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## INCREASE IN FARMERS' INDEBTEDNESS IN GERMANY AND NEW METHODS OF INDIVIDUAL CREDIT CONTROL

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PRIOR to the war the credit needs of the German farmer were supplied from one or both of the following sources:

1. Long-term credit was secured from the provincial Landschaften or other mortgage banks which were all under the supervision of the government.
2. Short-term credit, or so-called personal credit, was secured from private banks, independent business men, livestock merchants, and to a large extent from cooperative savings societies.

### FARM MORTGAGE CREDIT

The regulations of the various mortgage banks and Landschaften governing the appraisal of farm property for purposes of making long-term mortgage loans, were subject to the approval of a state official. Loans on first mortgage security were rarely granted in excess of 35 to 40 per cent of the estimated value of the farm. In connection with the Landschaften, special corporations known as "Banks of the Landschaften" furnished second mortgage credit, usually in an amount not exceeding 15 or 20 per cent of the appraised value of the farm. That is, a farmer might secure a first mortgage loan equal to 35 or 40 per cent of the value of his farm and a second mortgage loan equal to 15 or 20 per cent of the value of his farm, or a maximum loan on both first and second mortgage security equal to approximately 60 per cent of the estimated value of the farm. The Landschaften had a special provision in their regulations to the effect that in no case might a farm be appraised more than once within five years for purposes of extending mortgage credit. This was to prevent too frequent requests for increased credit based on rising land values.

Prior to the war, the German agricultural credit system functioned very satisfactorily. This was a period of rising land values in all parts of the country. German agriculture was prosperous, and there were few failures among the farmer-borrowers. In-

terest rates were in the neighborhood of 4 to 5 per cent, so that interest on indebtedness was not a particularly heavy burden. Land values were rising and farms were readily saleable. This latter factor accounted to a considerable extent for the satisfactory working of the system. Even if the individual farmer failed, the banks had little or no difficulty in disposing of properties acquired through foreclosure for more than enough to cover their investment. Steadily rising land values and increasing land rents provided additional security for all kinds of agricultural credit, though nobody remarked upon the fact that rising land values were an important factor in the situation until recent years when the opposite development began to take place.

### SHORT TERM CREDIT

Short-term credit was based largely upon the personal reputation of the individual borrower. There were some 23,000 local limited liability cooperative societies making short-term loans. These societies were organized into three "revision" federations.<sup>1</sup> Two of these federations had so-called central cooperatives covering a province or larger territory. The local cooperatives were members of these central organizations, which were in turn affiliated with the Preussische Zentral Genossenschaftskasse (abbreviated "Preussenkasse") in Berlin.<sup>2</sup>

The third federation, the Raiffeisen, had only one central bank which was affiliated with the Preussenkasse. This central bank had a large number of provincial branches of which the local cooperative societies of the Raiffeisen were members. The liability of the local societies was, for the most part, unlimited. The three federations as such were not directly engaged in granting credit. Their function was primarily a supervisory one. The Preussenkasse acted as a financial clearing house for the whole cooperative system toward which all the savings flowed, and from which they were distributed to the various points of demand in the system.

The cooperative system of supplying short-term credit to farmers functioned very well prior to the war. The by-laws of the local cooperatives usually fixed the liability of their members at

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<sup>1</sup> Revision=audit.

<sup>2</sup> The Prussian Central Cooperative Bank.

from 5 to 10 times the amount of their capital subscriptions. If an individual farmer failed, the losses arising out of such a failure were absorbed by the local cooperative. If so many farmers failed that the local cooperative could not absorb the total losses, such losses were passed on to the provincial cooperative and only if the central cooperatives with all their reserve funds failed, were the reserves of the Preussenkasse likely to be impaired.

During and following the inflation period the credit situation became critical. Early in 1924 farmers paid as high as 30 per cent interest on borrowed money and even in 1925 the interest rate remained in the neighborhood of 20 per cent. In addition to high interest rates, taxes, farm wages, and the prices of commodities which the farmer had to buy remained high relative to the prices received for farm products. Under these unfavorable circumstances, many farmers found themselves hopelessly in debt. During 1926 and 1927 many large farm businesses in eastern Germany became insolvent. The cooperatives as well as other agencies making short-term loans found their assets frozen. A general scramble ensued among the various creditors. Each tried to secure additional collateral security against his advances, in the form of chattel or crop mortgages, or the signatures of additional guarantors. This merely added to the difficulties of the situation. The whole atmosphere was charged with suspicion and uncertainty. Even farmers who were in good financial standing were in many cases threatened with disaster due to the possibility of failure of local cooperatives of which they were members. As previously stated, the by-laws of the majority of the cooperative credit societies provided that the individual members of such societies should be liable for the debts of all other members up to an amount equal to 8 or 10 times their capital stock subscriptions or, in the Raiffeisen system, to an unlimited amount. Many of the small cooperative credit societies were not in a position to stand heavy losses. Their membership in many cases included both large and small operators. The failure of a single large operator resulting in a heavy loss might well have started many small farmers of limited means on the way to bankruptcy.

