green zone, restricted to gold and barter. We've got to start from where people are, but we obviously want them to move out of the black zone as time goes on,' Khalid told me in 1995. 'The prototype of these markets was held in Birmingham in 1992, and they have since been held in Granada, Amsterdam, and Zürich. Umar Vadillo, who lives in Scotland, is the driving force behind them.'[11]

Despite Islam's failure to provide a suitable model, interest-free community banks do exist and are functioning successfully in the Nordic world. In Denmark in fact they are offering the conventional banks such strong competition that improper means may have been used to get one of the most expansionary of them closed down, as the story in the next panel reveals.

But the best example of what a community bank can achieve and how the interest rate problem can be handled is provided by the Lankide Aurrezkia (Working People's Bank) which operates largely in the Basque country in Spain. It is impossible to describe how this bank came to be and how it operates without also telling the story of the Mondragon co-operatives, which now employ 21,000 people in the same area and in whose expansion the bank played a crucial part.

The bank and the co-operatives owe their existence to a local priest, José María Arizmendiarrieta, who was so unimpressive when in 1941, aged twenty-six, he was appointed to work among young people in Mondragon, a steel town of some 8500 inhabitants, that some of his parishioners wished the bishop would reassign him. 'He spoke in a monotone with intricate and repetitive phraseology difficult to understand. He hardly even [read] with grace,' someone who became a close colleague wrote forty-five years later.[12]

One of Father Arizmendiarrieta's duties was to teach classes in religious and human values at a school run by the town's steelworks for its apprentices. This was the only secondary school of any type in Mondragon, and demand for places far exceeded the supply. Father Arizmendiarrieta asked the steel company to expand the school, offering to help raise the extra cost. The company refused, so the priest decided to open a technical school of his own. He had boxes placed on street corners in which people could post offers of labour or cash; when they were opened it was found that a quarter of the town's households had offered concrete support.

The school opened in December 1943 with twenty pupils and added a higher class each year; by 1952 there were 170 students, and eleven members of the first intake had just completed an external engineering degree from the University of Zaragoza. These – the first

Mondragon workers' children ever to graduate – had been meeting Father Arizmendiarrieta each week, and it was through them that he developed his plans. However, he also held hundreds of meetings with other groups; in 1956 it was estimated that since he had come to the parish, in addition to his teaching he had conducted a study session on average every 2.7 days and over two thousand small group discussions.

Five of his eleven disciples went to work with the steel company. When the company decided to increase its capital by issuing more shares, they asked that the workers be allowed to subscribe for them. The company refused, convincing the five that it was impossible to democratize this particular capitalist enterprise from within. Accordingly they decided to start their own company and set about raising money from friends. Eventually they raised eleven million pesetas from a hundred people on nothing but the strength of their personal promises. This was equivalent at the time to $362,000 – a huge sum from a working-class community – and in 1955 it was used to buy a bankrupt factory making paraffin stoves in Gazteiz (Vitoria). The plant was moved to Mondragon and opened in 1956 with twenty-four employees under the name Ulgor (a composite of the initials of the five men) to make copies of a British-made Aladdin stove the group had purchased in France and stripped down; only some time later did Ulgor regularize its position by buying the Spanish rights.

Demand for stoves was strong, and Ulgor soon began designing its own, buying an existing foundry in the town so as to be able to make all the parts. A few months later the firm added a range of electrical equipment to its product line and then, after opening a second factory, bottled-gas cooking stoves under the brand name Fagor. By the end of 1958, Ulgor had 149 worker-co-operators and its success had inspired several other co-ops to set up in Mondragon and elsewhere in the region.

At this point Father Arizmendiarrieta suggested that his ex-students establish a bank so as to be able to tap local savings to finance the co-ops' expansion. 'Our initial reaction was one of annoyance, and we literally sent him packing,' one of Ulgor's founders said later. 'We told him, "Yesterday we were craftsmen, foremen, and engineers. Today we are learning how to be managers and executives. Tomorrow you want us to become bankers. That is impossible."' Undaunted, the priest drew up the bank's constitution and by-laws, concocted the minutes of a fictitious founding meeting, and forged two of his disciples' signatures, and – lo and behold – the Lankide Aurrezkia bank

was formed as a co-op to be run by representatives of its own staff and that of its member-co-ops. It was recognized by the Spanish government in July 1959 and opened two branches, one in Mondragon, the other in Elorrio (then in a different province), just so that it could continue to operate should one province decide to revoke its licence and close it down. Persuaded of its potential importance, four of Ulgor's founders joined its board, one as president, another as chief executive. The fifth had already left Ulgor to found his own company.

