

Confidence before the crash

A visual guide to possible determinants of the 1920s

Dutch cooperative banking crisis

Chris Colvin, LSE

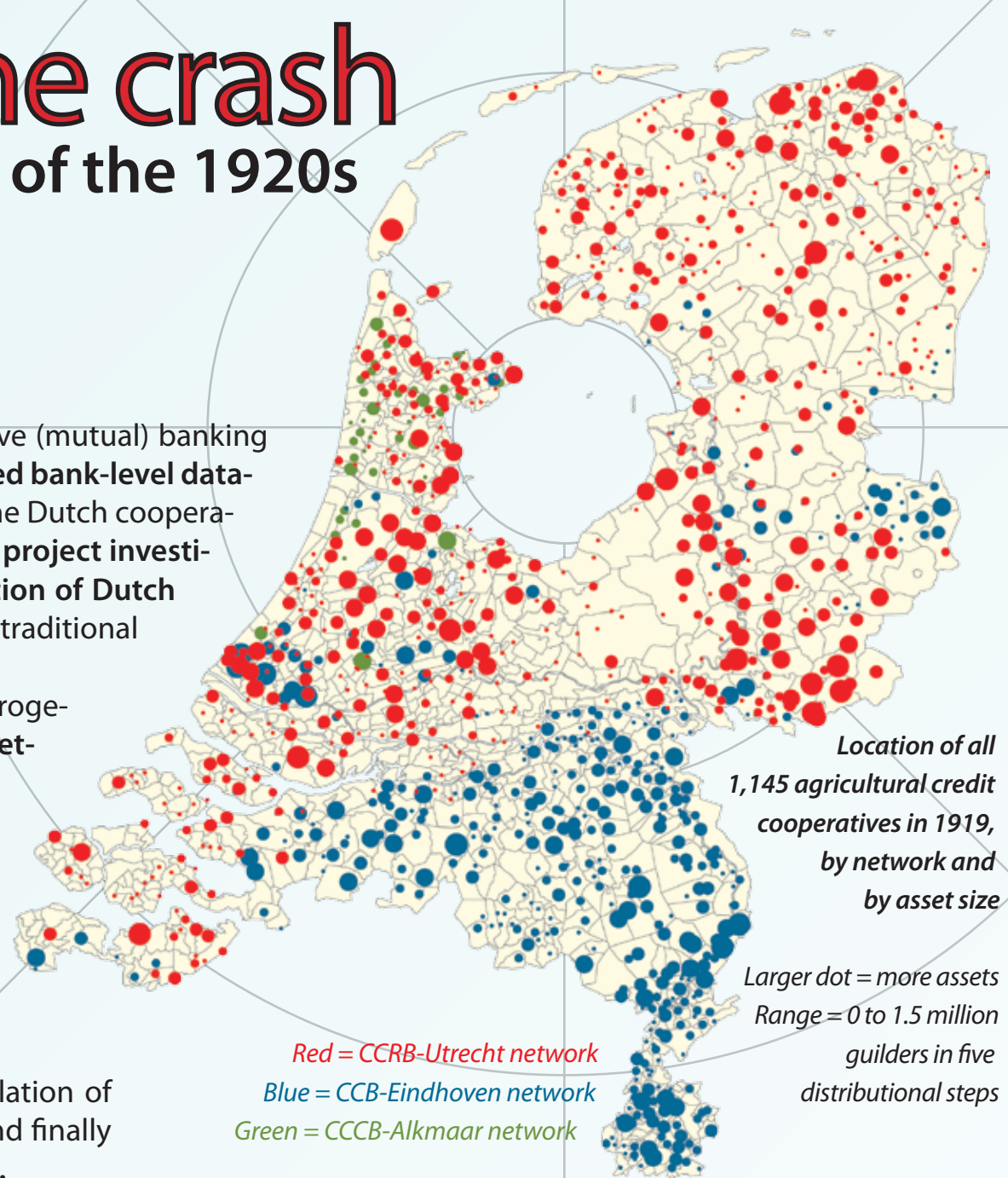
EHA Meetings, September 2008

This project examines the causes of the distress experienced by the cooperative (mutual) banking sector during the Dutch financial crisis of the early 1920s. It uses a newly created bank-level database constructed using original sources taken from the business archives of the Dutch cooperative movement's present-day successor institutions and the Dutch central bank. The project investigates the impact of price deflation and government policy on the entire population of Dutch cooperative banks, a class of banks that had a very varied experience of the only traditional banking crisis ever to hit the Netherlands.

The institutional differences observed across the sector – combined with its heterogeneous performance during the deflationary 1920s – provide a natural experimental setting in which to investigate the relationship between the institutional structure and performance of cooperative banks.

