.5B. Trend in Mean, 1Std. Dev., 5/95 Perc.

debt, it can be considered safe. This implies that a safe level of debt is less that a quarter of critical debt levels. Figure 4 shows that during 1993 the percentage of about 41%, decreased to about 24% during 1994 and increased to 35% in 1995.

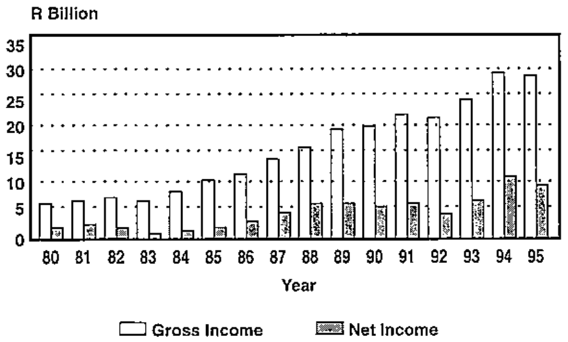
The horizontal line as given in Figure 5 shows the total outstanding farming debt of 1995 as just under R20 billion. The curved line was calculated by discounting the total NFI (based on 1995 figures) back on a year-to-year basis to show the repayment period at an average interest rate of 17,14% (1995) if the total income flow would be used to service debt. However, it must be remembered that this can be regarded as the most optimistic scenario and that several risks could result in the income line moving downwards.

For example risk simulation Figures 5A and 5B shows the difference between the predictability of income in high and low risk industries. In high risk industries the predicted income band (Figure 5A) is much broader indicating a much higher degree of income variation. In contrast lower risk industries will show a much narrower income band (Figure 5B).

On Figure 5, the income line and the total farming debt line intersect at a point just over four years. This implies that the agricultural sector is able, at present debt levels, to service its debt within a period of just over four years.

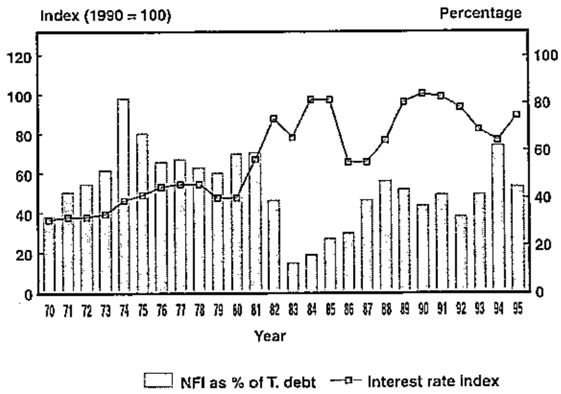
Profitability

Profitability refers to the return on capital during a particular period. Profitability also serves as a yardstick for comparing the return on investment in agriculture with that of other sectors.



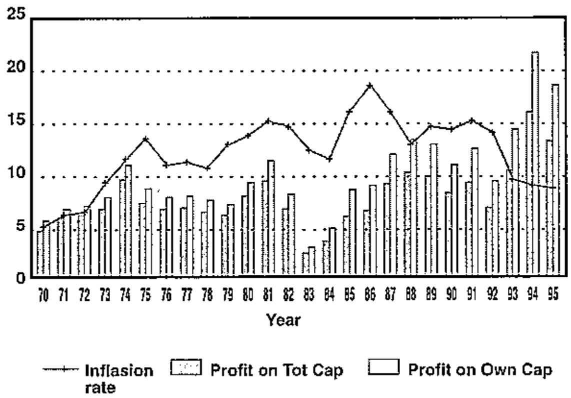
Source: Directorate of Agricultural Economic Trends

Fig.6. Gross and Net Farming Income 1980 to 1995 (Jan - Dec)



Source: Directorate of Agricultural Economic Trends

Fig.8. NFI as % of Total Debt



All figures are calculated before interest, rent payments
Source: Directorate of Agricultural Economic Trends

Fig.7. Profitability vs Inflation

The net farming income decreased by 14,17% to R9 662 million in 1995 in contrast to R11 257 million in 1994. Interest payments remained a major cost item in agriculture and are directly related to the relatively high interest rates and level of farming debt. While interest rate payments, for example, represented 5,5% of the gross income in 1980, they amounted to 9,5% for 1995.