In many ways Lankide Aurrezkia was, and is, the equivalent of an industrial holding company because each co-op signed a contract of association with it that set out in some detail how the co-op would operate. For example, wages paid by member-co-ops were tied to those in the bank by a clause that stipulated that their minimum rate of pay be no more than 10 per cent above or below the minimum paid by the bank to its staff and that their top rate not be more than three times their minimum. Each co-op also had to supply financial data to the bank every month and full accounts and details of future plans every year and was subject to a detailed assessment and audit by the bank every four years.

Naturally, all a member co-op's funds had to be banked with the Lankide Aurrezkia, and the contract of association also set the maximum and minimum amounts that anyone joining that co-op would have to provide as his or her share of its capital: not less than 80 per cent or more than 120 per cent of the bank's own joining fee, which at the time was equivalent to roughly a year's wages for anyone on its minimum rate. (New entrants could borrow the required sum free of interest and have deductions made from their wages until the amount was repaid; as the minimum Mondragon wage was usually above the equivalent in commercial companies, this entailed little hardship. However, a firm principle of the co-ops was always that worker-co-operators must risk their own capital.)

Finally, the contract of association set out how the profits of the co-ops were to be divided. Ten per cent had to go to charity, as required by Spanish law, a minimum of 20 per cent had to be retained by the co-op itself, and the balance was to be allocated to the co-op's workers and lodged in individual accounts, to be withdrawn in full only when the worker retired; anyone leaving prematurely or being sacked could lose up to 30 per cent. In the first year in which this system operated, 1960, workers were allowed to take 10 per cent of their co-op's profit in cash; between 1962 and 1965 this fraction rose to 30 per cent, equivalent to more than a month's wages. How-

ever, since then these cash payments have been abolished, and the only top-up to their wages the workers now receive is interest, up to a maximum of 6 per cent, on whatever funds they have invested with their co-op. As David Morris says in the best recent report on the way Mondragon operates, 'this disbursement formula means that the enterprise effectively controls 90 per cent of its net surplus. The individual capital account might be considered a long term, low interest loan to an enterprise that might not have the collateral to be able to borrow money outside.'[13]

What did the co-ops get in return for signing such a restrictive contract with the bank? Two massive advantages. One was and is low-cost funds. According to Morris, about half the capital of the member-co-ops is made up of loans from Lankide Aurrezkia, for which they pay interest at rates that are sometimes as much as 5 per cent lower than the prevailing market rate. This is possible because the top salaries in the bank were, at least until recently, significantly lower than those paid by banks outside and because the bank has automatic access to the surpluses of its member-co-ops. The bank is effectively the only source of capital open to the co-ops apart from the savings of their own members.

The other advantage the co-ops get from their association is first-rate advice and guidance on whatever they wish to do from the bank's consultancy division. This covers marketing, exporting, production techniques, industrial buildings, personnel, legal affairs, and audit and management control systems. In extreme circumstances, however, the bank does not limit itself to merely giving advice, and in the depressed period in the early 1980s when the Mondragon co-ops collectively made a loss for three years running, it intervened extensively, sacking managers, changing product lines, trimming wage levels, merging member-co-ops or transferring workers between them, and, when it was finally satisfied, making concessionary loans. In 1983 alone, thirty-four out of the 100 co-ops underwent this sort of treatment, which was highly successful – indeed in its entire history only three Mondragon co-ops have ever closed, two in special circumstances. Conventional firms in the Basque country have not survived so well; between 1975 and 1983 the region lost a fifth of its manufacturing jobs.

