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## **A Rich Man's Hobby**

Robin Sherbourne<sup>1</sup>

**This opinion piece argues that the price of commercial farmland in Namibia is high in relation to the profits that can be made from commercial livestock farming. As a result, farming is rapidly becoming the preserve of the urban rich who farm as a lifestyle choice and are prepared to subsidise their farms from their principal sources of income. Government policy is trying to encourage black Namibians into commercial farming through the Affirmative Action Loans scheme. However, given the price of land, many of these farmers will struggle to create commercially viable farms. This is bound to cause frustration further down the road and new farmers will start to demand more subsidies to purchase farms and diversify into other activities that will allow them to raise their incomes. Government will then have to decide whether to increase subsidies to encourage broader land ownership or simply allow those who can afford to farm to benefit from land reform.**

### **Is he rich because he farms or does he farm because he's rich?**

If you saw a man driving an expensive new car and you knew the man owned a farm, you might be tempted to put one and one together and conclude that the man is rich because he owns a farm. If it turned out, however, that the man was actually a lawyer in Windhoek who happened to own a farm, this conclusion would be incorrect. He is not rich because he owns a farm. He owns a farm because he is rich. Furthermore, the casual observer cannot see the man's personal balance sheet. It could equally be that he is highly indebted.

In Namibia the ownership of farmland is so inextricably connected in people's minds as a source of wealth that it is difficult to believe the initial conclusion is wrong. Traditional beliefs about land and livestock across races combined with a long history of racial preferences for land and subsidies make this a hard notion for economists to dispel. When dismal scientists apply their rational economic analysis to the question of land, they are generally viewed with even more suspicion than usual. Surely to claim that the ownership of farmland does not lead to untold riches is simply part of a white conspiracy aimed at keeping Namibian land in the hands of a privileged minority?

### **Commercial livestock farming is no pot of gold**

Economics is about numbers. Whether a particular argument or theory is right or wrong depends on the measurement of the relevant economic numbers. It is worth trying to put some numbers on this question of commercial farming. Take someone who wants to become a commercial farmer. He takes out a 25-year bond at 11.75% a year (the prevailing Agribank rate of interest) to pay for a 5,000 hectare farm which costs N\$300 per hectare or a total of N\$1.5 million. He invests in a livestock herd of 400 cattle at N\$2,000 a head, improves the infrastructure of the farm for N\$50,000 and purchases a vehicle for N\$150,000 giving a total investment of N\$2.5 million. In this case just to pay back the bond on the total capital investment of N\$2.5 million, the farm will need to make N\$313,000 a year as shown in Table 1 leaving the farmer without any disposable income at all.

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<sup>1</sup> Robin Sherbourne is the Director of Public Policy Analysis at the IPPR. He can be reached on [robin@ippr.org.na](mailto:robin@ippr.org.na).

However, if the farmer stocks the farm with 400 head of cattle which cost N\$2,000 per head and achieves an annual off-take of 25%, the income will be approximately N\$280,000 if he fetches N\$2,800 per head. Individual farmers have little influence over the price of cattle. The size and quality of the farm will limit the size of the herd the farmer can sustainably manage. This is far less than the repayment on the bond. The maths suggests that the profitability of such a typical commercial livestock farm is destined to remain but a distant dream. Clearly, the biggest cost to the investing farmer is the purchase of land. Profitability is only really possible if the farm is inherited and the land does not need to be purchased.

**Table 1: Example of farm economics**

| <i>Item</i>              | <i>Example</i> |
|--------------------------|----------------|
| Area of farm (ha)        | 5,000          |
| Price per hectare (N\$)  | 300            |
| Cost of land (N\$)       | 1,500,000      |
| Head of cattle           | 400            |
| Price per head (N\$)     | 2,000          |
| Cost of cattle (N\$)     | 800,000        |
| Infrastructure (N\$)     | 50,000         |
| Vehicle (N\$)            | 150,000        |
| Initial investment (N\$) | 2,500,000      |
| Annual interest rate (%) | 11.75%         |
| Repayment period (years) | 25             |
| Annual repayment (N\$)   | 313,000        |

Using typical numbers like the ones presented above suggests that livestock farming is not the pot of gold many believe it to be. Those farmers who have inherited farms (and who therefore do not have to pay the cost of buying the land) may be in a position to make a reasonable living from livestock farming. However, those who are paying for the land at prevailing market prices are unlikely to make a profit. New black commercial farmers have to buy their land and cannot rely on bequests from their families.

