Developments in Agricultural Finance and Farm Credit – Some Experience from Germany

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Problem statement

The objective of this contribution is to investigate recent developments in agricultural debt financing. Both, borrowers (i.e. farms) and lenders (i.e. banks) undergo structural changes that may have important impacts on the demand for and the supply of agricultural credit. Due to increased competition farms in the EU are forced to expand their production capacity. In many cases farm growth is financed with debt. An increase of the financial leverage together with an ongoing specialization leads to a higher risk exposition of farms. At the same time banks are also striving for more efficiency. This is frequently achieved by consolidation of their network of branches. Only a few banks maintain divisions that are specialized on agricultural loans. Moreover, the Basle committee on Banking Supervision recently issued new proposals about the minimum capital requirements of banks (Basle II accord). In essence, Basle II requires a more subtle risk measurement and ties the necessary equity capital of the bank directly to the credit risk. It is important to realize the aforementioned developments in order to appraise the access of farms to debt capital in the future.

Data and Methods

The investigation is based on a descriptive approach. We use the credit statistics of the German Federal Bank to get information about the development of the credit volume in agriculture and the market shares of the various banks. Moreover, we compare interest rates offered to the farm sector and to non-farm sector. Publicly available data are supplemented by expert interviews from financial institutions which give insight into the internal restructuring process of banks as well as in the development of rating systems as a response to Basel II.

Results, Discussion and Conclusions

The analysis of past developments of the bank sector in Germany suggests that the peculiarities of the agricultural credit system will vanish. In the long run farms and firms in the agribusiness will have to comply with general standards of creditworthiness which are common for non-agricultural industries. This is a result of the merger of specialized divisions within banks. As far as the impact of Basel II is concerned we conclude, that the immediate effects, expressed as cost of debt capital for farms, are moderate. Nevertheless, it is likely that the discussion about Basel II will lead to rating systems, which allow for a better distinction between good and bad credit risks. Due to this market separation the costs of credit default can be allocated more efficiently. Farms should anticipate this development and they should be prepared in order to avoid a rejection of their credit applications. For instance, the signaling of creditworthiness will become more important, in particular for expanding farms with limited collateral. Appropriate measures include, for example, the implementation of effective risk management systems.

References

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