FINANCING AGRICULTURE - CHALLENGES TO FINANCIAL INSTITUTIONS

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Abstract

The agricultural sector is in a process of change. The sector is seen as one sector encompassing all farmers in South Africa. An inequitable approach was followed in the past in supporting the sector, especially regarding the provision of financial services. The needs and participants in the sector and the different financial institutions are discussed and the inequitable approach is reiterated. The challenges to the financial institutions servicing agriculture are highlighted, that is a change in approach towards agricultural policy, interest rates, transaction costs, regulations and financial services. Changes needed are proposed. It basically entails changing the mind-set of the institutions. In the targeting of services, the role of public sector institutions will also include a high priority servicing of the previously ignored farmers in the sector. In considering the whole agricultural sector, unco-ordinated an inequitable approaches of the past will be excluded. The challenge however is to redress the inequities of the past, while at the same time pursuing the goal of an equitable, efficient and sustainable agricultural sector.

Uittreksel
Die finansiering van die landbousektor - Uitdagings aan finansiële instellings

Die landbou-sektor as geheel ondergaan veranderings. Dit word beskou as een sektor wat alle boere in Suid-Afrika insluit. In die verlede is 'n ongelyke benadering gevolg betreffende ondersteuningsdienste aan die sektor. Dit is veral waar betreffende finansiële dienste. Die behoeftes en deelnemers in die sektor word bespreek. Die organisasies wat finansiële dienste aan die sektor verskaf, word kortliks toegelig en die ongelykheid in dienste word beklemtoon. Uitdagings aan finansiële instellings wat die landbou bedien, word beklemtoon en sluit veranderings in die benadering tot landboubeleid, rentekoerse, transaksiekoste, sekuriteit, finansiële dienste en regulasies in. Veranderings word voorgestel. Die veranderings gaan basies oor 'n verandering in denke oor die sektor. Boere wat gely het onder die ongelyke benadering in die verlede sal spesiale aandag moet geniet, veral vanaf die staat. Indien die dienste-organsisasies die landbousektor waarlik as een sektor beskou sal dit verhoed dat dubbele standaarde gehandhaaf word. Die uitdaging is egter om die ongelykhede van die verlede reg te stel sonder dat die voortbestaan en doeltreffendheid van die landbou in die gedrang kom.

1. Introduction

The agricultural sector in South Africa is in the process of change. Some of the speakers at the annual conference of the Agricultural Economics Association of Southern Africa (AEASA, 1991) discussed the imbalances in the agricultural sector depicting an abnormal agriculture. The agricultural press reported on the opinions of the regional agricultural unions (Landbouweekblad, 1991a:97), opinions expressed by the Minister of Agriculture (Landbouweekblad, 1991b:97), changes in the activities of several control boards (Vink en Kassier, 1990), decreases in the agricultural budget over the past years (Christodoulou and Vink, 1990) and changes in policy that affect agriculture over a broad front, for example the repeal of the 1913 and 1936 Land Acts. These activities and discussions range over a broad spectrum with one common denominator, changes in the agricultural sector. It is hoped that these changes will culminate at some future date in the integration of all farmers into a comprehensive farm production and support system. In order to achieve this, all farmer support elements as embodied in different support institutions, have to be redefined in terms of target population.

The inequitable support of different farmers has been described in detail in many studies (*cf* Fenyes *et al*, 1987; Lipton, 1977). This is especially true in terms of the services provided by the agricultural finance sector (Coetzee, 1988). In the past the differentiated approach to financing the total agricultural sector was followed in studies and research assignments on financing the sector. Studies on the "commercial" agricultural sector (implying farmers outside the homelands[2])(*cf* Mostert and Van Zyl, 1988; Fuller and Darroch, 1988) did not address all the farmers in the agricultural sector. Studies that addressed the financing of the "small farmer" sector (implying farmers in the homelands) in most instances ignored the "commercial sector" (*cf* Coetzee, 1988). These studies implicitly supported the dual approach to supporting the broad agricultural sector.

