# The Role of Local Currency in Regional Economic Development

by Robert Swann, 1984

## Promoting Local Business and Local Markets

A primary objective for regional economic development is to expand employment of local people on a permanent, long-term basis by helping them to create their own small businesses and by creating local markets for locally produced goods and services.

This proposition can be defended in a number of ways. The first is that 90 percent of new employment in the country is generated by small businesses with assets under $300,000. Another factor is the fickle nature of large corporations, which have the power to place an industry in a region, hire several hundred people, and then, a few years later, close the industry down or move it elsewhere—probably to a Third World country, where lower wages or other conditions make for greater profits. Hundreds of small towns over the country have been subjected to this, especially within the last ten to fifteen years. More and more regions, especially in the Northeast, have learned to be wary of these situations. They are thus looking for alternative solutions to economic development.

Today, it should be clear to everyone interested in working for what E. F. Schumacher called "an economy of permanence" that it is necessary to encourage, support, and promote local business and industry initiatives. These initiatives are persistent in spite of the obstacles in front of them.

One obstacle is the lack of relatively small amounts of capital at reasonable interest rates—upon which start-up small businesses and industries depend. Why is capital either unavailable or only available at high interest rates? There are at least two major reasons why this is true.

The first reason is the simple fact that from a banking point of view, it is easier and more efficient to make large rather than small loans. The amount of time and paper work involved in a small loan is about the same as a large loan. Therefore, the bank either discourages small loans, or charges higher interest for them.

The second major factor is the especially high risk assumed in making small loans to untried businesses without adequate collateral or experience. Nevertheless, if properly structured, a small loan program can have a very low default rate. I will give two examples.

In Bangladesh, one of the poorest areas of the world, a lending program helping landless rural people to start or improve very small businesses has, over a ten year period, a record of only 1 percent defaults. In Spain, where the Caja Laboral in Mondregon has been making loans to start small, cooperatively organized industries the success rate on loans is almost 100 percent.

## The Structure of Successful Lending Programs

Why have these lending programs been so successful? I believe there are several factors relating to the structure of the programs themselves that are part of the answer to this question. We have tried to incorporate these factors into the structure of our SHARE program in Great Barrington. I will describe the SHARE program later. These factors are:

1. *Support from the local community.* Support is built in from the inception. For example, in the case of SHARE, peer groups are asked to review the proposed loans. In the process, they become aware and supportive of the businesses. In the case of the Grameen bank in Bangladesh, loans are made to groups of five, with only two members receiving a loan at any time. If their payments lag, then the other three must wait until the payments are up to date. Moreover, all members of the community can become members of the bank, and thus become aware of all such loans.
2. *Technical assistance*. Local people provide technical assistance in order to assure performance. This is built into the loan agreement, if possible. In the case of the Caja Laboral in Spain, the bank itself provides the assistance, particularly management assistance.
3. *Local markets*, which are encouraged through broad membership in the organization. An example in the SHARE program is the case of a borrower producing goat cheese, which members promoted to local groceries and specialty shops.

All these cases prove that with the right structure, the risk involved in small loans, even for start-up businesses without assets, can be reduced to a fraction. And this in turn means that a system of loans rather than venture capital is suitable to starting up small businesses. It also means that high interest rates based on risk are not justified. Thus, loans can be made, and are being made, at interest rates below "normal" market rates. For example, interest rates on SHARE loans are only 10 percent, while "normal" bank rates on small loans are as high as 18 percent.

It hardly needs to be suggested that low interest rates are very important in helping small businesses get started. A drop in interest rates of even a few percent can mean the difference between red and black ink. The other point I want to emphasize is how important even small amounts of capital can be in launching a new business, or in improving an older business. In the case of SHARE, small loans of up to $3,000 have been critical in either starting or improving seven small businesses.

An example is the case of Bonnie Mordoff. She borrowed $1000 through SHARE's lending program to purchase a small but very efficient knitting machine on which to knit wool sweaters and children's clothes from her own designs. Recently she was given a regular monthly order for a quantity of sweaters, and her small business began to grow and thrive, and employ local women in their homes.

Mordoff's loan is also an example of how technology, particularly small-scale but inexpensive technology, can increase productivity tremendously. Loans for such technology are essentially self-financing in the sense that they pay for themselves over a relatively short time. This points to the fact that new money can be created or issued through the lending process for such technologies without danger of inflation. In fact, most economists will agree that the primary reason the U.S. does not have a very high inflation rate—in spite of prolific government spending for nonproductive purposes, such as the military—is because the rapid increase in productivity rates due to advances in technology has offset this spending—at least thus far.