The new bank was successful in attracting private savings from the start, and by 1966 it was operating 21,653 accounts. 'Bankbook or suitcase' was Father Arizmendiarrieta's slogan – save or emigrate. By 1987 the bank had 600,000 depositors and $3 billion in assets. In its early days, however, most of its funds came from the co-ops, particu-

[main text continues p.168]

larly Ulgor, and 75 per cent of its loans went back to other co-ops in the group to fund their expansion. Indeed the bank's rules initially prevented it lending money except to its member-co-ops.

The way in which the bank operates can best be shown by describing the role it plays in the establishment of a new co-op. If a group approaches the bank with an idea of its own or one selected from a list of possible projects the bank maintains, it will pay the salary of the member of the group most likely to become factory manager to work on a feasibility study in conjunction with members of the bank staff, including a 'godfather' whose responsibility it is to see the project through its early days. If the study shows that the project is promising, the bank will lend 60 per cent of the required capital. Half the rest is covered by a low-cost (3 per cent) long-term (ten-year) loan from the Spanish government, and the final 20 per cent has to be found by the members of the group themselves. Seventy per cent of any losses the project makes in its first two years are converted into an additional loan by the bank, to be repaid over the following seven years. The godfather gets a seat on the new co-op's board.

The big advantage of this approach for the bank is that each feasibility study builds up its expertise and provides information and ideas that may be useful for future studies. The advantage for the new co-operators is that they get help and guidance from a team that has handled previous start-ups and ought therefore to be able to save them making costly mistakes. Indeed one estimate suggests that the value of the services provided by the bank to a new co-op is roughly equivalent to the amount of capital it lends.

This way of doing things is certainly a far cry from that in Ireland and Britain, where most small business start-ups are attempted by people who have never opened or run their own business before. In fact some people with start-up experience are actively discriminated against because if their start-up failed they are likely to be refused a loan on the grounds of their 'bad record'. It is therefore scarcely surprising that, according to Barclays Bank figures, only 40 per cent of start-ups are still trading after their first three years.

As the Mondragon bank is actively involved in the management of its co-ops and shares risks with the people working in them, and since the interest rates it charges co-ops have, at least in the past, been largely independent of those on the Madrid money market and capable of adjustment, they are better seen as a combination of payment for services rendered and a share in the co-ops' profits than as pure interest as normally understood. Interest rates represent a financial

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GOING DUTCH KEEPS INSURANCE PAYMENTS LOCAL

The payment of household and motor insurance premiums causes a serious and growing loss of national currency to almost every British and Irish community, but there is a way by which this can be reduced. Henk van Arkel, the director of the Dutch non-governmental organization Aktie Strohalm, lives in Soest, a village within commuting distance of Utrecht, in a thatched house he bought from a farmer who had built himself a spanking new residence across the road. Insuring a thatched building can be as difficult and expensive in the Netherlands as anywhere else, so van Arkel joined the local insurance co-operative, Statuten Soester Onderlinge Brandverzekering UA, which had insured the house for the farmer. 'There are five hundred of these co-ops throughout Holland', he explains. 'The way they work is that they collect premiums from their members based on the value of their properties and cover a proportion of the risk themselves. That keeps quite a lot of the money in the community. The rest of the risk they cover by sharing it with other local co-ops by re-insuring with a mutual insurance company a lot of them own, SOBH.'

Van Arkel thinks that the system works well because with only 425 members in the Soest co-op, one's fellow-members would soon know if anyone made a false or inflated claim, and be very unhappy about it. 'It would be reflected immediately in the rates of premium we all had to pay,' he says. 'The cost of insurance through these co-ops varies quite a lot because of their claims experience but it is normally cheaper than with the commercial companies.'

The co-op, which was founded by farmers in 1885, naturally has to maintain reserves to cover it if claims are greater than its share of the annual premium income. 'We've got 400,000 guilders [£175,000] set aside,' he says. 'I don't know how big reserves the co-op kept before 1944. It didn't take out re-insurance until then.'

SOBH, Meerndijk 11, 3454 HM de Meern, Netherlands.