The gross income of producers for 1995 amounted to R28 871 million compared to R29 285 million in 1994 - a decrease of 1,41% (Figure 6).

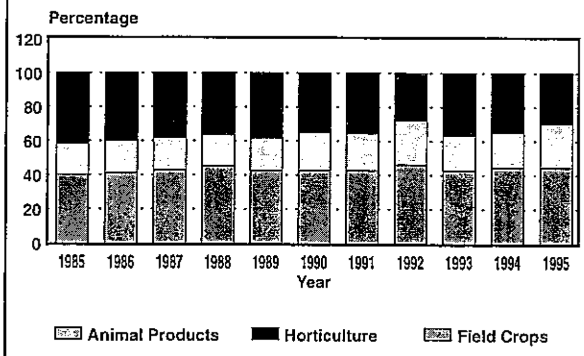
Figure 7 shows profitability on total and own capital for the period 1970 to 1995. Profit on total capital employed is calculated by expressing the net farm income as a percentage of the average total capital employed during a financial period. As seen in the graph, profit on own and total capital reached a low during 1983, increased steadily during the middle and late eighties and showed an erratic movement during the nineties.

Net Farm Income (NFI) as a percentage of total debt gives a good indication of an agricultural producer's ability to manage debt. The lower the percentage the poorer the potential ability to repay debt. It is evident from Figure 8 that NFI as a percentage of total debt in the eighties was not very good. This is particularly true of the period 1983 to 1986. It then improved for the next two years, reached a low during 1992 and increased substantially during 1994. During 1995 the potential ability of farmers to repay debt decreased to approximately the same level as 1979.

An inverse relationship is evident between this variable and the interest rate from the eighties. That is, if interest rates rise, the ability to make repayments will probably decrease as clearly shown during 1995.

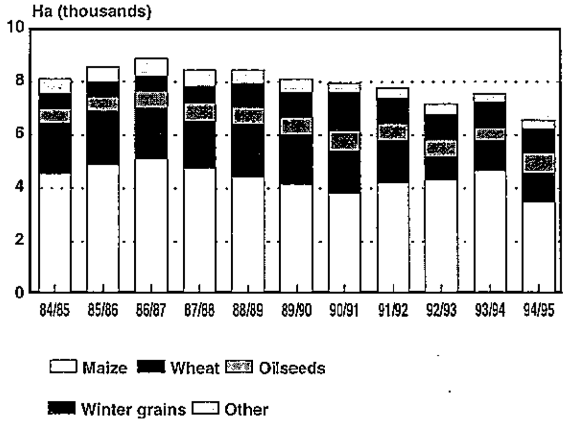
A Shift in Agricultural Production

South Africa is a semi-arid country and a large percentage of agricultural land is only suitable for extensive livestock production. As the eastern parts of South Africa and the Western Cape receive higher average rainfall than the rest of the country (map 3)



Source: Directorate of Agricultural Economic Trends

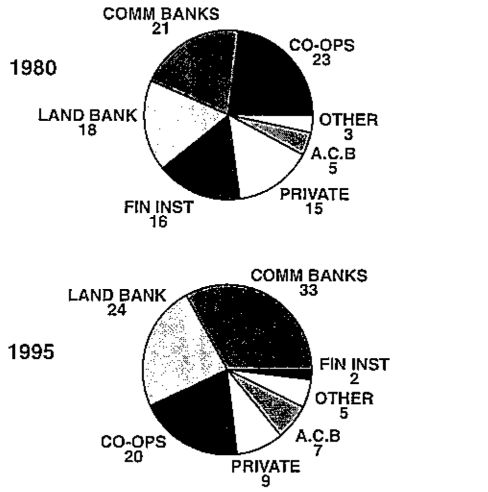
Fig.9. Percentage Contribution to Agricultural Production



Other: Tobacco, Cotton, Beans, Sorgum

Source: Directorate Agric Econ Trends

Fig.10. Area Planted to Field Crops



Source: Directorate of Agricultural Economic Trends

Fig.11. Outstanding Agricultural Debt per cent market share

these areas are more suitable for intensive production which includes our expanding horticultural industries.

