The State of Funding For Agriculture and the Whole Value Chain as well as Prospects for the forthcoming agriculture Summer Season.

BY

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1. INTRODUCTION

1.1 Agriculture Financing – A Historical Perspective

Agricultural production has always played a catalytic role in the economy. In terms of linkages with other sectors, agriculture output impacts directly on key sectors of the economy, including manufacturing, mining, construction, real estate, finance and insurance, among others. As agriculture thrived, post-independence, the manufacturing sector and many other sectors also prospered in tandem.

The manufacturing sector has traditionally been largely agro based, with several subsectors having direct linkages with agriculture. Strong linkages between agriculture and manufacturing also mirrored linkages with the banking and financial services sector. The two sectors contributed nearly a third each in foreign exchange generation and domestic deposits.

Post-independence, during the first two decades, agriculture financing was predominantly undertaken by commercial banks, the AFC and cooperatives, mobilizing financial resources from both the domestic economy and the donor community. Short term credit was normally used for seasonal finance and such loans were paid within a year whilst medium term loans were for a period ranging from 2 to 6 years, and were mainly for irrigation equipment, fencing, agricultural machinery and livestock. Long term financing was granted for periods often exceeding 10 years, for long term farm development projects, including dam construction.

In addition, Government through the Public Sector Investment Program also undertook major investments in agriculture infrastructure including dam construction and irrigation development. During this period several dams were constructed across the provinces such as the Zhove, Marovanyati, and Osborne dams, as well as various irrigation schemes under Government PSIP initiatives.

For the period 1980-1999 commercial banks' lending to the agricultural sector increased as a proportion of total loans. The proportion rose from 26% in 1980, to exceed 80% by 1997.

During the same period, agriculture contributed significantly to economic activity, accounting for 20% of GDP, 33% of exports with more than 350 000 employed.

Commercial bank lending to the agricultural sector increased significantly between 1994 and 1999. During this period, the proportion of loans to agriculture averaged above **60%** of total commercial bank credit. During the same period, the AFC also played a prominent funding role in agriculture infrastructure development – predominantly through provision of medium to long term financing.

The share of Commercial bank loans to agriculture increased from a total 31.3% in 1981 to a peak of 70.1% in 1996, before declining progressively through to 2000 and beyond. Lending by the AFC to agriculture averaged about 40% of total funding in the 1980s, declining to about 25% by the mid-1990s.

1.2 Structural Changes in Agriculture

The Land reform program brought about major changes in the structure of the economy. Prior to the advent of the Land reform, fewer than **5 000** white commercial farmers owned more than 11 million ha of prime agriculture land, while the majority of the indigenous population were marginalized.

The Land Reform changed that with nearly **350 000** new farmers being resettled under the Fast Track Land Reform Program, since inception in 2000. The transformation of the agriculture landscape has been complimented by Government efforts to improve agriculture productivity through mechanization and irrigation development and enhanced inputs management.

1.3 Recent Trends in Agriculture Production and Financing

Agriculture, currently accounts for about **11%** of GDP (Zimstats 2012 Statistics) and as much as **15%** of exports – nearly half the previous contribution to both GDP and exports. Over 70%

of the population derives sustenance and livelihood from agriculture and therefore measures to address poverty alleviation must be targeted first, to the agricultural sector.

There has however been a discernible shift in agriculture production towards cash crops, such as tobacco and sugarcane - away from traditional cereals such as maize and wheat. This shift has been particularly pronounced since the dawn of Multicurrency in 2009. The preference towards cash crops has therefore undermined food security, as increasingly farmers are choosing cash crops over cereal or grain production.

Last season, over **90 000** farmers registered for Tobacco farming, contributing to the surge in Tobacco output by more than **30%** to 216 million kgs and registered just over US$685 million from Tobacco sales. For this season, the number of registered tobacco farmers has increased to 106 000, with farmers of all categories swelling the ranks of tobacco farming.