Henk van Arkel estimates commercial insurers would charge him £500 a year for fire and storm damage cover on this old-style thatched farmhouse. Instead he pays £130 to a local co-operative insurance society.

performance target for a Mondragon co-op, not an absolute obligation to pay, as there is no question of the bank forcing it into liquidation if it is unable to cover them. Instead the ailing co-op is likely to be reorganized and, if necessary, refinanced, thus sharing the financial pain between the bank and the worker-co-operators.

The Mondragon system is therefore reasonably (if messily) close to the risk-sharing, profit-sharing, no-interest ideal, although, as the concept of interest is still omnipresent, a Muslim might not be happy with it. The individual co-ops are in effect interest-free too, as the rate of interest they pay to their worker-members for the use of the capital they provide on joining and contribute from their share of the profits is flexible and depends on the co-op's performance in a particular year: it is thus more akin to a dividend. The only guarantee the co-op gives to its members about their capital is that its value will be increased each year in line with the cost of living; and as this is a group of people giving a guarantee to themselves, they will have to find the resources themselves, perhaps by taking lower wages, if their co-op makes inadequate profits for the promise to be kept.

An equally valuable feature of the Mondragon system is that as its investors are also its workers and members of the local community, they are not solely interested in the financial return they get on their capital but in the whole range of social and economic benefits a project generates. This has enabled it to avoid the acute conflict between the interests of investors and those of the community. As a result, Lankide Aurrezkia represents the best working model for a community enterprise loan fund that we have – despite the fact that the Mondragon experiment is now unfortunately heading the wrong way, as we will see in the final chapter.

How, then, should a community set out to build its own local system? Its first step is obviously the establishment of a credit union if it has not got one already. The primary purpose of this would be to enable people to borrow to purchase consumer goods or to undertake house repairs without causing a leakage of interest payments and service charges to the outside world. The only decision the community needs to make before setting it up is whether it should charge interest. My personal view is that since most of the things members would buy with their loans would provide benefits year after year – freezers and greenhouses, for example – it is entirely right that they should pay for these benefits in addition to repaying the loan. As far as I am concerned, interest payments are acceptable so long as they stay in the community: it is only with business investments that problems arise.

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BACK TO BASICS WITH BUILDING SOCIETIES

One method of recycling an area's savings that has almost disappeared in the past hundred years is the local building society. In 1900 there were 2286 building societies in Britain, almost all collecting savings and lending them out again within a limited area and thus reducing the amount of interest payments and capital that leaked out of the districts in which they operated. By the end of 1995, however, only 79 were left, and the biggest seven of these had not only become so national (and in some cases international) in their operations but also, with the major banks, so dominant in the mortgage market that only 14 per cent of all house loans were still being provided by the 69 remaining building societies with strong local or regional roots. Many of these were expected to disappear too. Replying to a 1994 survey by an analyst with the Union Bank of Switzerland, John Wrigglesworth, 70 per cent of building society chief executives said they thought most of the smaller local societies will have been absorbed by national ones by the end of the century.

Such a change is not inevitable, though. If enough well-motivated people opened accounts in their local building society they would be able to prevent its amalgamation, no matter how big a bribe a national society offered members to secure their vote to take it over. But this would merely prevent further losses: reversing the trend is likely to be much more difficult, since the EU now requires new societies to have a capitalization of 1 million ECU (which the British government gratuitously made more onerous by rounding up to £1 million), thus making it almost impossible for people in places that have lost their society to start a replacement. The days in which a building society could be dreamed up over drinks after an Ecology Party conference and launched by persuading ten people to invest £500 each – as the Ecology Building Society was in 1981 – have gone. 'That road seems closed,' Bob Lowman, the present general manager of the society, told me. 'The government seems to be moving the goalposts all the time. Societies can do many more things these days, but they are much more tightly regulated.'

Two approaches might enable communities to get around this EU restriction, however. The simplest would be for an existing building society to accept an invitation from a community to set up a branch in their area on the understanding that it would not move capital in or out of that area and would restrict itself to granting mortgages using the area's savings. Such a policy could become an attractive marketing strategy for an existing society once a reasonable number of people begin to accept the desirability of investing their savings in their own area.