### **So why are land prices so high?**

If this is the case, the question for the economist: why are land prices in Namibia as high as they are given the limited productive potential of livestock farming? If livestock farming is indeed the main source of income generation, economists would expect supply and demand and therefore the price of land to reflect the profitability of the activity.

In theory, if foreigners could buy commercial farmland in Namibia, this would add to demand and push prices up. However, although the Namibian Constitution allows foreigners to own businesses in Namibia, Part VI of the Agricultural Land Reform Act of 1995 (Republic of Namibia: 1995) places heavy restrictions on foreign ownership of commercial farmland. Many believe that land prices were driven up in the more distant past by foreign demand boosted by a weak exchange rate and the financial rand. However, in theory at least, demand for commercial farmland should have fallen since the introduction of the 1995 Act.

Assuming that the market for land is functioning without significant distortions (that is to say, buyers and sellers cannot individually influence the market price of land), there may be several reasons why commercial farmland is as expensive as it is:

- there may be subsidies available which boost profitability beyond what the market would yield if left to itself;
- there may be other activities that make farms more productive than the profitability from livestock farming would suggest, thus justifying the present price of land in economic terms;



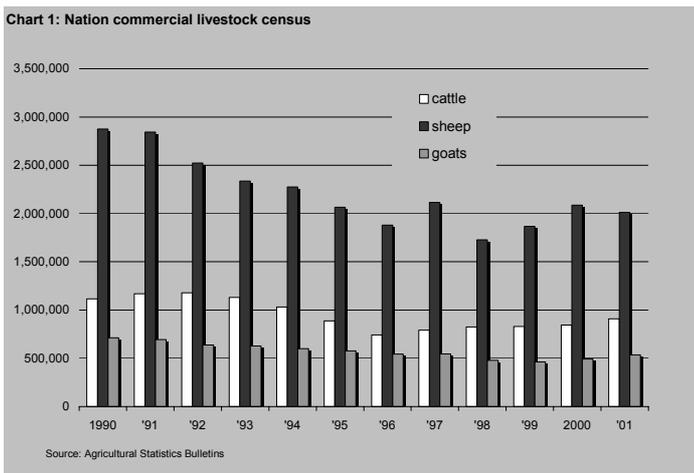
- the tax system may encourage the purchase of farms; and
- people may buy farms for reasons other than their productive potential.

The answer to the question of why the price of land is so high has profound implications for the Government's land reform programme.

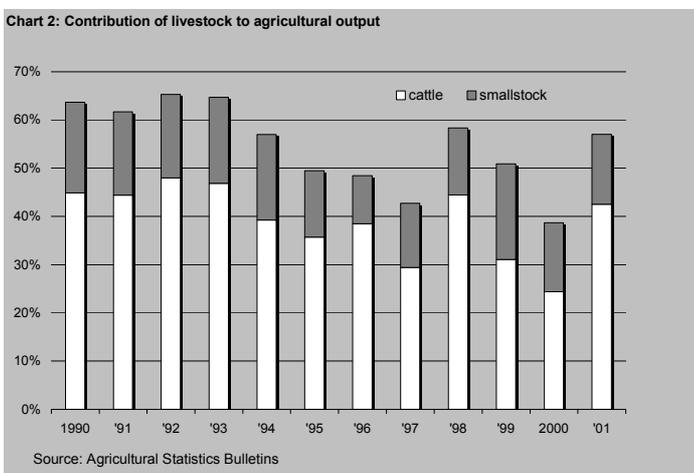
### Government no longer lavishes subsidises commercial farming

There is no single source of information on subsidies to commercial agriculture in Namibia. The national budget document provides, perhaps, the most comprehensive information on state transfers under Vote 20 for the Ministry of Agriculture, Water and Rural Development. An inspection of the 2003/04 budget shows that subsidies and other current transfers make up only a very small proportion of Government spending on agriculture. The most significant items are transfers under Main Division 07 to the National Agricultural Credit Programme (N\$9.5 million) and Affirmative Action Loans (N\$13.2 million) out of budgeted spending of N\$523.2 million for the Ministry as a whole. Although this does not provide a complete picture of subsidies to commercial agriculture (for example, general water subsidies and state loan guarantees to farmers are excluded as are protective measure through import tariffs), it would be difficult to argue that Namibia's commercial agriculture sector enjoys a high level of direct subsidies.