During the past season, local banks mobilized a total amount of **US$620** million for agriculture financing. As much as US$343.2 million (55.3%) was for tobacco financing. Support for tobacco farming by bankers and contractors is reflective of the following:-

a. The Value Chain is efficient and reliable;
b. The Stop Order Payment System is effective;
c. There is confidence in the Value Chain and Payment system

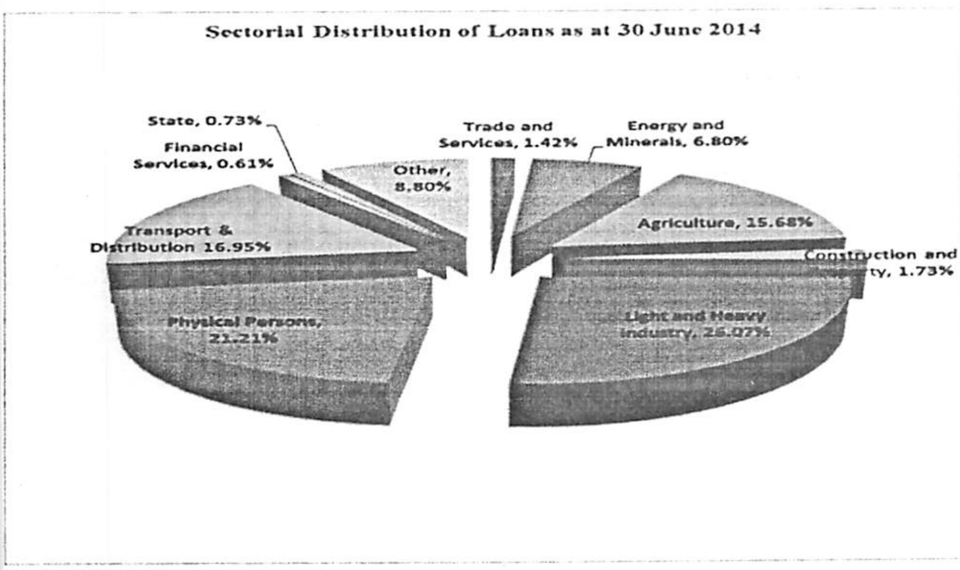
Merchants have succeeded in securing internal and external financing for tobacco because the Value Chain is effective and efficient. Banks find it easy to finance Tobacco Merchants, for on lending because the repayment system is reliable. This contrasts sharply with what has been the historical pattern with maize where loan repayments were considerably uncertain.

Government must however, be commended for the current efforts to raise maize financing through AMA bills which has enabled early payments to farmers for maize delivered. A total of US$53.1 million, of the expected US$55 million, has already been raised for maize purchase by the Grain Marketing Board. If sustained next year and beyond, this will measurably alter the dynamics of grain production in Zimbabwe, with improved loan servicing. The 2013/14 agricultural season benefitted from the Government US$160M input scheme for the communal, old resettlement, A1 and small scale farmers and coupled with the good rains resulted in significant improvement in maize production with production levels expected to be at least 1.4million tonnes.

Financing of sugar cane and cotton is also preferred by financial institutions as payment mechanisms are similarly effective as this minimizes the risk of default by farmers. The challenge with cotton has arisen in respect of the international price of the commodity, which is below viability. As a direct result, Cargill, one of the large cotton contractors has ceased operations while Romsdal has applied for judicial management, developments which will further impact negatively on the cotton sector.

Reflecting growing concerns regarding corporate indebtedness and rising Corporate Non Performing Loans, banks have increased their lending to the personal and consumer sector at the expense of Productive sector lending. According to the Reserve Bank of Zimbabwe Monetary Policy Statement, issued in August 2014, commercial banks' lending to the personal and household sector, accounted for **21.2%** of loans and advances compared to **15.68%** for agriculture, as shown in the figure below.

Figure1: Sectoral Distribution of Credit.