The purpose of this paper is to consider the financial structure of the total agricultural sector. The agricultural financial sector is roughly defined as that part of the broader financial sector that provides finance to the agricultural sector. This includes private sector institutions (eg. commercial banks), public sector parastatal institutions in the form of agricultural banks, certain government departments, co-operatives, traders, money lenders and other informal sources of finance such as family and friends.

The aim of this paper is not to identify the causes of the current agricultural debt, or to deliberate on arachnology, or to criticize people deliberating arachnology. This paper acknowledges the current debt position and provides no solutions for solving this problem (for discussions on possible solutions see Mostert and Van Zyl, 1988; Fuller and Darroch, 1988; Lamont and Martin, 1989). An attempt is made to highlight the challenges awaiting both the clients and the financing institutions in the agricultural sector. Issues, that should be considered in meeting these challenges are highlighted.

The structure of this paper is as follows. First, a short discussion on the financial needs of the participants in the agricultural sector. Second, the sources of finance and their target markets in the agricultural financial sector. Third, a discussion of the future challenges to the sector and lastly, some proposals on fundamental changes needed in the financial support sector.

2. Financial needs in the agricultural sector

As with the provision of any goods or service an analysis of the target market is needed. The complete agricultural sector incorporates participants with financial needs that were previously ignored by the major players in the agricultural financial sector. Homeland borders were used as an implicit categorization rule. Small farmers were to be found within these borders, and "commercial" farmers were to be found outside homeland borders. As farming is a dynamic sector and farmers change in terms of the type and size enterprises they control, and different farmers have different risk perceptions, it is not possible to define static mutually exclusive farmer types or categories.

2.1 The participants

In this article it will be argued that for ascertaining financial needs and applicable sources of finance all farmers should be categorised by the production objective per main enterprise. The production objective per enterprise will be the decisive criteria implying level of technology, other support needs and thus also will imply the demand for financial services. For example, an apple farmer, producing for the export market, implies hi-tech technology, support and financial needs, whereas a vegetable farmer, producing for home-consumption implies lower level technology and financial needs. Table 1 provides an indication of the difference in certain variables between farmers that produce for the local market and farmers that produce for own consumption. The production objectives of these two groups of farmers imply different levels of investment in equipment, different enterprise sizes, different levels of input and technology use and a difference toward the use of credit. The difference in credit use should be important to financial institutions as it implies a certain point at which farmers will generally start to make use of credit for agricultural production purposes. This point will be a function of the production objective of the farmer.

Table 1: Discriminant function for the grouping of farmers in producers for the market and producers only for home consumption in KaNgwane (N = 142)

Variable	Discriminant function: Coefficients	Group averages: Market	Consume	P > F
Net farm income	0.25	2555.82	-491.49	0.0003
Vehicles, implements	0.18	7462.56	3108.47	0.0001
Area farmed	0.33	8.11	3.31	0.0001
Total assets	0.15	14293.06	7831.02	0.0005
Fertilizer expenses	0.46	411.74	133.41	0.0001
Seed purchases	0.28	173.60	76.17	0.0001
Use credit	-0.29	1.74	1.88	0.0364
Mahalanobis distance between groups			1.54	0.0001
Wilk's Lambda			0.66	0.0001
Number of participants		42	100	

Source: Coetzee, 1988.

For the purpose of this paper there will be differentiated between farmers in economically advantaged and economically disadvantaged areas. This differentiation is based on the inequitable support structure discussed earlier. It follows that economically disadvantaged areas should be the target areas for agricultural development efforts. In both these areas the full spectrum of farmers can be found according to the popular classifications. For example, the majority of farmers from the economically disadvantaged areas are part time farmers (Cobbett, 1986) while part time farming is increasing in the economically advantaged areas, currently about 30 per cent of farmers in these areas[3] (Steenkamp, 1991).

Due to this historic (political) situation a certain part of the agricultural sector justifies more attention from the public sector in order to achieve an equitable, efficient and sustainable agricultural sector over the long term. Over the short to medium term the public sector should therefore have the farmers in economically disadvantaged areas of South Africa as the higher priority in the allocation of the agricultural budget, and should be adjusting and changing rules and regulations that denied these farmers access to the agricultural support structure.

