POLICY BRIEF

Land Tenure Security and Access to Finance of Agricultural Households in Cameroon

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Abstract

This study investigates the relationship between the land tenure security and the financing of agricultural households. The study uses data from the third Cameroun Household Survey (ECAM3), carried out by the National Institute of Statistics in 2007. The study has two objectives. The first objective investigates the effect of the land tenure security on the access to finance of agricultural households; the second assesses the impact of the land tenure security on the volume of credit extended to agricultural households. The regression switching model is used. The study assumes formal and informal financing sources. The empirical results reveal different impact of land property rights on the access

to financing of the agricultural households. Precisely, the legal land title improves by 5.4% the possibility to access to formal financing. On the other hand, the land title, whether legally of customarily defined, increases by 20% the possibility of access to informal financing. Such results imply a double orientation of economic policy. The first should set up a financing scheme adapted to rural environment. The second should aim to reconcile the legal and customary land property rights to ensure higher economic efficiency of the land property rights.

Introduction

Neo-institutional theory provides a coherent and formalized theoretical framework to investigate the relationship between the property rights and investment. According to North (1990), economic institutions such as the structure of property rights are paramount for economic and social achievements. The institutions help to allocate resources to the most efficient uses. In the neo-institutional theory, property rights reduce market imperfections and improve economic efficiency. This theory triggered a set of works that include the relationship between land law and agricultural finance. This issue is a priority in the development agenda in sub-Saharan African countries.

In Sub-Saharan Africa, agricultural activity is perceived as particularly risky, whether regarding price volatility of agricultural products or considering the uncertainty affecting production. For a financial institution, these factors represent a high repayment default risk that is difficult to assess. Faced with such risk, financial institutions require collateral that all the agricultural producers cannot provide (land title and other goods) and consequently charge generally high interest rates. According to the World Bank (2017), 80% of agricultural households in sub-Saharan Africa are excluded from the financial system. For Stiglitz (1981), this exclusion is due to imperfect competition in the financial and agricultural markets, characterized by a strong information asymmetry and high transaction costs. In the presence of imperfection in the credit market, economic theory proposes confidence instruments based on collateral and land rights (Demsetz, 1967; Armen, 1969). For the economic theory, such instruments help reduce uncertainties linked to imperfect contracts.

In most sub-Saharan African countries, agricultural households generally have land capital whose property rights would need to be clarified to reduce uncertainties vis-à-vis the credit market. Besley (1995) indicated that land law ensures a better allocation of resources in the presence of an imperfect credit market. De Soto (2000) considers land capital in its traditional form as a “dead capital”. For De Soto (2000), a system of legal land property laws can transform the dead capital of the poor into “active capital”. In this regard, economic theory establishes a close correlation between land law and access to finance by agricultural households.

This idea triggered many land reforms around the world. Those reforms led to far-reaching land securitization programmes. Many studies examined the effects of such programmes on the access to finance by agricultural households. The empirical results of those studies reveal mixed effects, which may be either positive (Abdoulaye, 2017; Adamon et al., 2017; Buehren et al., 2017) or negative (Barrows and Roth, 1990; Feder and Feeny, 1991; Mushinski, 1999; Dower and Potamites, 2005; Fleisig et al., 2006; Mellor, 1996; Lawry et al., 2016)

Despite the numerous studies, the issue of the relationship between property rights and financing of the rural sector is a priority in the development agenda of sub-Saharan African countries. The empirical results of previous studies are mixed and inconclusive. Furthermore, the previous studies rely on the hypothesis of superiority of legal land property rights. In fact, the institutional framework in many countries in Sub-Saharan Africa is marked by the coexistence of both regimes, legal and customary land tenures. While legal land tenure is inspired by considerations from Western positive law, customary land tenure is created and maintained by the community itself. In its original form customary land tenure is based on social trust, which gives it a strong capacity for resilience and flexibility.

In Cameroon, the low level of credit supply to agriculture persists. Empirical results suggest the reduction of risks in the economic environment on which depend the solvency of agricultural households and securitization of the loan repayment. While the issue of financing agricultural households is highly debated in Cameroon, by contrast, the issue of the link between financing and land tenure security has not been investigated enough in scientific works.

The objective of this study was to examine the effects of land tenure security on access to financing of agricultural households in Cameroon. It specifically assessed two issues: first, the influence of land tenure security on access to credit by agricultural households and second, the impact of land tenure security on the volume of credit extended to agricultural households.