### Farming incomes are diversifying away from livestock into other products and services



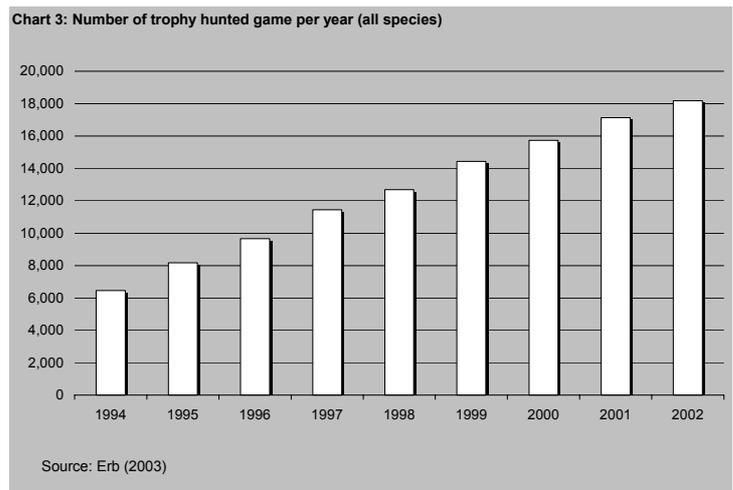
A casual drive through areas of commercial farmland in Namibia suggests farmers are now involved in much more than livestock production. Charts 1 and 2 present data taken from the Ministry of Agriculture's Agricultural Statistics Bulletins. Chart 1 shows that the national livestock herd in commercial farming areas (consisting of cattle, sheep and goats) has declined considerably since 1990. Chart 2 shows that the contribution to agricultural output from livestock has also declined since independence. The output of other farm products including game, cotton, ostriches, and grapes has increased. Many farmers have probably diversified into a range of tourist activities including trophy hunting, game lodges, wildlife photography and adventure sports.



Estimates of how important these activities are for the commercial agriculture sector as a whole are hard to come by. One study carried out by the Directorate of Environmental Affairs (Humavindu: 2002) estimated that the trophy hunting in Namibia generated a direct income of N\$80 million in 2000. Another study put the figure for the wildlife industry as a whole at N\$154 million (Erb: 2003) and concluded that "in the last decade real growth measured in income at farm level averaged 17.7%" (Erb 2003: 99). The same study states that registered hunting farms make up 20% of commercial farmland in north-western Namibia



(Erb 2003: 5). Chart 3 shows that the amount of trophy hunted game per year has indeed increased dramatically since 1994. There is anecdotal evidence that this boom in game is now over as farmers discover that providing feed in difficult times is costly and the area of land required to maintain game of high quality is vast. However, there is now clear evidence that activities other than livestock farming provide a significant boost to commercial farm incomes adding to the productive potential of farmland and thereby raising the price of commercial farmland.



### No one invests in farming purely for tax reasons

There is speculation that people buy farms in order to reduce their tax liability from other business activities. Table 2 gives an example of how this might be achieved. Individually, Business x makes a profit while Farm x makes a loss. The owner Mr x pays N\$35,000 tax on the profits from the business but pays no tax on the loss from the farm. However, by setting the loss from the farm against the profit from the business, Mr x's tax liability falls from N\$35,000 to N\$0. However, Mr x's disposable income would be N\$65,000 if he did not own Farm x but is N\$0 if he also owns Farm x.

**Table 2: How a farm can reduce an individual's tax liability**

|                        | <i>Business x</i> | <i>Farm x</i> |
|------------------------|-------------------|---------------|
| Profit/(loss)          | N\$100,000        | (N\$100,000)  |
| Separate tax liability | N\$35,000         | (N\$0)        |
| Combined profit        | N\$0              | N\$0          |
| Tax on combined profit | N\$0              | N\$0          |
| Disposable income      | N\$65,000*        | N\$0**        |

\* if Mr x owns Business x

\*\* if Mr x owns Business x and Farm x

Namibian tax law allows farm losses to be set against business profits. Capital expenditure on the farm can be set against farm income and any overall farm loss be set against business profits. However, this would mean taxpayers would have to spend N\$1 for every 35c they could claim in tax. The effect of this provision therefore reduces the cost of buying and running a farm and therefore adds to demand. However, interviews with tax experts make very clear that people do not buy farms in Namibia purely for tax reasons.

Government commissioned a comprehensive tax review in 2001 which was published by the Ministry of Finance in early 2003 (Republic of Namibia: 2003a). This tax review included a review of farming taxation and concluded with just two minor specific recommendations on livestock values and on housing for farm workers. The most important recommendation, however, was the more general one which would see individual businesses ring-fenced for tax purposes. This would have the effect of raising the cost of farm ownership to part-time farmers with other businesses.

