

# Community Banks - Microcredit

## The case of Brazil

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“Capitalism has as its basis not only the idea that capital is private property, but also that it is concentrated in the hands of a minority. Due to their lack of capital, the vast majority of people who have to work in order to survive, are forced to sell their capacity to produce to those who own the means of production. Therefore, capitalists have at their disposal a large supply of manpower begging to be hired, usually outstripping the demand.

If these workers had enough credit, many of them would prefer to have their own business instead of working for somebody else. The larger the number of people that open their own business, the greater the possibility of success, since the injection of many small quantities of capital in the market boosts demand, allowing for new businesses to find buyers for their products. There is a need to enhance access to capital for micro and small entrepreneurs, of which there were more than 10 million in Brazil in 2003, in addition to the huge number of unemployed, the million families that are *assentadas* (people given new land to cultivate) under the agricultural reform and more than 11 million families dependant on the *Bolsa Família* (Government program to supplement poor families' income). In spite of the various measures for democratization of credit taken by the current government, with examples such as the six-fold increase in *Pronaf* (National Credit Program for Family Agriculture), the large majority of those in need are still not taken care of.”

The above text was written by Professor Paul Singer and appeared in the newspaper *Folha de São Paulo* on June 10<sup>th</sup>, 2007; however, it could very easily have been the preface for a real practice that has been taking place in Brazil since 1998: community banks.

“Community banks offer solidarity-based financial services, in a network of an associative and communitarian nature focused on generating jobs and income within the perspective of the reorganization of local economies, having as their foundation the principles of the Solidarity Economy. Its objective is to promote the development of low income territories by encouraging the creation of local production and consumer networks based on the support of the Solidarity Economy initiatives and its diverse fields, such as socio-productive entrepreneurial activities, service delivery, and support to commercialization (markets, shops and solidarity fairs).”

This definition was agreed on at the second meeting of the Network of Brazilian Community Banks, which took place from the 18<sup>th</sup> to the 21<sup>st</sup> of April

2007 at Iparana (CE), and it is meant to explain or clarify an initiative that is gaining more and more momentum within the national economy.

### **The Background**

This topic becomes relevant the moment the world is faced with a crisis that has its origin in the international financial system. This crisis is now widely discussed in the different media networks; however, half of the Brazilian population has been excluded from this discussion for quite some time.

The banking industry in Brazil is highly concentrated: the largest 10 banks own 80% of the total liquidity owned by the 105 banks with a commercial portfolio and a credit offer that represents 75% of the total amount. For instance, the two largest financial institutions, *Banco do Brasil S/A* and *Ciixa Economica Federal* are responsible for 25% of the total credit offer.

Despite having grown in the past three years the credit offer is still disappointing in comparison to GDP, barely 27%, when compared to other countries such as Uruguay, Thailand and Chile where the indicator is significantly larger, 40%, 99% and 70% respectively.

Beyond the high concentration of their activities, banks are extremely selective in their credit offer and tend to favour transactions in neighbourhoods with stronger economic foundations. Furthermore, they finance part of the public debt, an activity which provides them with 40% of their profit on average. It is part of the nature of these financial institutions to concentrate their activities on short-term gains, instead of financing the mid- or long-term opportunities.

### **Banco Palmas: the Beginning**

The first community bank in Brazil was *Banco Palmas*, which was inaugurated in January 1998 in a neighbourhood called Conjunto Palmeira, which is located on the outskirts of the city of Fortaleza. The idea came from the *Associação dos Moradores do Conjunto Palmeira* (Association of Residents of Conjunto Palmeira) which has around 30,000 residents. They developed an economic system which has an alternative micro-credit line (for producers and consumers), incentive tools for local consumption (credit card and social currency) and new ways of commercialization (fairs, solidarity shops/stores) promoting local job creation and income generation.

*Banco Palmas* has three main characteristics: management responsibilities are borne by the community; an integrated system of local development which promotes credit, production, commercialization and training; and the local currency (Palmas currency), which complements the official currency (real) and is accepted and recognized by local producers, merchants and consumers, creating an alternative and solidarity market between the families.

The Palmas currency is pegged to the real (R\$) (1 Palma is worth 1R\$), which allows productive entrepreneurial activities within the community, like commerce, industry and services, to exchange currency each time it is necessary to replenish stocks of products that are not produced in the neighbourhood. The Palmas currency is already accepted by 240 businesses, which offer discounts from 2% to 15% to encourage people to buy with the social currency.

In March 2008 the Ministry of Work and Employment (MTE) hired the Federal University of Ceará to make an evaluation of the impact and image of the bank in the Conjunto Palmeira neighbourhood. Some of the findings are worth highlighting:

- 98% of those interviewed consider that *Banco Palmas* has contributed positively to the development of Conjunto Palmeira.
- 90% believe that the bank has contributed to an improvement in their quality of life.
- 26% believe that their income has increased because of the actions of the bank.
- 22% found jobs thanks to *Banco Palmas*.
- 61% would give the bank a rating of at least 9 out of 10.