Figure 9 shows the relative importance of the three main agricultural industries in South Africa. Over the last ten years the relative importance of the field crop industry declined as farmers diversified and concentrated on the production of more profitable export oriented horticultural produce.

Within the field crop industry, farmers are also changing their planting patterns and are moving towards more profitable crops. Figure 10 shows that the area planted under maize is decreasing, while relatively more wheat, winter grains and oilseeds are being planted. Furthermore, a recent survey indicates that farmers no longer perceive maize to be as lucrative a crop as it was in past and that they intend to plant less maize in the future. The recent demise of the single channel marketing system and the replacement of quantitative import control measures with import tariffs led to maize price fluctuations.

THE CHANGING ROLE OF AGRICULTURAL FINANCE

The Commercial Farming Sector

During 1980, commercial banks had a 21% market share of outstanding agricultural debt, compared to the 23% held by co-operatives. As seen in Figure 11, three other institutions, namely : the Land Bank, other financial institutions[2] and private individuals, held more or less equal shares.

In 1995 the picture looked slightly different. Commercial banks were the largest financiers of the agricultural market with a 33% share of the total farming debt, followed by the Land Bank (24%) and agricultural co-operatives (20%).

Presently there is a move away from funding by co-operatives, private individuals and institutions and a movement towards the use of the commercial banking sector and the Land Bank. The interest rates charged by co-operatives have increased in recent years because they have to charge more market related

2. Discount houses, other monetary institutions, insurance companies, pension funds, trust companies, non-monetary banks and trust assets, participation mortgage bonds and other financial institutions.

interest rates. This was necessary as they were facing increased risk because of decreased government support.

The recently released interim report of the Rural Finance Commission sets out proposed principles for financing in rural areas. The report proposes one central body, a "Rural Bank" to be a co-ordinator of the delivery of finance to developing rural areas. It is proposed that this institution will operate as a financial wholesaler of agricultural credit to finance retailers such as commercial banks, NGOs and other intermediaries, as well as being the administrator of grants. The commission furthermore recommends:

- Minimal direct government involvement in the provision of credit;
- Making use of grants rather than subsidising interest rates;
- The established commercial agricultural sector should continue to enjoy access to financial services;
- The withdrawal of the exemption for small loans through the Usury Act and the replacing of it by the Credit Bill and the phasing out of the Subdivision of Land Act;
- The legislation protecting the Agricultural Credit Board (ACB) and Agricultural Co-operatives should be revised and that the credit provisions functions of the national and provincial departments of agriculture and the ACB be terminated as soon as possible and that the loan books be transferred to the Rural Bank.

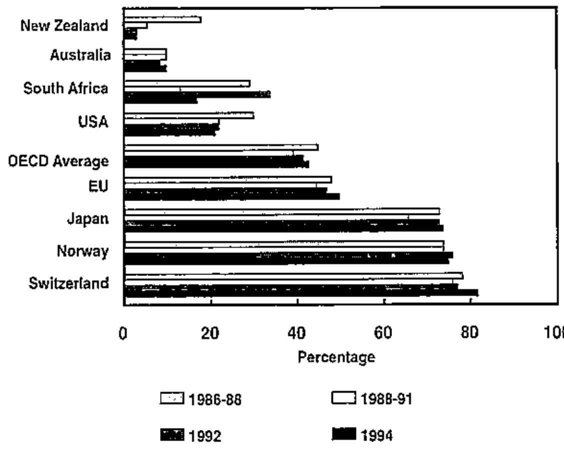
We believe that the Interim Report is a balanced document. The final report is expected in July 1996 after which the government will decide how to incorporate the recommendations into policy.

