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# **Credit Co-ops and Co-operative Banks - the Israeli Case Study (1998)**

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Credit Co-operatives and Co-operative Banks - the Israeli Case Study by Zvi GALOR

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(Zvi Galor, who is the Programme Director of International Institute-Histadrut, Israel, has been a regular contributor to this magazine. In the past, he has contributed several thought provoking articles on co-operative principles, business ethics, etc.

In the current article, he is providing a Case Study on the Credit Co-operative sector in Israel, which we hope will make interesting reading.

The readers are welcome to write their views on this article. We will try to publish all such views, opinions, etc. - Editor)

## **1. Introduction**

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Credit co-operatives were founded in Israel, then part of the Ottoman Empire, at the beginning of the twentieth century. These co-operatives, called at that time: Credit Funds, were founded by Jews who came to Palestine at the end of the 19th century and during the beginning of the 20th century, mainly from Eastern Europe.

In that part of Europe, during the second part of the 19th century, credit co-operatives were founded, influenced by the saving and credit co-operatives established in the middle of the 19th century in Germany by Herman Schultze-Delitch and by Fridrich Wilhelm Raiffeisen. (1)

These credit funds were created in Eretz-Israel (Palestine), and were supported by the Anglo-Palestine Bank, the bank of the Zionist Movement, founded at the end of the 19th century, in order to help to finance the resettlement of Jews in their homeland.

The common denominator of these groups was their profession, or their habitation area, and they organized themselves, to obtain loans on the basis of mutual guarantee. The finance of these funds came from the Bank.

In 1912 there were in Palestine 25 societies of this nature, and the total credit allocated was 38,000 Egyptian Pounds. The First World War put an end to the existence of these funds.

## **2. Savings and Credit Co-ops - Theoretical Aspects**

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In the following chapters, there will be a description of the development of these co-operatives in Eretz-Israel. This chapter will discuss some theoretical aspects relating to this type of co-operative.

A. The first distinction to be made, without referring to the classical distinction between the Raiffeisen funds and the Schultze-Delitch

funds, which are illustrated well enough in the literature (1) dealing with this type of co-operative, is the one which exist, between saving and credit co-operatives and credit and saving co-operatives.

The saving and credit co-operatives are those which have members who save their money. From these savings, the co-operative is able to allocate credit to its members.

The credit and saving co-operatives are those which loan to their members money from external sources outside the co-operative. The members utilize this money, generally for productive purposes, and then reimburse these loans, so that liquid funds can be deposited in the co-operative.

**B.** Another very important difference, to which we shall refer later, is in the ownership of the co-operative. The question is to whom does the co-operative belong. The response given by most co-operative literature is that the owners of the co-operative are its members. But, how is this ownership expressed? In most co-operatives around the world the members are the owners of the fixed assets of the co-operative.

The shares of the members do not express the real value of the fixed assets of the co-operative. The non-ownership of the members is expressed in the international co-operative principles, as well as in most of co-operative legislations over the world. (2)

Does this situation of non-ownership of members of their co-operatives influence the rate of success of these co-operatives? This question will be discussed later.

**C.** Another issue related to the question of ownership, is how able is the member to influence the democratic process of his co-operative, including the management of it?

The general phenomena observed in most co-operatives around the world, is that the larger the co-operative is and the older it is, the capacity of members to influence the management of that co-operative, including the democratic process, diminishes.

**D.** In the saving and credit co-operative members deposits are used as the source from where the co-operative is able to allocate credit. The commercial banks, theoretically at least, allocate credit out of the fixed deposits of their clients. They regulate the amount of credit and its duration according to the volume of fixed deposits and their due time of repayment. The savings and credit co-operative mobilizes its credit funds from the creation of owned capital, called by WOCCU - World Organization of Co-operative Credit Unions, the share capital of the co-operative. The member is able to withdraw his shares, at their nominal value, when he leaves the co-operative. There exists no link between these shares and the value of the fixed assets of the co-operative, which do not belong to the members. We shall examine later in our discussion how this situation influences the existence and the continuation of these saving and credit co-operatives.