Source: RBZ Monetary Policy Statement: August 2014

2. AGRICULTURE FUNDING CHALLENGES

Historically, agriculture financing covered:

a. Short Term credit which was normally for seasonal finance and repayment within a year;
b. Medium Term Loans were provided for periods ranging from 2 years to 6 years, mainly for farm mechanization, fencing, livestock watering facilities and;
c. Long term financing was granted for periods ranging from 6 to 30 years. These were exclusively handled by the AFC and related to the purchase of Land, erection of buildings, dam construction and development of irrigation schemes.

Since dollarization in 2009, the banking system has been characterized by short term deposits. Over 80% of the deposits are demand deposits and not readily available for medium or long term financing. International and regional lines of credit are few and subject to a high risk premium, reflecting the perception of Zimbabwe as high risk due to the existing external debt payment arrears and debt overhang.

This explains the predominantly short term lending available to agriculture and other sectors of the economy. The current high domestic interest rates prevailing are a clear symptom of the current liquidity constraints and absence of long term funding. The **tenor** and **price** of money in the domestic money is not appropriate for agriculture financing and development. The low margins in agriculture cannot absorb the high cost of funding, in part contributing to the high and rising Non Performing Loans.

2.1 Resolution of External Debt and Arrears Clearance - A Precondition For Access To Medium Term External Financing

The resolution of the country's external debt and arrears is conditional on progress on the 15 month IMF SMP Successor Program which commenced this month. It is within this framework, that hopefully the multilateral debt can be cleared, paving the way for negotiations with the Paris Club on bilateral debt and London Club for Commercial debt, and thereafter access to international capital markets for medium to long term financing and lines of credit.

Accordingly, at present, international facilities available for agriculture typically take the form of mechanization equipment facilities such as the Brazilian Facility (US$98.6 million). The facility which will be administered by Agribank is designed to enhance small holder agriculture productivity for output growth and the first tranche of the Facility will be disbursed during the 4th Quarter of this year.

2.2 The Ideal Scenario for Agriculture Productivity

There are several intertwined pillars that are important for improving agriculture productivity and viability. These include:

a. Sustainable Agriculture Financing (Short, Medium and Long Term)
b. Affordable and Timely Inputs Management;
c. Investment in Irrigation Infrastructure;
d. Availability of Extension Services
e. Harnessing ICT and Technology For Production;
f. Investment in Research and Development; and
g. Effective Marketing of Produce

The above are critical ingredients for sustaining agriculture recovery for overall economic growth, as espoused under ZIM Asset – the Food Security and Nutrition Cluster as well as the Value Addition and Beneficiation Cluster.

It is imperative that agriculture be adequately resourced with financing of **appropriate tenor** and **pricing.** This is singularly the most important challenge for agriculture recovery. Agriculture plays a critical role, not only for food security and catalyzing overall economic growth, but also contributes measurably towards poverty alleviation.

Over 70% of the population, in some way derive livelihood from the Land, either directly or indirectly. This means that any Government efforts towards poverty eradication must in some way target agriculture, where over **70%** of the population derives their livelihoods. There is therefore need for more financial resources to be channeled to agriculture to enhance agriculture productivity as well as value addition and beneficiation. Such an initiative is certain to achieve food security and measurable progress in poverty alleviation.

The challenge of agricultural financing in Zimbabwe must be viewed in the context of the broader economic situation prevailing in the country characterized by serious liquidity constraints, declining economic activity, low domestic demand and a widening current account deficit. This liquidity problem is permeating through all the sector of the economy including the mining, manufacturing, distribution, and others. This requires that the limited financial resources available be shared equitably across the productive sectors while exploring alternative sources of mobilizing foreign financing inflows.

Zimbabwe does not have access to medium and long term funding required in agriculture and the available short term funding is not adequate to meet the myriad financial requirements in agriculture. Over **80%** of total deposits are demand deposits that are not available for longer term lending. Compounding the challenge is the growth of Non-Performing Loans (NPLs) accounting for **18.5%** of total banking sector assets and locking as much as **US$700** million in potential financing which could be financing the productive sectors of the economy. Accordingly, Banks have become more risk averse and have therefore reduced lending, in particular to farmers, whilst increasing lending to corporate agriculture.