This poster – which focuses solely on the 1,145 agricultural credit cooperatives that operated in 1919, leaving aside the 200-odd urban cooperatives for SMEs – poses two related research questions that the analysis of this new financial database may help to solve. It describes and explains the relationship between banking and religion, and subsequently the impact of competition for depositor confidence in Dutch agricultural cooperative banks immediately prior to the crash of the 1920s.

This project's next steps are the expansion of the database to include the population of urban cooperatives, encoding cooperatives' success and failure into the database, and finally multivariate econometric analysis. Project planned for completion by January 2009.



Banking and religion

Whilst the agricultural cooperative movement adopted many of the institutional attributes of the German Raiffeisen model (as described in Guinnane 2001), a large difference existed as a result of Dutch religiosity. The Netherlands was socially divided along religious lines, with businesses often aligned to a single denomination. This phenomenon, known as pillarisation (Lijphart 1975), resulted in the creation of different cooperative networks.

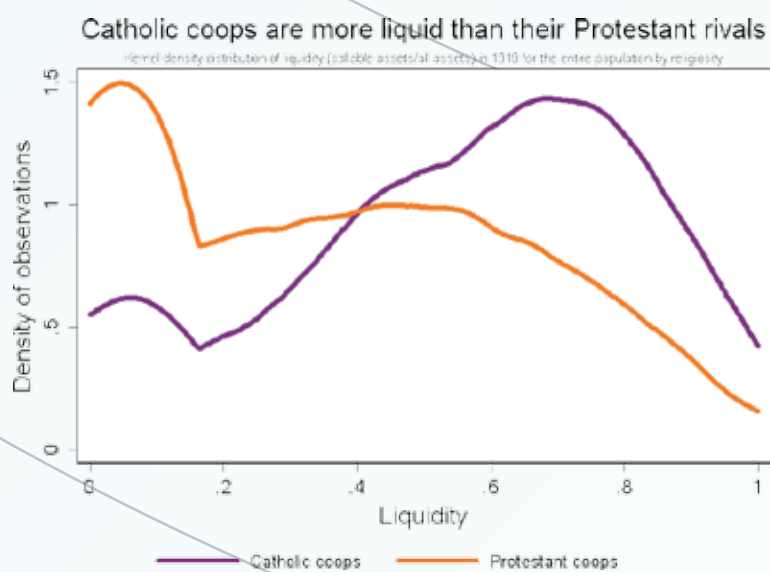
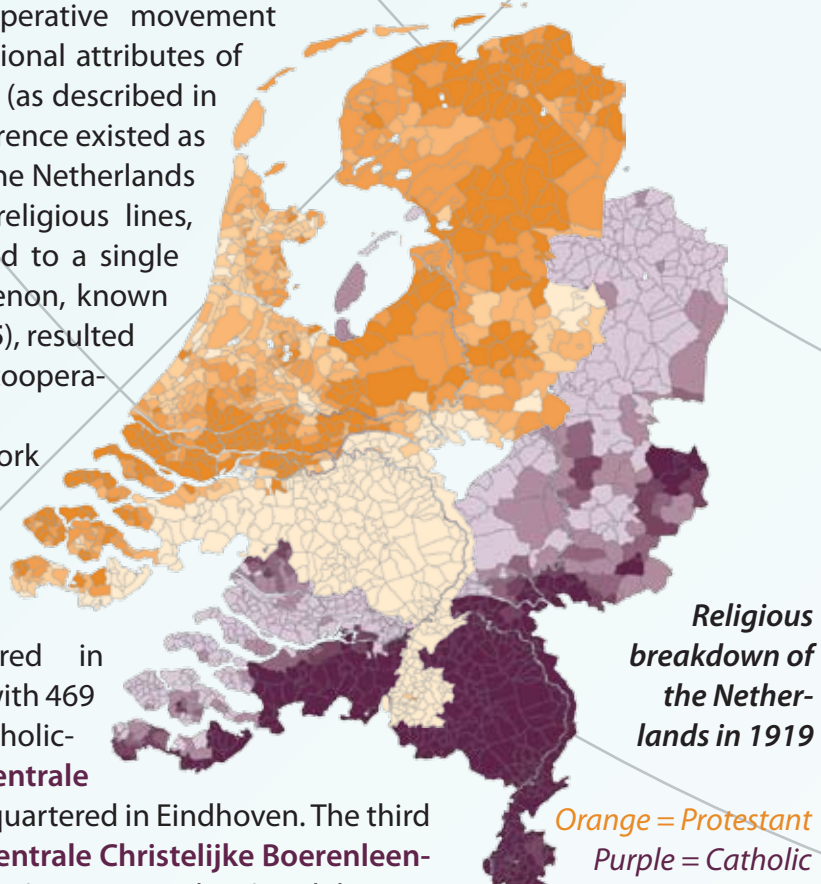
By 1919, the largest network (with 631 member banks) was that of the Protestant-leaning Coöperatieve Centrale Raiffeisen Boerenleenbank (CCRB), headquartered in Utrecht. The second largest (with 469 members) was that of the Catholic-leaning Coöperatieve Centrale Boerenleenbank (CCB) headquartered in Eindhoven. The third network, the Coöperatieve Centrale Christelijke Boerenleenbank (CCCB) was much smaller (just 45 members) and drew its membership from the Catholic minority in the northwest.