**E.** The practice is that the savings and credit co-operative charges members' credit at a rate of interest which is generally below the level of annual inflation in that given country. This situation brings about an ongoing erosion of the members' capital. At the same time, the savings and credit co-operatives - sacco - pay its members a rate of interest on their fixed deposits (which are practically what most sacco's call member shares) which is very low and minimal, generally below the rate paid by commercial banks in that given country. Once again, erosion of the real value of members money.

**F.** Another variable, very important to the understanding of the nature of these co-operatives, is the general approach towards the rate of interest policy imposed on members by these co-operatives. It is said that the co-operative is established by its members, in order to

provide them the best possible service, at the lowest possible price.  
(3)

Relying on this assumption, we may assume that the 'sacco' will try to pay members the highest possible rate of interest on their deposits, and at the same time will try to charge members loans at the lowest possible rate of interest. In most saccos the interest rate policy applied does not take these considerations into account. These co-operatives do not attempt to provide their members with the best possible service.

**G.** The following issue derives from the former one: what to do with the funds collected from deposits made by members? The economic logic tells us that the co-operative should allocate all funds deposited by members during a fixed period of time to members in need as credit, in order to maximize its income. The practice in most saccos around the globe is different. The amount of credit allocated to members is a small percentage, generally between 20-30%, of the total of its members fixed deposits or of its reserve funds. The solution in most saccos to over liquidity is to deposit these funds in commercial banks, or in co-operative federations, or co-operative banks, where the money will generate a rate of interest inferior to the rate of annual inflation in this given country, and as a result, its real value will be eroded considerably. The members lose out through the decrease of the value of their saving, and many of them, who are badly in need for credit for various purposes, are not served by their co-operatives.

**H.** One of the solutions applied by saccos in order to solve this over liquidity problem, but also because of other reasons, is the creation of federations of saccos, and in some cases, the creation of co-operative banks. The concept is that the federation will serve as a regulatory tool for liquidity problems of saccos. The idea is that co-operatives maintaining deposits not allocated to members as loans, would place them in the federation, or in the co-operative bank,

would therefore receive interest income on these funds, and the federation would then lend these funds to co-operatives where there exists a demand for finance. The main problem when applying this very useful and important idea is that of non-comprehension of the essence of what a co-operative should be in general, and what a sacco should be in particular, and to the non comprehension of the idea that the co-operative exists to best serve its members. In many cases, and in many countries, the federation instead of using these funds to provide credit for co-operative members, prefers to deposit these funds in commercial banks, or to invest it in fixed assets. These assets, even though they belong to the members collectively, are not illustrated in the balance sheets, or in the financial documents of the federation or of the co-operatives, as the members' property.

**I.** The saving and credit co-operatives are a very efficient tool for saving in various countries. The amount of money accumulated is enormous. The major problem is what to do with these funds. Members establishing these kinds of co-operatives, aspire to receive, among other things, loans in response to their needs, at terms more preferable than the commercial banks. One of the reasons for the existence of these co-operatives is to allocate members appropriate credit, when available, for various purposes, especially for productive ones. The policies of most saccos around the world is to minimize the amount allocated to members. In an ongoing survey among participants in the International Institute-Israel, coming from various countries' saccos, the average amount of loans available from funds is around 30%. The rest is deposited in financial institutions outside the co-operative itself. In so doing, saccos are not fulfilling their first duty and obligation.

**J.** There also exist credit and saving co-operatives. Their main objective is to channel their members sources of finance, which will enable them to realize their requirements from this credit. The members may be in need of finance to improve their houses, or for

various consumption needs, or, and this constitutes the main target of these co-operatives, to finance various economic initiatives. The problem with these co-operatives is their restrictive approach to the question of production. Generally, in every process of production, we find the essential triangle of production.(4) This essential triangle includes the supply of credit, the supply of inputs, and after completion of production, the marketing process. The major problem of the credit and saving co-operatives, is that they only supply credit. They do not relate to the establishment of an efficient production system, nor the supply of inputs nor the marketing system.