2.2 Their needs

The financial needs of farmers can be met in three ways. First, by using own funds (savings), second, by borrowing funds and third, by grants from governments and other bodies. The borrowing of funds can be from two sources, that is informal and formal. Most farmers in developing areas make use of informal credit. This source meets the need for small scale agricultural operations where production for the market is not developed to its full potential. Where the aim is to expand farming operations to a scale to produce for the market, a formal, more stable and comprehensive source of credit is needed. This implies a source that will provide short, medium and long term credit.

The needs of farmers, and broader agricultural sector are more than production finance. Long and medium term capital are also required. These financing needs are to sustain production. Finance is also needed where production has been halted by acts of nature, eg. floods, fire etc. These financing needs can be met by the Government through emergency relief programmes and through insuring against certain risks. For agricultural development farmers need to be put in a position to start or enhance production as discussed earlier. The necessary access to support services to enable the farmer to be actively part of the broad agricultural sector, should be put in place (Van Rooyen *et al*, 1987). To meet this financial needs finance can be sourced both from the private and public sector. The responsibility however lies with the public sector.

3. Sources of finance

The sources of finance for the agricultural financial sector will be presented by a discussion of the main activities of the role players in this sector. These role players can be divided into public and private sector institutions. Private sector institutions are further divided into formal and informal sources of funds. The specific institutions are briefly introduced, their sources of funds are stated and the clients they serve in the agricultural sector are identified. These institutions are discussed in terms of their current operations and applied policies.

3.1 Public sector financial institutions

The formal public sector institutions serving the agricultural sector are also referred too as specialised farm credit institutions. Specialised farm credit institutions are defined as a class of financial intermediary primarily engaged in the provision of loans to farmers, ranchers, and others undertaking or supporting agricultural production (Von Pischke, 1978). This type of intermediary is characterized by the specialization of its loan portfolio, and also by the reflection of that loan portfolio in a narrow range of financial services offered. Normally, specialised farm credit institutions do not engage in any significant scale of deposit taking. Specialized farm credit institutions are established by governments to provide financial assistance for agricultural production (Von Pischke, 1978). In their role as development finance agencies, specialised farm credit institutions usually are providers of supply-lending finance, a public sector development tactic which provides funds in advance of effective demand in an effort to stimulate enterprise, ie. risk-taking by borrowers, in a socially useful manner.

SA Land and Agricultural bank

The SA Land and Agricultural Bank (Land Bank) was established in 1912 arising from the need for a financial institution which, without a profit motive and on a co-ordinated basis, could undertake specialised agricultural financing with due regard to the distinctive credit requirements of the agricultural sector (Bosch, 1990). The Land Bank operates under the Land Bank Act, thus separate from the rest of the formal financial sector which operates under other acts (Lamont and Martin, 1989). The Land Bank sources its funds from the capital market under the regulations as prescribed by the Land Bank Act. The Land Bank does not take deposits from clients. Until 1988 the Land Bank Act provided for the financing of *bona fide*[4] farmers in South Africa. This excluded farmers in Transkei, Ciskei, Bophuthatswana and Venda. The Land Bank Act changed in 1988 to incorporate commercial farmers in these areas (Government Gazette, 1988). However, the procedures to obtain a loan for a farmer in these areas differed from the procedures to obtain loans for farmers in the rest of South Africa. Applications have been forwarded to the Land Bank from farmers via institutions in these areas. Until the Land Bank starts to finance the farmers (that can fulfill all their criteria, barring title deed to land) in the homelands, the Land Bank will be seen as the financier of white owner, operator full time farmers.

The Land Bank concentrate on long term financing, but is increasingly involved in short term financing through cooperatives. In the past the Land Bank concentrated their efforts on those farmers that could not readily gain access to commercial bank financing (so called category II farmers). Indications are that the Land Bank is reconsidering this stance and is willing to finance category I farmers (on a differentiated basis) until recently only financed by commercial banks (Landbouweekblad, 1991d:122).