Whilst the third network was completely eliminated following the deflationary 1920s, the other two survived. However, the fate of their member banks is little understood.

There were various institutional differences between the networks. For instance, members of the CCB and CCCB adopting a legal code that prohibited dividend payments but had lower legal set-up costs, whilst those of the CCRB chose one that allowed for more activities but had more legal hurdles.

Other peculiarities of the Catholic cooperative networks include the presence of priests on their management boards and lower permitted use of central bank liquidity.

The aim is to test whether there is a relationship between the stability of cooperatives during a deflationary shock and their religiosity. Inspiration is drawn from Weber 1905, who argues one denomination outperforms the other due to associated cultural factors, and from Iannaccone 1998, whose "club good theory" sees religion as a method of facilitating screening and peer monitoring.



Cooperative competition

Prior to the creation of the cooperatives, informal lenders (shopkeepers) held a powerful market position and were able to extract rent from farmers.

After their introduction at the beginning of the twentieth century, farmers started to benefit from their new collective market position. Farmers were now able to extract both the consumer and producer surplus for themselves.

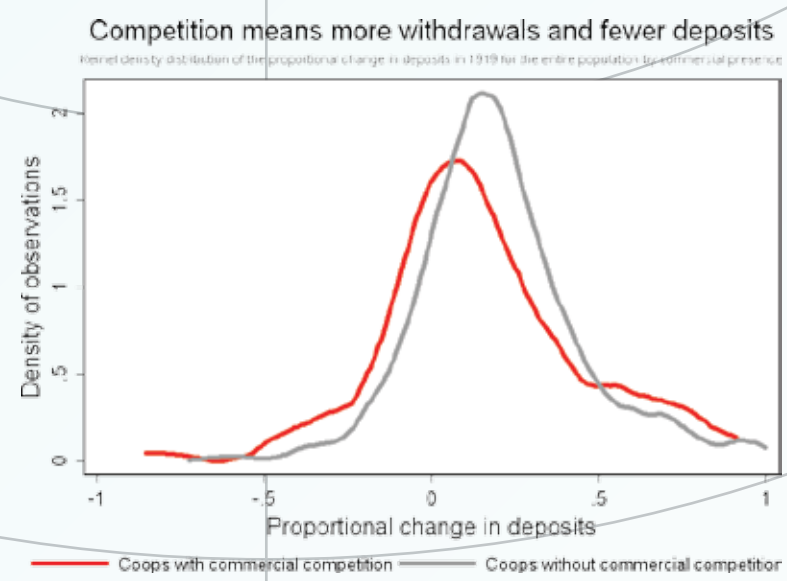
Rural cooperatives were arguably welfare improving as they created new markets for credit that had previously not existed. And due to above-market interest rates they were able to set, they attracted deposits away from traditional private savings banks.

The banking literature generally agrees that there is a negative relationship between competition and financial stability (Freixas & Rochet 2008). The more competition, the higher the potential returns are for risk-taking and the lower is depositor confidence. However, empirical evidence of this relationship is arguably problematic (e.g. Boyd & De Nicola 2005).

Cooperatives were initially able to sustain collusive market outcomes through the use of social sanctions and tacit agreements to split the market along socioreligious lines. But by 1919 new branches of commercial banks were taking business away from cooperatives in some parts of the country by offering sophisticated payment technologies.

Cooperative banks were created at the same time as producer cooperatives engaging in other agricultural activities (e.g. dairying). Not only did these other cooperatives form part of cooperative banks' clientele, but their membership base strongly overlapped. The structure, conduct and performance of cooperative banks therefore likely depended on that of these linked organisations.

This project will build a detailed picture of the industrial organisation of the cooperative sector and its performance during the 1920s in order to inform the competition-risk relationship empirically for an as-yet understudied type of business organisation.



"Despite the fact that the Bank does not carry out its business to make a profit, it nevertheless exists to improve the material and moral situation of her members, and it will therefore build up strong reserves."

Article 2.7 of statutes of Boerenleenbank Maasland, member of the CCRB-Utrecht network