The results are that loans are allocated, but economic initiatives fail, since the other elements of the essential triangle have not been taken into consideration. The credit and savings co-operatives should relate to all the elements of the essential triangle.

### **3. The Credit and Savings Co-ops in Eretz-Israel**

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The post first world war period saw the beginning of a new era in the development of credit and savings co-operatives, as well as those of the savings and credit type. In 1919 the first credit and savings co-operative was established in Tel Aviv.(5) In 1921 the first credit and savings fund of the Histadrut was established, when the Histadrut received a 1000 Palestine Pound loan from the Jewish Agency, in order to help resolve the severe unemployment problem.  
(6)

These two co-operatives were in effect the two main parallel streams of development of saccos in Eretz-Israel. The credit and savings funds were established and developed by the Histadrut. The credit and savings co-operatives were established by the non-Histadrut sector of the Jewish population in Palestine at that time - the "civil sector" as it was referred to, and which included traders, small craftsmen and artisans, and private farmers. Even though, these two movements differed on political grounds, but they had in common

their approach to what a co-operative should constitute. In both types of co-operative the managements was determined, largely on the basis of their political affiliations.(7)

### **3.1 The Histadrut Credit and Savings Funds:**

The basic principles of the foundation of these funds were based on mutual assistance:

A. The funds were part of a nation wide institution, maintaining branches all around the country.

B. The assets of these funds were composed of the payment of membership dues of one quarter of one Palestine Pound. Members quitting the fund would be reimbursed at the nominal value of these dues. The assets were used to allocate credit.

C. Only members who paid their dues were entitled to receive loans.

D. The size of the loan would not exceed 20 times the value of the dues, and it had to be reimbursed in 10 monthly payments.

E. Operational expenses were covered by a special levy of 2 % of the total of the loan amount.

Some problems are immediately identified. First, this co-operative had been established from "above", and not by its members. The status of this co-operative does not refer to the question of who are the owners. As a matter of fact, the members were not the owners of this fund. Another issue was the question of loans and guarantees. The status of this fund did not refer to this issue. In 1924 this fund ceased to exist, since it went bankrupt.(8)

In 1924 the Histadrut decided to reestablish these credit and savings funds for the workers every where in Eretz-Israel. The decision

stipulated that the funds should be established everywhere where there was economic and financial justification for them, and whenever conditions enabled it. The idea was that these various funds would be united and federated into one central umbrella fund. Bank Hapoalim (the commercial bank of the Histadrut) was used as the establishment and finance center for the support of these various funds.

In September 1925 the first new fund was established in Tel Aviv. The same year similar funds were established in Jerusalem and Haifa. Parallely, funds were established in the following years in the various Moshavot ( rural nonco-operative settlements, which later became small towns), as well as in the existing Moshavim ( co-operative villages) at that time. The major goal was to enable of credit supply for workers, who did not have access to banks.

In various Moshavot a process of development started which brought many daily workers to live alongside the farmers. The establishment of these funds, as well as the creation of the small Tzarchania (the consumer co-operative), was intended to attract these workers to join the Histadrut. These funds offered better savings conditions than those offered by the non Histadrut credit and savings co-operatives which were established at the same time, as will be explained later. In 1929 Bank Hapoalim gave a credit of 300 PP ( Palestine Pounds) for the establishment of a fund in Petah-Tiqva, as a complementary amount which would be collected out of the savings of members.

The funds established in the various Moshavim, were utilized mainly as a channel for the conversion of credit to productive credit for the members of the Moshavim. The major problem of these funds in the Moshavim was the very low ratio between the assets and the total loans transferred to the members, and as well the low ratio between members savings and the total credit. Another characteristic of these Moshavim funds, was the small number of members in each

Moshav, and therefore in each fund. All this brought about the disappearance of these funds in the Moshavim as independent funds, and the turning of the Moshav into a multipurpose co-operative, with one of the purpose being the saving and credit function.(9)

In 1935 there were 25 credit and saving funds in Eretz-Israel. 3 were in the three main cities, 10 were in the Moshavot, and 12 were in Moshavim.