### The number of hobby farmers has increased

The final reason for the high demand for Namibian commercial farmland is that rich Namibians may simply want to buy farms as a lifestyle choice rather than because they want to make a serious attempt to become full-time farmers. Urban lawyers, doctors, dentists, business people, politicians, senior government officials



and others may simply want to go to the farm at the weekends and during the holidays to enjoy a rural lifestyle in contrast to their urban daily lives. These people may employ farm workers and invest in infrastructure as a hobby they are willing to pay for without the expectation of financial return through greater output. Anecdotal evidence suggests many of these farmers lavish money on their farms – to a far greater extent than would be economically justified in terms of returns. Indeed, some suggest foreign owners lavished even more money on their farms than Namibian part-time farmers. Unfortunately, there is no quantifiable evidence to support these assertions apart from the fact that over 40% of Affirmative Action Loan recipients are officially part-time rather than full-time farmers.

### Government policy encourages racially balanced land ownership

Since the introduction of Affirmative Action Loans in 1992, Government has deliberately subsidised the purchase of commercial farmland for new formerly disadvantaged farmers that qualify. The policy has three fundamental rationales:

- to promote the ownership of Namibian farmland by formerly disadvantaged Namibians;
- to encourage farmers with large numbers of livestock in the communal areas to move to commercial farmland, thereby freeing up land for smaller communal farmers; and
- to encourage formerly disadvantaged Namibians to become fully-fledged commercial farmers able to enter the export market thereby contribute to economic output and exports.

Table 3 provides details of the Affirmative Action Loans scheme. Loans are provided over a period of 25 years. The degree of subsidy depends on whether the farmer is full-time or part-time and non-farming income if the farmer is part-time. Full-time farmers enjoy a three-year grace period after which interest payments gradually rise over a period of six years until they reach the normal lending rate of the bank (currently at 11.75%). No business plan is required since Agribank values the land extremely conservatively and uses the land as collateral for the loan. Resales of AA purchased farms are not allowed within the first ten years of the loan unless the interest rate subsidies are repaid.

**Table 3: Affirmative Action Loans repayment schedules**

| Year               | Full-time<br>Interest | Part-time<br>Interest |                            |                            |                            |             |
|--------------------|-----------------------|-----------------------|----------------------------|----------------------------|----------------------------|-------------|
|                    |                       | < N\$100,000          | >N\$100,000<br><N\$200,000 | >N\$200,000<br>>N\$300,000 | >N\$300,001<br><N\$400,000 | >N\$400,000 |
| Non-farming income |                       |                       |                            |                            |                            |             |
| Year 1-3           | 0%                    | 1%                    | 2%                         | 6%                         | 10%                        | 11.75%      |
| Year 4-6           | 2%                    | 3%                    | 4%                         | 10%                        | 11.75%                     | 11.75%      |
| Year 7-8           | 4%                    | 5%                    | 6%                         | 11.75%                     | 11.75%                     | 11.75%      |
| Year 9             | 8%                    | 9%                    | 10%                        | 11.75%                     | 11.75%                     | 11.75%      |
| Year 10+           | 11.75%                | 11.75%                | 11.75%                     | 11.75%                     | 11.75%                     | 11.75%      |

Source: adapted from the Agribank Annual Report 2002

Table 4 shows the annual uptake of AA Loans since 1992. The year after the scheme was introduced saw a massive number of loans being granted, probably partly due to the conversion of existing loans to AA Loans. Between 1992 and 2001 the amount of land transferred into the hands of black Namibians through the AA Loan scheme has been more than three times as much as that transferred through the Government's resettlement programme (IPPR: 2002). Government transfers money from the national budget to Agribank to provide for the interest rate subsidies under the scheme. Table 4 also shows the magnitude of these transfers since the scheme was introduced.