Resolving the problem of limited credit to the agricultural sector calls for concerted efforts by all stakeholders including farmers, bankers, Government, non-banking financial institutions to chart a collective response to augment the flow of credit to agriculture. Some of the best mechanisms for overcoming the challenges of financing agriculture is through agricultural value chains and also for farmers to timeously repay their facilities so to retain credit worthiness which is important for support from financial institutions.

3. BANKS FINANCING AGRICULTURE

Agriculture financing continues to evolve, notably since dollarization with increasing focus on value chain financing and also the increasing role of merchants in crop financing. Historically, banks assumed the highest exposure for agriculture financing and agriculture was one of the prime sectors targeted for financing by commercial banks. Increasingly over the past few years, contract farming has featured prominently, but there appears to be marginal benefits being derived by farmers with more of the benefits accruing to Contractors. Whilst output has therefore increased measurably, particularly for tobacco and sugar, the welfare of farmers has not significantly changed.

Commercial banks have also shifted towards commodity based financing – financing on a select basis, targeted commodities on the basis of repayment prospects within the value chain.

As highlighted earlier, during the 2013/2014 agriculture season, banks availed **US$620 million** towards agriculture financing. As much as **US$343 million** (55%) was for tobacco and this reflects, in the main the recognition among financiers that tobacco repayment arrangements were markedly more efficient and effective. The risk from non- repayment was much higher for maize and cotton. Banks are thus targeting financing crops with well-structured and organized value chains such as tobacco, sugar cane and soya beans.

3.1 Catalyzing Agriculture Value Chain Financing

All stakeholders have a role to play in catalyzing the agricultural value chain. There is need for the Government to put in place a framework designed to boost agricultural productivity and financing. The agriculture framework must address critical issues for agriculture productivity, including financing and the bankability of 99 year leases. Currently there are ongoing discussions with Government and the Bankers Association of Zimbabwe towards resolution of this important issue. Similarly, farmers are encouraged to honor their repayment obligations. A successful Value Chain should:

a. Enforce the repayment of loans and advances availed to the farmers by the financial system and other financiers in the value chain.
b. An effective stop order system to ensure creditors are paid upfront when the farmers are paid and any loophole around side marketing are eliminated
c. Strengthening the marketing structures of the agricultural sector. This would ensure that there is a well-functioning pricing framework for the agricultural commodities. More importantly would be the need for the determination of producer prices before the farming season begins so that decisions are made timely for production;
d. Support small holder agriculture farmers and agro traders

e. Strengthening the agricultural value chain so that financial and technical support assists all agents involved in agricultural production. Also associated with this is the need to strengthen agro-dealer networks throughout the country
f. There is need to expedite the issuance of bankable and transferable 99 Years Leases.
g. In line with the Zim-Asset there is need to fast track the Agricultural Commodity Exchange which will include Warehouse Receipt Act and Warehouse Receipt System to ensure that farmers are able to use the receipts for securing the loans from the banks.

4. PROSPECTS OF THE 2014/15 AGRICULTURE SUMMER SEASON

The capacity of the banking sector to finance agriculture is a function of the performance of the domestic economy, (which generates deposits for lending) and the extent to which local financial institutions are able to raise external lines of credit.

Government, under the Presidential Input Scheme is mobilizing **US$252,3M** to support A.1 households, communal, Old Resettlement and former small scale purchase area farmers. The programme has now been extended beyond maize/small grain inputs which will be financed to the level of **US$184,8M, US$51,2M to livestock farmers, US$9,9M** to cotton farmers and **US$6,2M** for soya beans/cowpeas farmers. The challenge will be to ensure that the inputs are availed timeously for early planting particularly with an expected shorter second half rainfall season. It is pleasing to note that Government has indicated that this is the last season farmers will be provided with free inputs. Provision of free inputs to farmers is not a sustainable financing option available to Government and a mechanism must be established for farmers to access credit for inputs at affordable terms through a revolving agricultural facility. Free inputs should only be given to the targeted vulnerable poor members of society.