Something else that plays an important role in developing new local businesses and affecting the volume of existing business is the region's purchasing power. Many studies have demonstrated that money deposited in local banks in small towns and rural areas tends to be quickly into the large urban financial centers, where it can demand a higher interest rate in the money markets from which large corporations and governments borrow. Small banks cannot necessarily be blamed for this practice.

They have to exist in a competitive market, and they would lose out if they did not move deposits in the direction of the highest interest.

**The Rural Flight of Money**

The simple resulting fact is that money moves out of the rural areas where it was generated, and into the central banking system. Thus, rural markets are deprived of their buying power. In a sense, all rural areas have become colonies of the central financial system. For that matter, the central city areas have also become colonies, as funds have moved into the suburban areas or have taken flight overseas into the central government treasuries.

Much of this tendency for money to leave the rural areas and be sucked into urban financial centers results from the centralization of banking, which took place in the early part of this century under the Federal Reserve Act of 1913 and the pressure of World War I. Previous to 1913, local banks created their own funds based on their gold reserves. They were not dependent on the Federal Reserve Board to control reserve requirements—the amount of credit or money available within local regions. During the early part of the nineteenth century, this fact played a very important role in the rapid development of the U.S.

In his book *Money—From Where It Comes and Where It Goes*, the twentieth century economist John K. Galbraith demonstrates that this was probably the most important factor in the rapid development of the U.S. Galbraith's argument suggests that Third World countries, as well as rural areas in the U.S. since 1913, both have been victims of a centralized money system that prevents the creation of adequate funds for local development and distributes funds in disproportionate amounts throughout the different regions.

Jane Jacobs, in her book *Cities and the Wealth of Nations*, develops this last point regarding the poor or inadequate distribution of funds across the country to show that no matter what methods are used, a central system of money creation cannot create the correct amount of credit or money for local regions. It can only create a general level of funding, which may be entirely inadequate for one region experiencing severe depression, but excessive for other regions experiencing boom economies. Thus, she advocates the use of local or regional currencies to ensure that every region can adequately regulate its own credit needs.

**The SHARE Program**

What all this points to is the need for creation of regional currencies by some kind of banking system centered in, and accountable to, a local community.

In our work at the E. F. Schumacher Society to develop the SHARE program in Great Barrington, Massachusetts, we have seen the necessary of this second step. Let me recap our experience with SHARE.

The Self-Help Association for a Regional Economy (SHARE) is a membership organization open to anyone in the region who opens a SHARE account at a local cooperative bank. The minimum deposit in the account is $100. It is a ninety-day notice account and the depositor earns 6 percent interest on the deposit. Upon opening the account the depositor agrees to let SHARE use the account to collateralize loans that meet its social and environmental criteria. Depositors become members of SHARE and are entitled to elect the board of directors and set policy. Members are also eligible to apply for collateralization of business loans through SHARE.

Proposals for loan collateralization are made to SHARE's board of directors. To review the application, the board seeks to form a group of consumers and local business people in the same field as the applicant—cottage industry, farming, home service providers, etc. Upon the group's approval, and final approval by the lending committee of the board, SHARE staff go to the local participating bank with the applicant. SHARE brings enough passbooks of members to fully collateralize the loan. The bank actually makes the loan at 10 percent interest while handling all of the paperwork, including the collection of payments.

The bank's participation simplifies SHARE's administrative work so that it can concentrate on building local support, while creating a future bank credit reference for the borrower. We also feel that the bank's participation helps ensure payback, as the borrower's credit rating is at stake. Another advantage of the bank's participation is that the program is easy to start without large overhead and staff costs.

The role of SHARE is in essence that of coordinator. It coordinates efforts between community members willing to invest in local, small businesses that have trouble obtaining conventional financing, and the borrower. The work coordinating investors and borrowers can be accomplished on a part-time and volunteer basis so long as a bank is handling the record of monies deposited and borrowed, as is customary. With such a simple method available for increasing loans to small local businesses, SHARE-like programs can be started in other areas, which is already happening.

But the SHARE program, as it exists, remains dependent on the deposits of social investors, a limited group with limited resources. The launching of a local currency is the next logical step in the development of the program, a step that could increase the credit available and reduce the interest rate to as little as 3 percent, the cost of servicing the loan. Such a favorable increase in local credit could make small, local businesses once again economically competitive.