In 1934 these funds advanced a step ahead, with the founding conference of the Credit and Saving Audit Union. Delegates of all funds came to this meeting. It should be mentioned as well that Bank Hapoalim supported these funds during this time.

In 1932 Bank Hapoalim allocated credit to the value of 10000 PP to the 8 major funds in the towns and the Moshavot. One very important characteristic of these funds was that they developed continuously, and in some cases created competition to Bank Hapoalim by offering parallel services to their members, but still they remained within the framework of the Histadrut, with the financial support of Bank Hapoalim.

The umbrella organization of these funds was always the audit union, which served also as their federation. Its roles were in the fields of training, guidance, control, audit, financial liquidity control, and appropriate co-operative management. The role of Audit Unions will be further examined later.

### **3.1.1 The Structure of the Credit and Savings Funds:**

These funds were practically co-operatives, even though they were not referred to as such. The members were individuals, and other funds, provided that they were affiliated to the Labour Economy - Hevrat Haovdim (the social and economic enterprises of the Histadrut).

The Management ran on the basis of any co-operative: one member - one vote, the democratic principle. The institutions of the co-operative included a council committee, management committee, and a control committee.

All these funds were affiliated to Brit Pikuach (the Audit Union), as well as to the Hevrat Haovdim. Hevrat Ha'ovdim had a voting right in all general meetings.

The objectives of the funds were: to supply members with credit; support the establishment of common enterprises - housing, insurance; savings; accepting fixed deposits and running current accounts of members as well as the public; purchasing of land for housing and settlement; distributing part of the profit for public needs.

We shall see that this openness mentioned in the last objective gave way to two phenomena:

- Searching for the maximization of profit for the funds, rather than seeking the cheapest possible service to members. The outcome of this policy will be examined later. Immediately, it could be said that the quality of the service to members has deteriorated over the years, and this has also affected the existence of these funds in the future.

- The distribution of funds for public needs was replaced very soon afterwards. The Histadrut utilized the profit gained out of the operation of these funds for various purposes, which may have been justified in their importance to the Histadrut, but did not match the concept of the co-operative, and were not for the benefit of the members of these funds.

The assets of these funds were accumulated out of the membership fee each member paid upon joining the fund, and the reserve funds.

Membership fees were 0.25 PP. Every member upon receiving a loan, paid immediately 10% of it as a one time investment for the building up of the assets of the co-operative. It is worth mentioning once again that there is no link at all, in the perception of these co-operatives, between the member and the ownership on these funds. Practically, the members were not the owners of their funds, nor especially of their reserve funds and the fixed assets. Members quitting the fund, even after many years, would be reimbursed only the membership fee originally paid at its nominal value. It is clear therefore that the members did not actually own their funds.

Profits were directed towards special reserve funds, and a special fund for bad debt. Part of the profit was transferred to the "Labour Economy". There was no distribution of profits to members. We should recall that these funds did their utmost to create profits. The creation of profits was considered by these funds as a positive activity.(10)

This creation of profits leads to a more expensive service for the members, and another consequence is that the co-operative increases gradually and continuously its total accumulated reserve funds, which practically speaking, do not belong to members. The co-operative should therefore invest this capital in real value investment in order to safeguard its real value.

This kind of investment is generally speaking rare, and the consequences are therefore that co-operatives accumulate funds which diminish continuously in terms of their real value, and as a consequence, the inability to serve the aims for which they have been created.