Less government support

In the past South African agricultural producers received substantial government support. Farmers were not only assisted during disaster periods, but also received substantial supports in terms of government grants and subsidised interest rates. These support mechanisms did not only distort agricultural markets but made agricultural producer insensitive to risk and agricultural debt.

However, as shown in Figure 12 South African farmers can no longer be regarded as a "protected species". If compared internationally only Australian and New Zealand producers enjoyed less government support in 1994.

It is expected that in future local commercial produc-



%PSE = Total PSE/Value of agric production
Source: Department of Agriculture

Fig.12. Agricultural Producer's Support (%PSE)

ers will receive even less support as government support programmes and attention will focus on the emerging farming sector. Commercial farmers will not only have to depend on their own resources to survive, but they will also be exposed to international competitors who enjoy much more government support.

Emerging Farmers

There is a strong possibility that with changes in technology and donor funding, this market could be serviced increasingly by commercial banks. Any financing will, however, be aimed at the top end of the market. At this stage higher risk farmers will have to be accommodated by the government.

It must also be borne in mind that credit will not necessary benefit this market unless access to inputs, markets, training and appropriate extension services exist.

Rural people are not an homogeneous mass and selective marketing has to be applied to these farmers in order to identify those individuals with commercial possibilities. Only where the marginal gain from using credit exceeds its marginal cost (transaction plus interest costs) will there be an incentive to repay loans. This only applies to farmers who produce a surplus for sale (emerging commercial farmers).

Case studies throughout the world support the notion that rural people have a strong propensity to save. Savings also allow non-creditworthy customers access to banking facilities. Cash flow information on these clients can be assimilated over time to determine if they qualify for future loans.

A VIEW OF THE FUTURE

- A clear shift in emphasis away from the commercial farming sector towards the small farming sector is evident. In future, agrarian extension as well as research and financial support will lean towards new entrants into the farming sector. Commercial farmers will increasingly be dependent on their own resources for survival.
- There will probably be an increase in more intensive farming operations close to urban centres and more extensive operations in rural areas. At the moment, the smallest farms are in the "old homeland" areas, which are furthest from the urban centres.
- A shift in emphasis from food self-sufficiency towards household food security is evident. Cheap food for consumers is the priority. This will mean that uncompetitive commercial producers will not be protected at the cost of the consumer. We will see a "leaner and meaner" agricultural sector in which only the fittest will survive.
- South African agricultural producers will be faced increasingly with import competition. Thus, local producers should focus on producing products in which they have a comparative advantage.
- Land reform will continue to receive emphasis. As the current government will be averse to relocating people, most land reform will occur in the areas close to where the people are who need access to the land. Agricultural land close to the "old homeland" areas and urban areas will be under pressure for redistribution. Land reform will occur in "pockets" in other areas.
- High expectations were created before the 1994 general elections. The government cannot meet these expectations for land reform. As such, unhappiness and frustration will be seen and requests for "meaningful" land reform will occur.
- There will be mounting pressure from landless communities for land and the acceleration of land reform. It is possible that there will be a land reform drive from the government towards 1999 when the next general election will occur.
- It is expected that on average, agricultural land prices will decrease with marginal agricultural land likely to show the most significant decrease. High potential land and land utilised for export industries will probably continue to increase in value.
- The one important principle affecting the future of any financier is the "risk reward" principle, that is, the higher the risk the higher the reward (interest) should be. Agriculture is a high-risk industry with some enterprises being more risky than others. Producers in the higher-risk enterprises can expect to pay more for finance.
- Agricultural producers no longer have a ready-made market. In future, the most profitable farmer will be the one who can produce his produce cheapest and sell it at the best price.
- With the introduction of trading in agricultural commodity trading, producers will be able to manage their price risk more effectively, thus reducing overall risk.
- Farmers will operate in a more structured and unionised labour environment. They will therefore have to improve labour management through improved labour practices.
- Adaptability and the ability to analyse a situation timeously will increasingly determine a farmer's success. Agriculture will no longer be a "way of life" but a highly competitive and relatively complex business.