The other approach goes back to the origins of building societies. The first society for which records exist was founded in the Golden Cross Inn in Birmingham in 1775 and was soon followed by others in the growing industrial towns of northern and central England. They were set up by working-class men who drank in the same pub (for the first fifty years of the movement every building society was linked with a public house).[15] These were all 'terminating' societies: they built the houses themselves and wound themselves up when everyone was housed; the last one was

their financial performance. In other words, communities are very limited in the extent to which they can employ business, perhaps the most powerful human force for transforming the world, to achieve the collective as opposed to the private good.

This is one of the industrial system's most serious failings, and as competition increases as a result of international free trade, each firm's freedom to act for the common good will decline. Instead the world market will dictate more rigidly what a manufacturer should produce, at what price, and with what technology. If a firm should try to resist the market's decision because its directors have moral scruples about, say, the emissions produced by a new chemical process, it will make lower profits than its rivals unless it can make a marketing feature out of its refusal to adopt the technique – as the Body Shop has done with its rejection of animal testing – and thus persuade enough people to pay its higher prices. In most cases, however, taking a moral stance would cut its profits and hence its ability to exploit commercial opportunities, giving its less moral competitors the advantage and jeopardizing its survival. As Adam Smith knew, only if the law imposes morality or public obligations on every firm can all firms afford to observe them.

Competition forces firms to don a commercial straitjacket and to act in a very particular way. It is more effectively totalitarian than ever a Soviet central planner was able to be, which is exactly what its supporters like about it because they believe that only one way of operating a company or an economy is 'efficient'. They are happy to admit that their definition of efficiency is entirely commercial and excludes social objectives because they think that non-commercial objectives should be tackled separately once maximum profits have been made. However, as these profits are likely to be made at the expense of social objectives, the ultra-competitive, maximize-profits-first-and-then-use-some-of-them-for-social-ends-later approach is a highly inefficient way of achieving them. What our communities need is a form of economy that gives the producers within it sufficient protection from outside competition for them to meet social objectives as well as their own.

We are a long way from such an economy at present. As a result, one of the largest and, in some terms, most successful examples of community enterprise, the Mondragon co-ops, have been unable to protect themselves adequately against the forces of international competition, even though they had no outside investors and had their own source of low-interest funds. 'The particular genius of the Mondragon co-operators is not that they have found a mechanism to make money or create wealth – something done all the time – or that they have discovered a way to institutionalize the establishment of new business,' Roy Morrison writes in *We Build the Road As We Travel.*[4] 'Those are only part of the means to the end of creating and strengthening the bonds of chosen and discovered community.' Unfortunately, since the early 1980s the wealth-creating means Morrison mentions have increasingly become the end, and the goal of strengthening community has been diluted or lost.

When the first Mondragon co-ops were set up, demand for their products was high because Spain was just entering the consumer age and the Spanish market was protected by high tariffs. As a result, 'management was easy, without great burdens, and profitability flowed with abundance,' according to Jose Maria Ormachaechea, one of the founders of ULGOR, the original enterprise that became a cash-cow for the system.[5] Even as late as 1980, the manufacture of domestic appliances, the co-ops' most important activity, was sheltered from foreign competition by a 35 per cent duty. By 1991, however, the barrier had been lowered to 5 per cent, and it disappeared completely with the creation of the Single European Market in January 1993.

As the tariffs came down in the 1980s, foreign competition increased and the Spanish consumer became much more discriminating. This made marketing and management more important activities within the co-ops than actual production; and the wages of younger people performing these functions – who, as a generation, were less committed than their predecessors to the co-operative ideal – had to be increased to persuade them not to move elsewhere. To make this possible, the old rule that no one could earn more than three times the wage of the lowest-paid had to be relaxed, first in 1973, when the limit was raised to a factor of 4.5, and again in 1983, when it was increased to 6.* Then, in mid-1992, relativity restrictions on managerial wages were lifted altogether, a move that inevitably damaged the solidarity between the worker-members of the co-ops. The heightened competition also caused the co-ops to concentrate on increasing

* David Morris points out that since virtually no one was employed on the basic scale, the actual wage differential was about 4.3 to 1, much less than in Spanish industry overall, where the ratio was about 15 to 1. In Britain, chief executives earned on average 18 times more than manufacturing employees in 1995, compared with 16 times more in 1994. In the United States the multiple was 28, while Sweden and Switzerland had the lowest differential, 9 to 1, according to Towers Perrin, a firm of pay consultants, quoted in the *Financial Times*, 23 November 1995.

labour productivity, despite the fact that unemployment in the area had risen to over 16 per cent. So, while the amount of capital employed per worker has increased substantially since 1985 and output has also gone up, the number of people in the manufacturing co-ops has been static.