This study is particularly relevant at least for two reasons. First, the study is justified in a context marked by the coexistence of two land property regimes, notably the legal and customary land property regimes. In fact, Cameroon recognizes the equality of the two regimes. Previous studies have been more interested in the impact of land securitization programmes on the classical credit. They were carried out under the hypothesis of customary non-market tenure, hence non-transferable. Yet Cameroonian rural communities rely on a socio-cultural trust that underpins the legitimacy of the customary land property regime. This legitimacy can constitute an efficient instrument as a guarantee to financing.

Second, previous work is exclusively interested in the access to credit. Yet, the credit is useful when it not only increases the production capacity of the agricultural households, but also helps households face the uncertainties of agricultural production. The agricultural activities in the rural areas are subject to many risks, notably economic, technological, and environmental risks. These risks sustainably imply mobilizing important financial resources. Yet, both land tenure regimes are underpinned by a different legal basis and degree of trust, which if accounted for, can affect the volume of credit extended.

This study contributes to a better understanding of the link between property rights and agriculture sector financing.

Institutional developments of the agricultural sector finance

In Cameroon agriculture sector financing has long been of great concern. It manifests in two economic models: the interventionist model and the neo-liberal model. The first model allowed the government to have a predominant role in the financing the sector. During almost two decades after independence, government financing was implemented through two institutions, namely the National Fund for Rural Development (FONADER) and the Agricultural Bank of Cameroon (BAC). The numerous economic crises experienced in the 1980s, associated with poor strategic management led to the bankruptcy of the two financing structures. The results of the experience did not meet the expectations. In this regard, less than 20% of the mobilized resources were allocated to the agriculture sector during this period (Fouda, 2003). The inconsistency between the financial services delivered by the State and the rural conditions are the main explanation of the failure.

Since the early 1980s the withdrawal of the State from economic activity was advocated. A new model was adopted, one that relied on private financing. The new model was based on neo-liberal economic theory. In this model, the banking market plays a predominant role. However, at the beginning of the 1980s Cameroon's economy was characterized by low development of the banking system development, resulting from the controlled management of the post-colonial financial system. This system was not favourable to efficient financing of the rural sector. The subsequent liberalization of the financial system led to diverse development of the commercial banks. Unfortunately, the capital structure of the banks, which were predominantly located in urban areas, did not improve access of the rural sector to financing. In this regard, according to Central African Banking Commission (CABC, 2018), only 3% of agricultural households obtained credit from the existing commercial banks. It is in this context that the informal financial system took the lead as the main financing instrument of the rural sector. According to CABC

(2018), the informal financing system accounts for 93% of total credit obtained by agricultural households.

During the 1990s microfinance institutions experienced strong development that created an additional source of financing to rural households. The underlying idea of the new paradigm is to associate the financial return to social return supported by specific financial services fitting the socio-economic conditions of the rural sector. Since the first year of their operation, the relative weight of credit extended to the economy by the microfinance institutions stood around 14%. Only 4% of the financing was channelled to the rural agriculture sector (CABC, 2016). The economic environment of the 1990s which was linked to competitiveness requirement reinforced the conditioning package of access to the new financial services. In this context, the extension of credit from microfinance institutions focused more on the urban areas; this further reinforced the exclusion of the rural areas from the access to microfinance credit.

Previous studies carried out on financing the rural sector in Cameroon show that the rural agricultural households are excluded from access to financing due to lack of collateral (Kamajou, 1978; Fouda, 1988; Foko, 1994 ; Fouda, 2003). According to the fourth Cameroon Household Survey (ECAM4, 2014), around 70% of agricultural households are excluded from access to financing. Furthermore, according to the National Institute of Statistics (NIS, 2017), more than 60% of credit extended to agricultural households is collateralized by land titles.

During the two last decades Cameroon has experienced changes in land policies, of which the reform[1] carried out in 2005 puts in place two innovations. The first innovation introduces greater flexibility in the land securitization procedure in Cameroon whose objective is to improve substantially the number of delivered legal land titles. This reform assumes that the fragility of the property rights does not improve economic efficiency (North, 1990; Tortensson, 1994; Goldsmith, 1995). The second innovation gives full legitimacy to customary land property in contract matters. This second innovation constitutes important progress, as it recognizes primacy and legitimacy to customary land tenure in rural area. The legitimacy granted to customary land tenure aims to reinforce its capacity to act as collateral. From this point of view, the last decade simultaneously registered reinforcement of the private land property in rural areas and an increase of 2% in credit extended to agricultural households (NIS, 2017).