Agricultural Credit Board

The Agricultural Credit Board is even more removed from the total agricultural sector than the SA Land Bank. The Agricultural Credit Board resorts under the Department of Agricultural Development, a so called white "own affairs" department (Bosch, 1990) and source their funds directly from the public sector. The role of the Agricultural Credit Board is primarily to accommodate the group III farmers, ie. those farmers than cannot gain access to financing from commercial institutions or the Land Bank. Applications are evaluated in terms of the ability of these farmers to contribute over the long term to the agricultural sector. The Agricultural Credit Board provides short, medium and long term credit to white farmers.

The Development Bank of Southern Africa

The Development Bank provides concessionary finance to institutions in developing areas who on-lend to the farmers in these areas. Short, medium and long term financing is extended. The Bank does not extend financing for land purchases. No agricultural projects have been financed by the Development Bank outside the homeland areas. The Development Bank obtains its finance from the public sector and increasingly from the capital market.

Other agricultural banks

The Ciskei Agricultural Bank, Agribank (Bophuthatswana) and the agricultural arm of the KwaZulu Finance Corporation are *inter alia* examples of specialised farm credit institutions. These institutions operate in the homelands and provide medium and short term credit to local farmers.

Traditional specialised farm credit institutions in developing countries have a patchy record as financial intermediaries (Donald, 1976). The problems encountered by these institutions resulted in insufficient loan recovery levels to permit them to break financially even before the allocation of administrative expenses (Donald, 1976). The basic reasons for the failure of these institutions rest on the two traditional assumptions, the provision of cheap credit and the inability of rural people to save (Coetzee, 1988). Past experience in other Third world countries have however proved that policies based on these assumptions, invariably resulted in credit programmes that all but helped the target population. Credit mostly landed in the hands of the larger farmers as depicted by the 'Iron law[5]' of interest rate restrictions. It was impossible for these institutions to provide a great number of small farmers with cheap credit, while they have to rely on donors for funding and had no other source of funds.

During an evaluation in the areas served by some of these institutions in South Africa it was noted that the typical pattern of these institutions world wide, could also be picked up locally. Restrictions placed on the level of interest rates, had the result that more funds were targeted away from the small operation, part time farmers to the bigger, lower risk and transaction cost, mostly full time farming operations (DBSA, 1991).

Development corporations

In the absence of formal credit sources for farmers like the Land Bank, cooperatives and commercial banks, agricultural development corporations in the homelands extend short and medium term credit to farmers. They obtain funds to do this from public sector sources, for example the Development Bank of SA or generate their own funds through farming activities.

3.2 Private sector institutions

3.2.1 Formal institutions

Commercial banks

Commercial banks extend short and medium term credit to farmers. These institutions are now responsible for more than 30 per cent of the agricultural loan book where this loan book refer to farmers outside the homelands. The commercial banks adhere to strict securitising stipulations in decisions to extend loans. This often excludes most farmers, who do not have title deed to the land they farm or cannot meet the other conventional commercial bank security arrangements, from commercial bank credit. It also excludes a number of clients who need small loans which implies high transaction cost per unit. Risk and transaction cost are the two most important reasons why commercial banks play a limited role in financing of farmers in the homelands. Commercial banks favour bigger accounts which imply lower cost per unit extended and lower risk transactions (Green, 1983:155).

The infrastructure of the South African commercial banks cover most areas and in several areas commercial bank branches have been the only formal financial institutions to provide services. These services are however limited to deposit taking and in limited instances, the extending of credit (Coetzee, 1988). Commercial banks obtain their funds from deposits, share capital, credit arrangements in the capital market, returns on investments and credit arrangements with the Reserve Bank.

Experience in other countries showed that commercial banks in general are not very willing to allocate much of their credit portfolio to farmers not producing for at least the local market on a continuous basis. Where farmers develop their enterprise to produce for the local market, or export market, commercial banks are more willing to act as financier. The contribution of commercial banks to the financial servicing of agriculture correlates with the degree of commercialisation of agriculture (Green, 1983).

Insurance companies, Participation Bond Schemes, Pension Funds

The exposure of these institutions to the agricultural sector decreased in terms of proportion of total debt. For example, before the late 1950's insurance companies were an important financier in long term agricultural financing through the financing of bonds. This decreased because of changes in regulations controlling the activities of financial institutions (Bosch, 1990).