**Table 4: Affirmative Action Loans granted**

| <b>Year</b>  | <b>Number of loans</b> | <b>Value (N\$)</b>    | <b>Subsidy (N\$)*</b> |
|--------------|------------------------|-----------------------|-----------------------|
| 1991/92      | 2                      | 619,800               | N/a                   |
| 1992/93      | 66                     | 24,861,600            | N/a                   |
| 1993/94      | 15                     | 5,458,000             | N/a                   |
| 1994/95      | 14                     | 6,462,400             | N/a                   |
| 1995/96      | 21                     | 9,179,900             | N/a                   |
| 1996/97      | 12                     | 5,897,300             | N/a                   |
| 1997/98      | 39                     | 24,625,900            | 7,000,000             |
| 1998/99      | 50                     | 37,767,700            | 8,162,000             |
| 1999/00      | 46                     | 33,410,300            | 21,059,210            |
| 2000/01      | 71                     | 59,838,700            | 22,717,422            |
| 2001/02      | 35                     | 29,420,200            | 15,000,000            |
| 2002/03      | 92                     | 114,970,400           | 15,000,000            |
| 2003/04**    | 65                     | N/a                   | 13,216,000            |
| <b>Total</b> | <b>528</b>             | <b>352,512,200***</b> |                       |

\*AAL interest subsidies under Vote 20 Main Division 07 Item 043

\*\*year to October 2003

\*\*\*excludes 2002/03

Source: Agribank and main budget documents

From the beginning, AA Loans have been deliberately made available to both full-time and part-time farmers. According to Agribank, by October 2003 a total of 528 AA Loans had been made by Agribank of which 218 or 41% were officially to part-time farmers. In reality the number of part-time farmers is likely to be much greater since the classification is subject to interpretation and loan recipients are often backed by other individuals who provide the cash to pay for the difference in the Agribank valuation and the market valuation of the land being purchased. In terms of land area, by October 2003 full-time farmers had purchased a total of 1,842,434 ha compared to a total of 1,279,261 ha for part-time farmers.

### **New black farmers are being subsidised by the state**

A typical AA loan will include a large element of subsidy. For example, an Affirmative Action Loan of N\$500,000 to a full-time farmer will contain a subsidy of almost N\$400,000 over the life of the loan at a 11.75% rate of interest compared to the equivalent loan to a non-Affirmative Action farmer. Data from the Deeds Office suggests that average prices paid by AA Loan recipients have been much higher than for other buyers of commercial farmland. It is not yet clear why this is so but it is possible that subsidies on the AA Loans may have contributed to the rise in land prices.

### **Commercial farming is becoming the preserve of the urban rich**

There is still much about commercial farming that is not fully captured by official statistics. However, if one looks at Namibia's commercial farming sector, one is struck by stagnant output and the increase in the number of Namibian hobby farmers. Real growth in commercial farming value added has been a mere 1% a year since 1994, less than half the rate for the overall economy (Republic of Namibia: 2003b). In the absence of generous state subsidies, traditional commercial livestock farming does not make money for the individual farmer. It is especially difficult to run a profitable farm if the land first has to be purchased rather than being inherited. Instead, commercial farming is becoming an expensive hobby that is increasingly the preserve of Namibia's urban rich.



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Does this matter? There are several reasons why it might. Black Namibians are being encouraged to go into commercial farming on the premise that this is an inherently profitable activity. Given the economics of commercial livestock farming, it could be argued that these new farmers are being set up to fail. If profitability is unlikely, black farmers will struggle to repay loans and there will be pressure for more subsidies. Government may decide that this is justified since the political priority has to be to transfer greater areas of commercial farmland into black hands. Donors would have to decide whether to contribute towards this greater fiscal burden. The magnitude of the burden would depend upon Government's willingness and ability to allocate land to those best able to use it: the less capable the beneficiaries, the greater the number of failures and the greater the fiscal burden. It would not be easy to set up a system of land allocation that avoided using land as a tool of political patronage. Alternatively, the pressure may be more in favour of transferring land without compensation to the owners. But again, how would land be allocated if not on the basis of willingness and ability to pay?

Where does this leave Government's land reform programme? Up to now most efforts at land reform have been premised on the belief that farming is inherently profitable and that therefore the transfer of land will boost growth and reduce poverty. It would be difficult for Government to somehow reduce demand for commercial farmland by prohibiting its purchase by part-time and hobby farmers. Such a move would be likely to exclude many senior government and ruling party figures as well as other wealthy urbanites. Paradoxically, the introduction of the Land Tax may accelerate the present trend. By raising the cost of farming further, only the even better off will be able to farm.

Would it be possible for Government to come clean on the issue and change policy in a way that recognises commercial farming is rather for the rich? The single priority here would be the political one of ensuring land ownership is racially balanced. If this means that wealthier blacks are the ones to benefit most from commercial land reform so be it. But the wider economic success of such a policy would depend on how successful hobby farmers were at commercially exploiting their farms.

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