### **3.1.2 Brit Pikuach:**

Brit Pikuach (the Audit Union) of the Histadrut Credit Co-operatives was founded in 1934. Its membership consists of all the Credit and

Saving Funds. Additional tasks performed, besides those mentioned above, were audit, control, legal supervision and bookkeeping for all the funds; coordination amongst the various funds, advancing co-operative ideas through co-operative education, and assistance in the establishment of new funds.

Each fund member would be audited once a year. Each fund paid the audit union for this supervision which was the correct approach. In various countries around the world the audit of co-operatives is performed by civil servants. The salaries of these officers is usually very low. In many cases co-operatives are exempted from payment for this supervisory function. This practice opens the way for inefficiency and corruption.

The Annual General Meeting of Brit Pikuach, which is practically speaking a tertiary co-operative, is comprised of delegates coming from all the member funds. Each fund sends one delegate for every 500 members. Each delegate is entitled to one vote, and no fund can have more than 5 delegates.

### **3.2 Credit and Savings Co-ops :**

The first credit and savings co-operative was founded in Tel Aviv in 1919. It was an institution with the intent to allocate small scale loans. The political and colonial structure in Israel at that time did not afford appropriate solutions to those who were in need of credit but could not access the official banking system. Such persons were small traders, craftsmen, and small non-co-operative member farmers.

These co-operatives were organized within the framework of, what was referred to at that time the civil sector, which included those who were not included in the "political environment" of the Histadrut.(11)

As a general remark, we should point out that in all these variants of co-operatives during that time, the Histadrut Funds and the Credit and Savings Co-operatives, the members were not the real owners of their co-operatives. In both co-operative movements, the leadership was influenced and controlled by the Jewish political entities existing at that time. Another interesting issue is that in time much later, the Histadrut also reached an influential position in the leadership of the credit and saving co-operatives.

The members of the credit and savings co-operatives were those who paid up their membership fees. The services supplied by the co-operatives were savings, especially fixed deposits, in addition to the allocation of credit. Savings were accepted from non-members as well. Credit was allocated only to members.

The advantages of these co-operatives lay mainly in the simplicity of their operations, in the easy handling of treatment for members by the officers of these co-operatives, and in the competitive rate of interest offered by these co-operatives to those who deposited their money in the co-operatives instead of in the banks.

Fixed deposits were utilized as a financial source to allocate credit. Credit was destined for the individual members, as well as for small scale businesses membership. As a general rule, credit was granted only to members who paid up their membership fees.

The credit and savings co-operatives created profits as a deliberate policy, like the Histadrut funds. These profits were not distributed amongst members, but were accumulated in reserve funds by the various co-operatives themselves. One of the major problems when applying such a policy is how to safeguard the real value of these funds. The solution found was to invest them in various fixed assets, which are not really necessary to the running of the co-operative itself.

This policy is very common in many savings and credit co-operatives in various countries around the world. The outcome of this policy is the accumulation of huge amounts of property by the co-operatives, whilst this property belongs to the co-operatives, not to their members.

Another reason for the creation of these reserve funds, mentioned by Avraham Brenner, was for their use in case the co-operative finds itself in financial difficulties, or in the case of dissolution of a co-operative, when the co-operative has accumulated many bad debts. In both cases, the reserve funds are utilized to pay off these bad debts. This practice creates yet another injustice among the members of the co-operative. The reserve fund is created over the years through deductions made out of members participation in the business of the co-operative. This participation of the members is not necessarily equal among all members.

There are members who participate more in the financial activities of the co-operative, and as a result pay more to this reserve fund. There can also be a situation where a given member, who for many years did not participate actively in the co-operative finances, and of course, has therefore contributed a relatively small amount of money to the reserve fund.

This member may have received a large loan from the co-operative, according to the regulation and the bylaws, but he was unable to repay this loan, and an analysis made by the co-operative shows that he was unable to respect his obligations. Here enters the mechanism of the reserve fund for bad debts. This money is reimbursed to the co-operative out of this reserve fund, at least theoretically.