Co-operatives

Co-operatives supply farmers with short term finance, which they obtain from the Land Bank. Obtaining finance from the Land Bank means that the co-operative benefit from the Land Bank's privileged position in the financial sector. In theory the co-operatives are in a position to pass this advantage on to the farmers. However, in practice "handling charges" (added to products sold and financed by co-operatives varies up to three per cent (Bosch, 1990) and in some cases as high as 7 per cent) may negate the advantage of the below market rate finance obtained from the Land Bank. Co-operatives also serve as the front for schemes like the Drought Relief Scheme which is administered by the Land Bank. This scheme entails the subsidization of interest and limited guarantee of short term finance.

Co-operatives therefore concentrate on short term finance to farmers. Farmers have to be members of the co-operative to qualify for credit facilities. With co-operatives outside homeland borders it usually means that farmers from the homeland areas cannot become members. An example exist of a specific co-operative where individual farmers could not be members while the homeland agricultural development corporation could become a member on behalf of the farmers (DBSA, 1990).

3.2.2 Informal financial institutions

Informal financial markets are the markets that are not regulated or formally monitored under the acts that govern the behaviour of the country's financial institutions. The informal financial market and the institutions active in these markets play a major role in developing areas (Miracle *et al*, 1980:703). The major reasons for the existence of informal financial institutions can be ascribed to the lack of activities of formal financial institutions in the developing areas. The people taking part in informal arrangements usually will not qualify for a loan at the formal institution, or have no access to the formal institution, or there are no formal institutions represented in the area. Formal institutions normally have very strict stipulations in terms of credit applications. Most of the people in rural areas cannot meet these requirements. Further to strict stipulations it is also costly in terms of time to apply for a loan at most formal financial institutions.

Table 2: Differentiation between formal and informal sources in KaNgwane

	Formal	Informal
Average:		
Distance to source (km)	39.7	33.6
Number of visits to source	6.4	3.1
Application time (days)	59.5	8.3
Size of loans (R)	1951.6	446.2
Pay out in:		
Cash (% loans)	19.0	94.7
Kind (% loans)	81.0	5.3
Deposit needed (% loans)	36.0	10.6
% of farmers who took up loans		
KaNgwane	43.0	57.0
Lebowa*	29.0	71.0

* From a survey in Lebowa (Fenyes, 1982)
Source: Coetzee, 1988

Informal institutions are locally based and know their clients and the circumstances within which these clients find themselves quite well. They accommodate their clients in a number of ways that would have been unacceptable to institutions in the broader financial sector. Table 2 serve as indication of the difference between formal and informal institutions in terms of variables that impact on transaction costs, both for the lender and the borrower.

Informal sources of credit are the major sources of credit of rural communities in the homelands. Survey results in Lebowa and KaNgwane indicated that 71 and 57 per cent of farmer loans were from informal sources respectively.

In the informal financial sector the following well known institutions could *inter alia* be found:

Stokvels

Stokvel is a rotating savings and credit association. In these institutions a fixed number of participants contribute on an agreed on period and agreed on sum of money to a central purse. At every contribution, one of the members receives the total purse. There are many variants of stokvels in terms of the period of existence, the way in which the purse is paid and the number of people taking part. Stokvels in urban areas generate up to R52 million per month in cash contributions (Lukhele, 1990). Stokvels also operate in the rural areas, but quantitative information on rural stokvels are not available. Stokvels is a rotating savings and credit association indigenous to South Africa, although many versions can be found right through Africa.

Other sources of informal credit

Other informal sources of credit include money lenders, traders, family and friends of which family and friends are the biggest source of agricultural credit in the rural areas (Coetzee, 1988:102; Cross, 1986).

3.3 Total farming debt

Considering one agricultural sector implies the inclusion of more institutions providing financial services, as well as more farmers to which to provide these services. This also necessitates a re-look at the total farming debt quantification used in the past. It will be difficult to ascertain the total farming debt including all the farmers in South Africa as the sources of data are few and in many instances incompatible. It will suffice to say that agricultural debt is more than the approximately R17 billion as reported for only a part of the total agricultural sector.