As alluded before, the country's ability to secure lines of credit is also conditional on progress with the resolution of the current external payment arrears and external debt, hence the Government's commitment to continued engagement with the international community, as reflected by the ongoing Staff Monitored Program with the IMF and its successor program.

The Government is commended for both the fiscal and monetary policy measures designed to strengthen banking sector stability and to enhance financial intermediation. These include:

a. the setting up of ZAMCO to facilitate the transfer of NPLs from banks through the Special Purpose Vehicle;
b. The setting up of the Afreximbank US$100 million interbank facility, which will enhance the interbank flow of liquidity in the economy by unlocking idle surplus funds sitting with banks and thereby resuscitate interbank trading;
c. the setting up of a credit reference bureau for information sharing among banks to minimize adverse selection;
d. The RBZ Debt Assumption Bill whereby Government assumed liability for FCAs balances previously held by banking institutions.

The Banking sector welcomes the expected full normalization of development cooperation with the European Union under the 11th European Development Fund (11th EDF) in particular the finalization of the National Indicative Plan for 2014-2020 which should result in the allocation of more than US$110M to further strengthen the links between agriculture and private sector trade to boost agriculture recovery and growth.

Banks are also putting together various financing schemes for agriculture for the 2014/15 season and will once again play a pivotal role in supporting the agricultural sector. As before the likelihood is that over 60% of the financing will be dedicated for Tobacco financing due to the reasons highlighted earlier.

Early indications by the Met office are that there are increased chances of normal to above - normal rainfall for the country during the first half of the 2014/15 rain season, whilst the south and western parts of the country will experience lower rainfall during the second half of the season. Given adequate rainfall as currently predicted, the success of the forthcoming season is now highly dependent on financing and timely availability of inputs to farmers as well as availing of affordable funding.

Generally, there is growing preference for cash crop farming particularly tobacco and horticulture by small scale and commercial farmers to grain crops and cotton due to uncertainty in terms of prices and timing of payments. Tobacco is likely to register even higher number of growers for the 2014/15 season compared to last season, notwithstanding the likelihood of lower prices due to over production and quality concerns.

The Government can also optimize synergies for agriculture financing and development through public private sector partnerships, encouraging private sector agriculture infrastructure investment.

Such PPPs can focus on specific agriculture infrastructure such as irrigation infrastructure and dam construction or this can be widened to include joint marketing and export promotion programs so as to enhance the entire value chain in agriculture from production to marketing.

5. Concluding Remarks

Banking and financial institutions view farming as a business and are therefore keen to build on mutually beneficial long term relationships, based on win/win partnerships. It is imperative that farmers prioritize repayment of facilities to enhance recycling of credit for increased lending. At the minimum, farmers need to engage their bankers early, should circumstances dictate the need for restructuring of loans, so that such arrangements are proactively undertaken and appropriate refinancing is provided per the revised cash flow and repayment plan.

The introduction of the Credit Reference Bureau implicitly means that banks will be able to share information on borrowers and obtain credit references from wider sources including utilities and chain stores. This wealth of credit information means that banks will only provide funding to credible borrowers.

There is also need to reach consensus on the issuance of "collateral friendly" bankable ad transferrable 99 year leases.

Banks and financial institutions will continue to fund crops selectively on the basis of payment performance and crops such as tobacco and sugar have a clear advantage. It is important that the payment performance of Cereal/grain crops be improved and sustained to enhance financing by banks. The fast tracking of the Warehouse Receipt Act and the Warehouse Receipt System will assist farmers to use the receipts for securing loans from banks.

At the national level, it is critical that as a country, focus is shifted towards value addition, in particular with regards to agriculture output. For instance, in the tobacco sub sector, in light of the current shift in global trends, there is need to focus more on the quality of tobacco and the transcending value addition that has potential to measurably contribute to real GDP, foreign currency generation and employment.

Going forward, in light of the necessity for balanced growth across all the country's agricultural provinces, there is need for Government to set up a Livestock Fund, dedicated towards livestock and dairy development - a key sub sector for agriculture.

Thank You

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