Furthermore, during the last decade, financing of the rural sector and promotion of microfinance institutions (EMF) in rural areas constituted an important component in

1 The reform was implemented by Decree No 2005/481 dated 16 December 2005 which modifies and complements some of the provisions of Decree No 76/165 dated 27 August 1976 determining conditions for obtaining land title.

the documents on Poverty Reduction and Strategy Paper (PRSP) and on Rural Sector Development Strategy (RSDS) in Cameroon. In this context, the country has put in place a supporting programme to promote the development of rural microfinance. This programme was also supported by international organizations such as the Food and Agriculture Organization of the United Nations (FAO) and the International Fund for Agriculture Development (IFAD). This programme allocates in its component an amount of US$14.1 million (MINAGRI, 2008). This programme aims to increase the financing capacity of smallholders in the rural farming sector. It seeks to set up an appropriate financing system that fits the socio-economic needs of the farmers. One feature of the programme is that it focuses on the customary land tenure as a financing instrument.

Methodological framework

This study aimed to investigate the impact of land security on access to financing by agricultural households in Cameroon. In particular, the study analysed the impact of land security on access to credit by agricultural households and examined the effect of land security on the volume of credit extended to agricultural households. The access to credit by agricultural households takes place in a context where the agricultural households have to do with two financing sources: internal or external. The internal financing represents self-financing, while external financing implies a formal or informal financing. Based on these considerations, we assume that there are two categories of agricultural households: those in need of external financing and those resorting to self-financing. It implies that the impact of land security will have less effect on the households resorting to self-financing. The volume of credit extended is only observed for persons who are part of the population participating in the credit market, and this may concern a selected group. To consider the selected group, it is common to include a bias correction of the sample in the credit equations following the procedure proposed by Heckman (1979).

Furthermore, access to credit can affect land security. The assumption in this case is that households which have access to credit can better secure their land transactions, which implies two kinds of bias: the selection bias and the endogeneity bias. To account for both methodological issues, we use a regime-switching model known as the “Endogenous Switching Regression Model” (Freeman et al., 1998; Lokshin and Sajaia, 2004; Ali and Deininger, 2012).

Conclusion and policy recommendation

The objective of this study was to assess the impact of land tenure security on access to financing by agricultural households in Cameroon. Two specific objectives of the study were: to evaluate the effects of land tenure security on access to credit by agricultural households; and to investigate the impact of land tenure security on the volume of credit received by the households. The data used were sourced from the third Cameroon Household Survey (ECAM 3, 2007). Given these objectives, we used a dynamic regime-switching model with two regimes. The first regime deals with the access to credit, and the second regime assesses the volume of credit. This study was carried out to highlight the land issue, which is at the centre of development in rural areas. Land is the main asset of rural households. It may be used at the same time as the farming framework and as a financing instrument. In the latter case, it is associated with the land property rights. The different rights imply the idea of land securitization. Consequently, the economic theory of land property rights distinguishes three categories of rights, namely the legal land right, the customary land right and the sharecropping and tenant farming rights. In addition, it establishes a hierarchy in the land rights recognizing predominance of the legal land right. Consistent with this theoretical framework, a positive impact of the legal land property right on access to credit by rural households is assumed. Moreover, this study posits that in the context of informal financing, customary land property right can also back access to credit by rural households.

The findings reveal that the rural area is strongly supported by informal financing. This can be explained by two reasons. First, the traditional character of rural agricultural activities is an obstacle to formal financing. Second, the lack of collateral excludes most rural households from formal financing (56%). In addition, the results indicate that the land security has a differentiated effect on access to financing. In this regard, a legal land title improves the likelihood of obtaining financing from formal structures. In contrast, customary land rights can back informal financing. This result is not favourable to sustained development of activities in rural areas, because the credit obtained from informal financing is generally small. This credit is not enough to allow rural households to finance sustained and productive activities. Finally, the empirical results suggest important reforms are needed to encourage financing in rural areas. These reforms should seek to reinforce the value of customary land rights. This will reduce the risks associated with the rights. Another reform direction would be not only to popularize the securitization of rural land, but also to reconcile customary and legal land rights. Finally, setting up a rural finance scheme based on a public–private partnership would increase access to financial services by rural households.

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