In this practice, we create an injustice amongst members. Bad debts should be borne by all members equally. A member who was very active in the co-operatives' financial activities, should not be "punished" and pay more than another member for bad debts. The

more practical and just solution would be an insurance policy for bad debts, where every member pays according to his participation, and will be entitled to the fruits of this participation when necessary.

## **4. From Co-ops to Banks**

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The transformation is almost inevitable. Savings and credit co-operatives are becoming over the years, commercial banks.

### **4.1 Credit and Savings Co-ops :**

The credit and savings co-operatives experienced a process which transformed them into banks. The credit and savings co-operative of Tel Aviv was the largest one, and at its peak reached the figure of 49 branches all over the city.

The other co-operatives, around the country, created a central tertiary co-operative, which became, in time, the Zerubavel Bank. This bank became the central financial arm of all the credit and savings co-operatives in the country, except the one in Tel Aviv.

The big leap of the co-operative of Tel Aviv was towards the end of the forties, after the second world war, and especially after the independence of the State of Israel. Avraham Brener states that what happened to this co-operative was the process through which the co-operative grew more and more.

From a small number of members, several hundred, and one branch, where all members knew each other, and the member who is in need of a loan, met the director in his office over a cup of tea, the situation has gradually evolved into a co-operative where there are tens of branches, including tens of thousands of members. This process leads to a situation where there is alienation and isolation of members from their co-operative. At the end of the sixties the credit and savings co-operative of Tel Aviv comprised nearly 50 branches,

and the co-operative employed 600 workers.

Growth brings about an inevitable process. The expanding co-operative society, which is functioning as a bank, is unable to compete with the banks, and is forced to become a bank by itself.

We are observing this at the end of the sixties, when the credit and saving co-operative of Tel Aviv, which invested a lot in fixed assets, and as a result of the economic recession of that time, became engaged in financial liquidity difficulties. The solution was to be amalgamated with the nation wide Bank Zerubavel, the central financial organ of the non Histadrut co-operatives. The name of the new creation was "Credit and Saving Bank - Israel".

The next stage, two years later, was the merging of this bank into The Bank for Industry and Commerce, a bank which was under the control of the Histadrut's Bank Hapoalim. In November 1971 the merger into Bank Hapoalim took place. Bank Hapoalim was interested in this step, as it acquired tens of branches all over the country, but especially, the increase of tenths of branches in Tel Aviv, where it had a weak presence.

Avraham Brenner summing up this description by saying that according to his view, the process by which credit and savings co-operatives become banks is inevitable and obligatory. The time comes when the small society has no economic justification to continue existing. It can't compete with the banks in its services, from the point of view of price and quality alike.

## **4.2 The Credit and Savings Funds :**

The credit and savings funds of the Histadrut have undergone a process which has brought them also to the same destination, but with their own specific problems. In 1935, we know that there were already 25 funds, mainly in the Moshavot, which accounted for more

than 21000 members.

The chief characteristic of members joining these funds was the economic-financial motive, rather than because of any adherence to co-operative ideology. Another major problem was that members were not involved in the democratic life of these co-operatives, nor in the daily management of these funds.

The authors of the book on Bank Hapoalim mentioned(12) this phenomena, that members are not involved in the activities of the co-operatives, and especially, their non willingness to become involved. They stated that this factor brought about later, besides other factors, the unification of these funds into Bank Hapoalim.

The process, over the time was towards the reduction of the number of funds, and the expansion of the number of members over all. In 1947 there were 20 funds in Eretz Israel with 35500 members total.

At the end of the forties these funds expanded, as did the volume of their activities. An annual report of the Tel Aviv Credit and Savings Fund for 1949 indicated that, with regards to the volume of activities and the variety of services offered to members and clients, they were not different to any other commercial bank. Moreover - a competition developed between the funds and Bank Hapoalim. During the fifties a process started of mergers and amalgamations of these funds into Bank Hapoalim, a process which was accomplished by 1957.