In 1992 the co-ops signed contracts of association with a new organization, the Mondragon Co-operative Corporation (MCC), instead of with the system's bank, which now only makes about 15 per cent of its loans to them. The word 'corporation' in the new organization's title is significant. Since it was set up, the MCC has merged some of its smaller co-operatives by moving their worker-members and equipment into a single building. It believes that co-ops with forty to sixty members cannot compete, and any that cannot meet strict market criteria must die. It is also reducing the number of products produced by the co-ops as a whole, and has made profit-sharing between them mandatory. Joint ventures with private firms are increasingly important, and most of its new investment and new employment creation has taken place outside the Mondragon area in places with no co-operative tradition. Moreover, whereas in the past it would have been unthinkable for a worker not to have been a shareholder, this has become quite common as profit-driven rather than people-driven managers think it desirable to be able to hire and fire staff easily to cope with fluctuations in demand.

Much of the consciousness of being a partner with a group of others in one's own enterprise has been lost as a result of the MCC's increased power in relation to member-co-ops, the compulsory profit-sharing, and the bigger co-operative units themselves. 'The Mondragon co-operative system increasingly looks similar to some decentralized US corporations (*e.g.* Johnson & Johnson),' David Morris notes.[6] In 1995 it abandoned enough of its community and co-operative principles to raise $96 million by selling shares to outside investors on the stock market.[7]

It had little alternative. Making car parts for Volkswagen, Ford and General Motors and holding 35 per cent of the Spanish refrigerator market against competitors like Electrolux and Bosch, which also manufacture in Spain, impose extremely tight commercial straitjackets. Consequently, once the directors had decided that executives' wages in Mondragon should be equivalent to those outside, the organization was well on the road to becoming conventionally commercial. What other path could it have taken, given that three of the ways of breaking out identified in chapter 2 – lower wages, shorter

distribution chains, and the protection afforded by being able to price part of the output in a community currency – were not available to it, and the fourth – access to cheap funds through a community bank – was no longer as important as in the past? Mondragon may still be a network of community enterprises, but it is not serving a community market. If it was, it would now be operating in a more stable, less competitive commercial environment under a very different set of constraints and obligations.

The chief obligation likely to be placed on community enterprises in the type of local economies we are hoping to build will be that if a business makes profits as a result of the community's help and sacrifice, those who own it should accept that those profits are not theirs alone: they are in part the community's profits too and should be used with that in mind and not spent or invested outside the community's boundaries. This is one of the things I had in mind when I wrote of the need to strike a new balance between community and personal goals. While some writers define community enterprises as businesses owned and controlled by community groups, I regard any business as a community enterprise if it supplies the wants or needs of a community and its owners accept that they have a moral obligation to balance their community's interests against their own.

It could be argued that if a local firm makes its profits in the mainstream economy using labour, capital and environmental goods provided by the community on a full-cost basis, its owners ought to be free to use its profits as they wish. But what is full cost? Isn't every successful business in the world today making additional profits because it has access to many, many factors for which it never pays the full amount? Indeed the industrial system might never have developed – and would certainly not have developed in the way it has – had businesses not been subsidized on a massive scale by taxpayers, society, and the environment. All firms therefore have social obligations which I suspect extend far beyond whatever they pay in tax and which, if recognized, cannot be discharged in the mainstream system because of the constraints imposed by the forces of competition.

Competition can work against society in other ways too. Under the conventional, profit-driven approach, shop-owners are under permanent pressure to increase their turnover, even if this means forcing rival shops to close down. This is because the conventional business world works on the basis of 'dog eat dog' rather than 'live and let live', and any shop that does not behave accordingly is likely to be weakened and then swallowed up by one of its competitors. But a