#### INDIVIDUAL CREDIT CONTROL

To deal with the situation, Otto Klepper, the newly appointed President of the Preussenkasse, formed a special division for in-

dividual credit control in January, 1928. It was the task of this division to make a careful detailed analysis of the status of each loan on all of the larger farms, since it was the operators of the larger farms who were experiencing the greatest difficulty, and it was among this class of loans that the possibility of heavy losses appeared greatest. By August, 1928, reports had been made to the Preussenkasse on some 5,300 farms. These reports were based on questionnaires sent to the farmers by the credit control division of the Preussenkasse through the central and local societies. Each record represented a preliminary report on the individual farm. In the meantime, an intensive farm to farm study was started by the central division. Specially trained experts, all graduates of agricultural colleges and with experience in the management of large-scale farms, were sent into certain districts to make a careful study of all farms on which money had been loaned and to keep in close touch with both local and provincial societies.

In the reports on individual farms, the investigator was asked to report, among other things, the following:

1. The estimated sale value of the farm under normal conditions, and the estimated forced sale value of the farm.
2. The total indebtedness of the operator, including both secured and unsecured debts. The trend in the farmer's indebtedness, that is, whether it was increasing or decreasing, was given special consideration.
3. The probability of loss to the cooperative arising out of the loan in question, and the estimated amount of such loss.
4. The probable operating income or deficit of the farm for the current year and for the year next following.
5. The investigator's estimate of the managerial ability of the operator. It was recognized, of course, that managerial ability is a rather intangible factor and that in last analysis the investigator's report merely reflected his opinion. However, as subsequent reports are made on the same farmer by different investigators such information becomes of increasing value.
6. Changes in the operation and management of the farm which, in the opinion of the investigator, would lead to increased returns.
7. Recommendations as to the course to be followed by the bank in making future extensions of credit.

The investigators sent their reports to the main office in Berlin where all data were checked and recommendations noted. Copies of these reports were then sent to the provincial cooperative banks and copies were, of course, retained by the Preussenkasse. The reports placed before the executives and directors of the various organizations the facts of the situation and gave a sound basis

for action. Certain farms were found to be operated at a loss and the farmer hopelessly encumbered with debts. Other farms were found to be on a sound financial basis, while a third group was classed as doubtful. With accurate and adequate information at hand the action of the bank could be suited to the needs of the individual case. A regular inspection of doubtful cases was maintained. In some instances the farm was visited four or five times a year. The investigators of the Preussenkasse were all men who had been trained in agriculture, and who were familiar with farm management practice. It was not only their duty to make a credit report on each farm visited, but more important still, it was their duty to keep the central banks and the Preussenkasse fully informed as to general conditions in their district. At first, farmers objected to the new system of control, but within a short time the relations between farmers and investigators were excellent, and the farmers began more and more to carry into practice the advice of the investigators.

The cost of the system of individual credit control, which is relatively low, is borne by the Preussenkasse. The prevention of losses on two or three large loans would more than justify the expense, and experience during the first year proved that hundreds of losses, both large and small, could be prevented by such a system. There are at present 15 investigators in eastern Germany controlling, for the most part, loans on large farms. Investigations are made of small farms when necessary, but the past three years have shown that relatively little trouble is likely to develop among loans on small farms.

The system of individual credit control has had far reaching effects. Under this system, the extent and trend of farmers' indebtedness is known at all times. Such information provides a sound basis for action on all matters pertaining to farm credit. The system of control has not only helped the farmer who was in difficulties, but what is equally important, it has resulted in the granting of increased credit to those farmers whose farms are shown to be efficiently and profitably managed. The cooperative credit societies affiliated with the Preussenkasse are in a position to promote improved farming methods, and to assist the individual operator in making adjustments to meet changed economic conditions. A closer control over credit has worked to the advantage of the individual farmer as well as to the advantage

of the loaning agency. Close supervision means decreased losses, which in turn means lower interest rates to the borrower, and a reduced risk of loss through failure of the local cooperatives. Closer contact between bankers and agricultural experts means greater elasticity in loaning policies and a closer adjustment of such policies to agricultural conditions. Furthermore, to the extent that losses are decreased, the possibility that the local cooperative will fail is decreased. Since each member of the local cooperative credit society is individually liable for the debts of every other member, to the extent that losses are decreased through careful credit supervision the risk of loss to a member in good standing arising through the failure of another member or members, is greatly reduced. The system of individual credit control works, therefore, to the advantage of all classes of borrowers as well as to the advantage of the Preussenkasse, the central co-operatives, and the local cooperatives.

The system of individual credit control has been extended to cover loans made to operators of greenhouses, creameries, and other types of agricultural business organizations. One of the most interesting recent developments in this direction is a proposal to extend the system to the field of farm mortgage credit.