These figures are supported by the words of one of the world's most respected individuals in the area of finance, who states "*Banco Palmas* is similar to *Wir Bank* from Switzerland, created in 1934 and it is more advanced than the *Grameen Bank* of Nobel Peace Prize winner *Muhammad Yunus*, because it provides the poor with better help to get out of poverty" (interest rates are lower). This statement comes from *Bernard Lietaer*, former director of the Central Bank of Belgium and an expert on complementary currencies (from frequent flyer miles to social currencies). Just as it is with the *Palmas* currency, *Wir Bank* makes transactions with the *Wir* currency as well as with Swiss francs. Of course, the scale of transactions of *Wir Bank* is much higher since they involve 65,000 businesses and the value of such operations is 2 billion dollars a year. Author of the book "*The Future of Money*" (2001), *Lietaer* defends the view that social currencies promote certain exchanges that would not happen otherwise and help fight the liquidity problems that occur during recessions. He estimates that currently there are 5000 types of social currency. Furthermore, he firmly believes that "spreading banks such as *Banco Palmas* as a tool to reduce social tension, should be used as an important precedent for developed countries, such as Switzerland, to follow" (Jornal Folha de São Paulo 02/02/2009).

### **Instituto Banco Palmas: Spreading the Idea**

In order to spread the social technology of the bank, in 2003 the inhabitants of Conjunto Palmeira decided to create the *Instituto Banco Palmas*. Two years afterwards the entity signed an agreement to enter into partnership with the Secretaria Nacional de Economia Solidária do MTE (National Secretariat of

Solidarity Economy) and the Banco Popular do Brasil. The agreement allowed not only *Banco Palmas* but also the rest of the community banks to have access to credit and to act as banking correspondents of Banco Popular do Brasil.

Thanks to that support it was possible to arrive at the number of 37 community banks by the end of 2008, 25 of them in the state of Ceará, 4 in Espírito Santo, 3 in Piauí, 2 in Bahia and 1 in Mato Grosso do Sul, Paraíba e Maranhão. These banks are located in areas characterized by poverty, banking and financial exclusion, in *quilombolas* communities (where descendants of African slaves live), indigenous areas, communities of *quebradeiras de coco* (women whose job it is to cut open coconuts whose seed is used in industries to produce cosmetic products), and isolated districts in the semi-arid northeast and the urban periphery.

The inhabitants of the majority of these places travel in *paus-de-arara* (privately owned trucks used to transport people) for about 40km just to pay their electricity bill or to receive their pension. Credit is not even a possibility and thus there is even less possibility of any local development.

This was the case in São João do Arraial (PI), a region where *quebradeiras de coco* live and work. With 7,000 inhabitants, the city has **an 81° HDI** (Human Development Index), the lowest in Brazil, and 77% of its population lives on less than half the minimum salary, based on the data from the United Nations Development Programme (UNDP). The county's economy is based on subsistence agriculture, mainly rice, corn, beans and yucca and raising animals such as pigs, cattle, goats and fowl. Moreover, the inhabitants work in the extraction of *Babaçu*, producing 200 tons of almonds and oil. In order to understand the true dimension of the local poverty it suffices to say that within the county 260,000 USD circulate per month, of which 110,000 USD come from the INSS (National Institute of Social Security), 110,000 USD from the City Hall, 30,000 USD from the government programme *Bolsa Família* and just 10,000 USD from local production, according to data provided by the local government of São João de Arraial.

Similarly to the example above, the inhabitants of this city had to cover around 30km of dirt road to the county of Esperantina if they needed any banking services. Besides paying the bills they also used these trips to buy whatever they needed, spending most of their income in their neighboring county. However, the story of São João de Arraial began to change at the start of 2007, when an NGO called CARE asked *Instituto Banco Palmas* for advice on how to open a community bank in the city. With the support of the City Hall and the leadership of COCAIS (Council of Community Organizations for Support and Social Inclusion), a seminar was held to present the proposal and ...Bingo! The local residents were mobilized. Afterwards, some community leaders and experts from the City Hall went to Fortaleza for a series of training sessions at the *Instituto Palmas*.

As an infrastructure sponsored by the municipal authorities, on December 12<sup>th</sup> 2007 the Community Bank of *Cocais* was inaugurated. Today, it is possible to use it to pay bills, receive pension payments, and have access to credit and social currency for consumption in São João do Arraial. One of the

municipal laws to support the *Banco Coceais* lays down that government workers of the municipality receive their salary from the community institution, giving the option that up to 25% of the payment can be in social currency. Thus, São João do Arraial began to redesign its own development.