## **5. Characteristics of the Creation of Co-op Banks**

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The history of the savings and credit co-operative's existence in Eretz-Israel and in Israel shows us that these co-operative forms have practically vanished from existence. Simply, there is no more need for their existence or for their services. They vanished when they ceased to fulfill the role for which they had been created. Today

in Israel this form of savings and credit function, exists by and large, only in the multipurpose co-operative - the Moshav.

The accepted model, to which people aspire, is the co-operative bank, or the co-operative federation. These two forms are created out of a group of primary savings and credit co-operatives, which come together to establish this new structure. The primary co-operatives are the owners of the bank.

The co-operative bank offers its members a variety of services, which the primary co-operative is unable (because of capacity and cost considerations) to offer its members, and at the cheapest possible price. The co-operative bank should primarily serve as a financial regulator amongst its members - the primary co-operatives which have high liquidity over a certain period of time, and other primary co-operative members, which are in need of liquidity during the same period of time.

This activity should be accompanied by a policy of imposing a competitive rate of interest. Co-operative members who deposit their money in the co-operative bank should receive a rate of interest higher than that available in commercial banks. Co-operative members which seek credit should pay for it at a rate of interest which is lower than that charged in the commercial banks.

The transfer from co-operatives to co-operative banks has some specific characteristics.

**A.** The first factor concerns the size and the age of the co-operative. A well-established primary co-operative has more ease to become a co-operative bank. Older primary savings and credit co-operatives generally have a larger number of members. Also, the number of branches has increased overtime, as well as the territory it covers. At the same time, the number and the variety of services offered by the co-operative to its members has increased, not only because the

members requested these services, but also because of the desire of the leaders of the co-operative to expand their activities as a sign of good performance. All these factors bring a co-operative which has many branches, or a group of primary co-operatives to come together by creating a co-operative federation or a co-operative bank. In the case of Israel, this was the merging and the amalgamation of the co-operatives and the funds into Bank Hapoalim

**B.** Another characteristic of the activities of a co-operative bank is in the operational concept. The question first and foremost is why it exists. The first answer would be that the co-operative bank exists in order to serve its members, the primary co-operatives. Service means - the lowest possible price, without making any profit, but only covering operational expenses. In reality, in many countries around the world, co-operative banks, or co-operative federations, are running a pricing policy aiming at the creation of profits, which means for the members - a more expensive rendered service. The co-operative banks do not, generally, pay the primary co-operatives a competitive interest rate on their deposits. They do not, as well, charge their members the lowest rate of interest for credit. In short, they are generating profits, or in the co-operative terminology, surpluses.

These surpluses are, generally, not being distributed to the members. This policy leads to the co-operative banks increasing their managerial administrative structure, and therefore increasing their expenses, which is economically unjustified.

Parallel, to this such a situation which encourage the banks to invest these funds, either in fixed deposits in commercial banks, where the rate of interest is usually lower than the annual rate of inflation - i.e. an erosion of the real value of their money, or to invest in real estate, which exposes the bank to the fluctuation of this market, and especially, to its low liquidity rate.

Another justification for the accumulation of these funds, (called reserve funds or reserves) is for bad debts. These funds are also deposited in fixed deposits in commercial banks, where their annual yield is below the rate of annual inflation. The result is the continuous erosion of the real value of these funds, which at least, theoretically, are intended to cover real money losses.

**C.** From this discussion we arrive at the third characteristic of co-operative banks, which is their way of determining their interest rate policy. In the framework of this discussion, light should be thrown on the policy determining which rate of interest is placed on deposits made by primary co-operatives.

Analyzing the issue relating to the question of what is a co-operative, shows us that a true co-operative seeks to serve its members at the cost price of the service, without the creation of profits or surpluses. This means that in a saving and credit co-operative, the policy should be to offer members on their fixed deposits, an interest rate which would be competitive, and higher than, other financial savings institutions. Whilst at the same time, charging a rate of interest, on members loans, which is lower than that in other financial institutions.