There has been little current experience from which to draw. Thus the E. F. Schumacher Society, along with SHARE, has been developing plans slowly over the past two years for launching a local currency in the southern Berkshire region of New England.

Thanks to the help of a prestigious national advisory board for the currency project, we have obtained clearance from the United States treasury, from the Security and Exchange Commission, and from the Massachusetts State Banking Commissioner that the project does not violate any of their regulations and statutes. This clearance was important to secure, as many people are under the illusion that only the federal government can issue currency. The Constitution gives the federal government the right to regulate currency, but not the sole right to issue it. Essentially, this means that any local currency must be "exchangeable" with Federal Reserve notes on some recognized basis for the purpose of computing and taxing income.

Throughout our two years of preparation, we spoke with local merchants and bankers about the project; their input has shaped our strategy for implementation. We realized that there were many new, and for most people, complex aspects of a truly independent regional currency that would take time for the community to understand and fully accept. Prioritizing the different aspects, we felt it would be most important to get the currency in motion so that merchants, employees, and customers would become accustomed to seeing, using, and accepting the currency as payment. Therefore, we decided to initiate the currency in the simplest way possible.

**The Local Currency: Berkshares**

To make it simple, we will start out with a twelve-month period in which the currency is fully backed by U.S. Federal Reserve notes. In order to do this, SHARE will open two accounts at a local participating bank: a deposit account and a withdrawal account. On depositing Federal Reserve notes into the deposit account, the customer will get a receipt in units of *Berkshares*. These receipts will be exchangeable for goods at local stores. Merchants with too many Berkshares can exchange them for Federal Reserve notes from the withdrawal account. The Berkshares will act as a check against the withdrawal account. The bank's role is merely to handle the deposits and withdrawals from these two accounts. Responsibility for meeting the availability of funds with withdrawals rests entirely with SHARE, as with any other checking account.

The Berkshares will be denominated in units of cordwood and will be indexed against the dollar according to the price of cordwood in the area. Merchants will receive a monthly table noting any change in the exchange rate between Berkshares and Federal Reserve notes. To maintain the value in Berkshares relative to cordwood, SHARE will purchase options from cordwood dealers to buy cordwood at a specified price over a specified period. Our expectation is that during this trial period, the price level and relative value of cordwood as a local energy source will remain stable, and therefore rapid changes in the exchange rate will not occur.

We expect that this first issue will provide a good opportunity for testing the feasibility of the various components of the program and insuring their efficient operation. The first two parts of a three-part printing process are complete. Three press runs using different printing methods and different colors, will help discourage Berkshares counterfeiting.

We are now at the stage of working out contractual arrangements with a local bank for handling the two Berkshare accounts. Once arrangements are complete, SHARE will launch an extensive local advertising campaign to invite merchants to participate in the use of Berkshares. We expect to begin circulating Berkshares in January of 1987, a slow time for area merchants, thus giving them time to acquaint themselves and their employees with the mechanics of handling a second currency.

**Commodity Based Currencies**

What are some of the advantages of a local independent currency based on a real commodity?

Certain advantages are obvious. Unlike dollars, Berkshares will not leave the region of the Berkshires. They can only be exchanged for goods at local stores. Thus they will continue to circulate locally, bringing business to the small shops and service persons in the area.

Because Berkshares are based on a real commodity, or can be redeemed for a real commodity (such as cordwood), they will not lose value. Therefore, they should become more attractive to keep than dollars. If the dollar devalues quickly, persons holding Berkshares will still maintain their purchasing power. The choice of cordwood as a standard for Berkshares is important in that cordwood is a locally produced commodity. The abundant small and large woodlots in the area are overgrown; and landowners pay to have their woodlots thinned and upgraded. This means that access to cordwood is democratically available to anyone who owns or rents a chain saw and can work hard.

In addition, cordwood is a renewable form of energy. When combined with the right technology, cordwood can produce heat, gas, and electricity at a cost equal to other forms of energy. As energy is a significant part of all production costs, this keeps the cost of energy stable with the cost of production.

Finally, and perhaps most importantly, with its own currency, a region can issue all the credit it needs to local merchants, small businesses, and farmers to encourage local production and distribution. It can do this for as little as 3 percent interest, the estimated cost of handling the currency and the loan. The Berkshire region can do this without fear of inflating its Berkshares, as long as the loans stimulate new production.

The importance of this last point cannot be overstated. When regions begin assuming the power to support their own business needs by issuing their own currencies, then we will have taken great strides toward regional self-reliance, greater security, full employment, and an economy of permanence.

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