3.4 Summary

The discussion on institutions active in the agricultural financial sector illustrated the lack of formal financial services in certain areas and the concomitant activities of informal sources of financial services. It was also indicated in the discussion that farmers from economically advantaged areas in general had an advantage over the rest of the agricultural sector in terms of access to financial services.

4. Challenges of the total agricultural sector

The challenges are presented in terms of issues that need to be addressed by the participants in the agricultural financial sector to be in a position to service the complete agricultural sector. Agricultural finance was one of the issues discussed during a recent strategic debate on the future of agriculture, attended by the "role players" in agriculture (Landbouweekblad, 1991c). A number of issues were highlighted at this discussion. Research results (cf Coetzee, 1988; Mostert and Van Zyl, 1988) also addresses some of these issues.

- Agricultural policy should encourage the farming community to increase their ability to finance themselves. Farmers will have to take their own precautions against emergency conditions. It is only in extreme cases that government will provide financial relief, for example in cases of natural disaster.

Farmers in a less protected environment should incorporate the risks of a drought ridden country in their production planning.

Assistance to agriculture will be selective. Assistance to agriculture should be justified to the voters. Government will have to concentrate on developing agriculture in addition to developed agriculture. Concessionary finance will be targeted towards developing agriculture to redress past imbalances.

- The conventional concept of security should be reconsidered by the majority of agricultural finance institutions. The dominant form of conventional security is the ownership of land, embodied in title deed to land. All the formal institutions in the agricultural financial sector try to secure a bond over the farm in the majority of loan agreements with farmers. The effects of the past approach in valuation of farms only according to market value, whereas the loan had to be served from the productive value of the farm has conveyed incorrect signals to farmers in terms of loan limits. In reaction on the negative results achieved by such an approach, too much emphasis is placed on the productive values of farms. In the instances where land needs to be part of the security a combination of valuation methods, applied area specific and enterprise specific, should be more successful in the highly dynamic agricultural environment. However, depending on the purpose of the loan and the security measures that can be offered by the farmer, research has shown that the most important norm in extending credit to farmers will be the ability of the farmer to repay the loan, and the best motivation to repay a loan will be access to future loans (Coetzee, 1988).

- The pressures will increase for farmers to pay market related interest rates. However, the high levels of rates necessitates the curbing of inflation in order to decrease rates to levels more affordable to agriculture and other sectors. Mostert and Van Zyl (1988:360) concluded that there is reason to believe that interest rate subsidies distort financial markets and result in incorrect financial decisions by participants in the financial market. It seems as if this can disadvantage the farming community more over the long term, than what is benefited in the short term. Research findings in other Third World countries also indicate the negative effect interest rate ceilings have on the targeting of these funds (see Coetzee, 1988, for sources). It has been calculated that interest rates contribute 17 per cent of total transaction costs per loan to farmers in less developed areas. The rest of the transaction costs are *inter alia* made up by transportation costs, opportunity cost of the time of the farmer and cost in terms of the timeliness of receiving funds.

- The whole issue of transaction costs needs to be carefully analysed by financial institutions. This applies for transaction costs of both the borrower and the lender. The conventional view on the costs of borrowing and lending tends to be a narrow view. An analysis of transaction costs will provide institutions with information on which to base decisions to reduce transaction costs of financial intermediation. Several types of improvements, both internal and external to financial institutions, are suggested by Meyer and Cuevas (1990) and discussed by Coetzee and Vink (1991). These include improving the economic environment (a challenge broader than the scope of financial institutions), improving banking procedures and regulations (with the emphasis on more applicable procedures and regulations), reducing risks, diversifying financial institutions and thus financial services, expanding the network to bring the service to the borrower, group lending, improved and more efficient internal operations and linking informal and formal finance.

- Regulations and procedures for extending credit to farming clients will have to be re-looked by almost all the participants in the sector. Due to the fact that many farmers cannot meet the requirements of the formal financial sector in obtaining credit, financial institutions will have to deliberate on a new approach to servicing the sector. Lessons can be learned from the activities of the informal financial institutions. For example, as discussed above, research has shown that the most important norm in extending credit to farmers will be the ability of the farmer to repay the loan, and the best motivation to repay a loan will be access to future loans.