The DNA of the community banks is the same everywhere: local economic flow of credits for production purposes (in Real R\$) and credit for consumption in social currency, with ownership of the financial system in the hands of the community.

Nevertheless, every institution has its own name and currency and its own social organization which manages the project. A community bank is not a branch of a central bank, even though it follows a reference and common work methods defined by the Brazilian Network of Community Banks.

## **The Structure**

In order to better understand the inner workings of a community bank, it is essential to describe its main structure.

### **a) Objective of a Community Bank**

Promote the development of low income areas, through the encouragement and creation of local production and consumption networks, based on the support of the economic initiatives by the Solidarity Economy and its diverse scope such as: socio-productive enterprises, service provider, support for commercialization (markets, solidarity fairs) and consumer organizations.

### **b) Characteristics of the Community Bank:**

- the community itself decides to create the bank, becoming its manager and proprietor;
- it always acts with two credit lines: one in Real currency (R\$) and another one in circulating social currency;
- its credit lines stimulate the creation of local production and consumption networks, promoting the endogenous development of the area;
- it supports enterprises, as a commercialization strategy (solidarity shops, fairs, central office for commercialization etc.);
- it acts in areas characterized by a high degree of exclusion and social inequality;
- it is aimed at a public characterized by a high degree of social vulnerability, in particular the beneficiaries of governmental programmes;
- it aims to establish its financial sustainability in the short term, obtaining subsidies justified by their social utility.

### **c) Financial Services offered by the Community Bank**

- Local social currency
- Solidarity credit through the concession delegated by financial institutions such as Banco Popular do Brasil
- Credit for financing solidarity enterprises
- Credit for personal and family consumption without interest
- Popular Solidarity credit card
- Opening account and account statements
- Deposits
- Invoice reception (water, electricity, telephone etc.)
- Subsidies and pension payments
- Cash withdrawals with or without credit card

### **d) Functioning of the credit system in Community Banks**

- The interest rates are lower than the market interest rates.
- The credit system is fair. In solidarity finances this means for instance, that those with fewer resources pay lower interest rates and those with more resources pay higher interest rates. The interest rates are progressive to ensure a proper distribution of income. In this system the fortunate subsidize the most vulnerable in economic terms.
- This solidarity dimension has to be understood by the residents and recipients of credit. A policy of lower interest rates is not enough if its application does not raise critical awareness and a sense of solidarity among the population. Only these values can have a mid- and long-term impact in the process of radical transformation of the structures of society.
- The community itself (members of the association of residents and the credit recipients) owns and manages the credit system. As a result, any income from the credit operations, return on resources, interest and fees have to remain within the community. When we say “remain” it means that the community is at the same time customer and owner of these resources. The self-management aspect is extremely important. Many credit systems that function in specific communities simply provide a credit operation, but the resources generated are directed towards the headquarters of the main bank. This means that the recipients of credit are merely clients and so end up contributing to increase the wealth of the financial institution at the expense of the community.
- The credit system serves as a supply source for the production chains, the local production and consumption networks, the production arrangements and other ways to foster the creation of solidarity cooperation networks. Credit can be made available to someone but soon they have to be encouraged to participate in one

of the local networks of producers and consumers. In other words, it is essential that the recipient of credit (individual or group) is involved in some way with a local production or social network.

- For the credit analysis other verification tools for the trustworthiness of the client are used than the traditional capitalist instruments. One of the tools often used is the “neighbour guarantee” or the “introduction” system which basically means the recipient needs to have a reference from a local organization (e.g. association, church, union). Trust, therefore, has to be put in the community which ultimately decides on the future or direction of the credit system

### **e) The Circulating Social Currency and the Community Bank**

The circulating social currency serves as a complement of the national currency (Real R\$), created by the community bank. It is essential to cultivate the circulation of money and wealth within the community itself, strengthening local commerce and generating jobs and income.

These social currencies possess some characteristics that make them different. Let us see what these characteristics are:

- a) The local currency is backed up by the national currency (Real R\$). Basically, for each unit of social currency issued, there is a correspondent value in the national currency.
- b) The currency is issued with security measures (paper money, watermark, barcode and serial number) in order to avoid falsification.
- c) The currency circulates freely in local commerce; generally, those that use the social currency get a discount from businesses and producers to encourage the use of the currency in the municipality or neighborhood.
- d) Any producer, shopkeeper or entrepreneur that is registered in the community bank will be allowed to exchange the social currency for the national currency (Real R\$) if he or she needs to buy or make a payment outside of the municipality or neighborhood.

Through the partnership with Banco do Brasil, the *Instituto Banco Palmas* organizes and manages a credit fund, which transfers a start-up sum of 30,000 R\$ for each new community bank that is created. Furthermore, Banco do Brasil has also made available the software that it uses to monitor the activities of each bank, in order to avoid mistakes by correcting possible distortions. In this way, out of the thirty-five community banks integrated in the Brazilian network, thirty use the same credit fund and are linked by a computer program.