**D.** Many savings and credit co-operatives are often facing a situation where the total of their accumulated deposits is more than the total demand for credit. This situation is generally temporary, and often seasonal. In all cases the dilemma stands before the leaders of the co-operative: what is the best use of these extra funds?

We have a situation where in the same town or in the same country there may exist co-operatives where the aggregate demand for credit is more than the total of the members deposits. The linkage between these two groups of co-operatives may be made in a very effective way by the co-operative federation. We find this situation in Israel

with the multipurpose co-operative - the Moshav.

The Moshav regulates the money flow amongst its members, between those who have surplus liquidity and those who are in demand for it. The Moshav offers members who have money the possibility to deposit it in the savings and credit function, by offering them a competitive rate of interest, higher than that which is offered by any other banking system in Israel. At the same time, the Moshav charges the members who are in need of capital at a rate of interest which is below the commercial rate.

The difference between the rate which the Moshav charges, and the rate paid, should exactly cover its own operational expenses, and not to make any profit or surpluses. This linkage is achieved as well by the Regional Purchasing Organizations in Israel, which are practically, secondary co-operatives, belonging to the Moshavim and the Kibbutzim in Israel.

It is possible to find, around the world, this important linkage effectively in the co-operative federations, or in the co-operative banks. The problem lies in the unawareness, and the misunderstanding of this role, by the majority of the leadership of these co-operatives. We witness this in various co-operative federations, or co-operative banks around the world. According to bankers' criteria, they are considered to be very successful organizations. But, according to the criteria of the service they are rendering to their members, they leave a big question mark.

The understanding that a co-operative enterprise exists to serve its members, and credit co-operatives exist to allocate credit to their members, does not exist in most co-operatives around the world.

A survey(13) concerning the ratio between the total amount of fixed deposits in co-operative banks, and the total loans granted to members by these co-operatives, shows us that only between 30%

and 70% is allocated as loans. The rest of the money is maintained either in liquid balances, or deposited in commercial banks.

It is clear that this policy reduces the total annual income of the co-operative bank, or the co-operative federation, and so therefore decreases their capacity to serve better their members. Income from fixed deposits in the bank is lower than if the funds were to be allocated as loans to members, or to member-co-operatives.

Another problem here is the fact that many co-operative leaders do not understand their primary role - to serve their members. The reasons which they offered, why they are not applying this policy are many, but can't be supported by in any logical analysis, nor in an economic examination.

E. Another major problem of these bodies is the democratic nature of the co-operative. The democratic nature of the co-operative is one of the most important values of the co-operative movement. The primary co-operative is characterized by the principle of one member - one vote, when members in these co-operatives are individuals. The tertiary co-operative, the federation or the co-operative bank, is a co-operative where the members are primary or secondary co-operatives. The democratic process is implemented not through direct participation, but on a basis of representation.

Generally, each primary co-operative delegates for the general meeting one representative for some several hundred members, depending on the size of the co-operative. What we are observing in co-operative banks and co-operative federations is a degradation of the quality of the links existing amongst the co-operative members, in general, and the individual members in particular. The members do not feel that the co-operative is their organization, and become more and more indifferent to their co-operatives.

## **6. Summary**

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This article has attempted to analyze the process of the development of savings and credit co-operatives, and to show that the road leads to the creation of federations of co-operatives, that in many cases become co-operative banks, which in turn, become regular commercial banks.

Today, around the world, it is rare to find a so called co-operative bank, which is really a co-operative, which means an organization which belongs to its members, i.e. an organization which is supposed to belong to its members, and foremost, to serve them in the best possible way. Abandoning these objectives, lead most of the co-operative banks around the world to disappear, either towards becoming commercial banks, or they simply ceased to exist as such.

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6. The Book of Bank Hapoalim, mentioned above, p. 239.

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8. The Book of Bank Hapoalim, p. 244.

9. Op.cit. P. 246.

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13. Taken from Study Circle Report of participants of an international course at the International Institute - Histadrut at Beit-Berl. September 1997.