- Financial services to clients should be broadened. Institutions previously dependent on the public sector or donors as sources of funds may find more competition for these funds. The provision of deposit facilities may not only serve as an additional source of funds, it can also serve as a source of financial information on potential borrowers. Thus a financial institution that has an active deposit relationship with a customer can accumulate information on the customers reliability, cash flows and savings potential. Deposit mobilization may also contribute to superior loan recovery. By lending funds that have partly been mobilised from deposits, the financial institutions know they must be more careful when granting loans, as they are more likely to be able to avoid political pressure with regard to loan applications. At the same time borrowers may be more inclined to repay loans that they know represent their neighbours' deposits.

  The ability to save of people in rural areas should not be underestimated, notwithstanding the often harsh conditions these people often have to face. For example, in the KaNgwane area, a savings propensity of 0.26 has been calculated for people that save (55 per cent of the sample)(Coetzee, 1988). Of these people 75 per cent had savings accounts at commercial banks while only three per cent of the same group enjoyed the benefit of credit from the commercial banks. The ability to save is also illustrated by the popularity of stokvels as discussed earlier. In countries like Taiwan, Japan, Korea and India savings propensities in rural areas that range from 0.14 to 0.34 have been noted (Adams, 1978).

5. Proposed changes

The changes highlighted here represents the most important changes needed. The first change needed in the agricultural financial sector is acknowledgment of the total agricultural sector. This implies acknowledgment of the financial needs of all participants in this sector, as well as the institutions that operate in this sector. The concept of prioritisation and justification of the activities of the public sector financial institutions are central to the activities of these institutions.

The second proposal refers to a shift in mind-set. Agricultural finance institutions have a conventional approach to their activities. They base this approach on a conventional view of their clients. If the agricultural financial institutions are serious about servicing agriculture they will have to re-assess their views on the total agricultural sector. This is as true for the clients in the total agricultural sector as it is for the clients in the conventional agricultural market.

The third proposal is on the concept of security. Formal financial institutions can learn a lot from informal financial institutions. The policy of following conventional approaches to agricultural finance should be re-looked. Instead of treating all farmers by the same securitising criteria, institutions need to study the participants in the total agricultural sector and structure loan packages that will ensure the sustainability of both the financier and the borrower. For example, uncertainty about the future form(s) of land rights necessitates a re-look at land as a form of security. The productive capacity of land will therefore come much more into play. Lessons can be learned from other countries regarding this issue.

6. Conclusion

The agricultural sector should be addressed in totality and no differentiation should exist within the sector. This view represents a turnaround for most institutions active in the agricultural financial sector. Alternative approaches to servicing clients will have to be considered. The target market for these institutions also need to be redefined. Certain issues, like the level of interest rates, the concept of security, the reduction of transaction costs of both borrower and lender and justification of public expenditure on agriculture, need attention.

In the targeting of services, the role of public sector institutions will also include a high priority servicing of the previously ignored farmers in the sector. In considering the whole agricultural sector, unco-ordinated an inequitable approaches of the past will be excluded. The challenge however is to redress the inequities of the past, while at the same time pursuing the goal of an equitable, efficient and sustainable agricultural sector.

Note

1. The usual disclaimers are valid. The author would like to thank Johan van Zyl, Christo Mostert and Hein Prinsloo for usefull comments.

2. Homelands refer to Transkei, Ciskei, Bophuthatswana, Venda, KwaNdebele, Gazankulu, KaNgwane, KwaZulu, QwaQwa, Lebowa. These areas are also called less developed, developing or economically disadvantaged areas.

3. Although part time farmers outside homeland borders were not served by public sector financial institutions these farmers did enjoy access to other support services.

4. *Bona fide* farmers refer to full time owner operator farmers for all practical purposes.

5. That is, the more restrictions on the provision of credit and more specific the level of interest rates, the more funds do not land in the hands of the target group.

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