From the legal point of view, each community bank functions as a Civil Society Organization of Public Interest (OSCIP) of Micro-credit. *Instituto Banco Palmas* acts as an umbrella organization; it manages the network which provides legal support to all the community banks, the majority of which are just local associations with no institutional structure.

As part of being an OSCIP, *Instituto Banco Palmas* can establish partnerships with the public sector and official banks, generating resources and technologies for the benefit of the community banks that are part of the network.

### **Starting up a new Community Bank**

For a new community bank to be created three factors are necessary/essential:

1. Local mobilization and a community organization process, and a strong, motivated civil society institution to manage the bank.
2. Availability of premises and infrastructure provided by a local partner, usually municipal City Halls.
3. Organization of training sessions for the agents, credit managers and cashiers, in addition to the sensitization of the local economic actors to join the initiative

It is the responsibility of *Instituto Palmas* to certify the creation of a new community bank and to communicate the creation of a new social currency to the Central Bank, even though other organizations that take part in the Brazilian Network of Community Banks also facilitate training and consulting services in other states.

### **Next steps for Community Banks**

Despite the financial crisis the Brazilian Network of Community Banks continues to grow all over Brazil. With its decentralized model and broad social supervision, focused on the balance between local production and consumption, it has already had an impact on the lives of more than 200,000 people.

After so many successful initiatives a new set of goals has been defined for the future.

1. To create 1000 banks by the end of 2010 of which 300 should be in the north-east of Brazil.
2. To have at least one community bank in each state of Brazil by the end of 2009.
3. Develop a legal framework for community banks; a bill **Nº 93/2007** supported by congresswoman Luiza Erundina.
4. To set up the *Centro Palmas de Referência*, a place to train future employees of the bank.
5. To train 200 technicians in community banks by the end of 2009.
6. To obtain 10 million R\$ to fund the community banks with low interest rates and long-term repayments.



7. To help 2 million Brazilians benefit from proper financial services by the end of 2010.
8. To create the Latin-American Network of Community Banks.

The *Instituto Palmas* is aware that in order to accomplish these goals a broad process of training, mobilization and community organization throughout Brazil will be necessary. To find organized areas and properly trained and empowered community leaders are the biggest challenges faced by community banks. Despite the best efforts by different social movements, taking into consideration our vast territory, there are still very few organized communities in Brazil. Of these, only a few give economic issues priority. The vast majority of local organizations are focused on initiatives such as, *inter alia*, the *regularizaçao fundiária moradia* (right to build and own a home), access to health services, education, and human rights.

The economic issue, focused on financial and banking exclusion, remains distant from social movements, almost a taboo. The economy is viewed as just for economists, a hard topic that is almost never found amongst the priorities of local organizations. However, an example for the popularization of this type of initiative is being practiced outside Brazil.

In March 2008, the Instituto Banco Palmas signed a Memorandum of Understanding for social and economic cooperation with the Ministry of Popular Power for the Communal Economy of the Venezuelan Government.

As part of this agreement, the Instituto Banco Palmas trained a team of 30 technicians of the Venezuelan government in the methodology of the community banks and they established a visit schedule for monitoring and training in Venezuela. At the same time, the government of Hugo Chavez passed the *Law of the Communal Banks*, which provides that for each organization of 200 families a Communal Council can be created to form a community establishment. This process has resulted in the foundation of 3,600 community banks in different states of Venezuela.

Thus, a priority for the Brazilian Network of Community Banks is the creation of a legal framework of a similar nature in Brazil. An important step towards this goal is the already mentioned bill N° 93/2007 by Congresswoman Luiza Erundiana, which is being discussed at the National Congress. The text provides for the creation of the National Segment of Popular and Solidarity Finances. Its approval will constitute a great leap forward in the democratization of the Brazilian financial system – or more importantly – for the financial and banking inclusion of more than half the Brazilian population that continues to have no access to commercial (public or private) banks.

A look at the current international state of affairs encourages us to reflect that this alternative way to understand the world of finance, starting at the local community, stands out as an alternative to the globalized exclusion and speculation so present in the current global financial system. We believe that the poor, when empowered, become the solution; they are capable of creating their own financial system, in harmony with the local culture, strengthening neighbourhood relationships and cooperation.

It is not our objective to create a movement for the elimination of the current financial system. On the contrary we aspire to start a global crusade for the broadening of financial and banking services. It has been proved that commercial banks (public or private) only reach a small part of the world's population, leaving the poor outside of the financial system. Thus, our model becomes essential; it is more democratic, humane, and inclusive. After all, it is named community bank because the *common-unity* itself is the owner of the bank.

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