Covestment with Community Currencies

Financing the future and creating economic resilience by weaving innovations in network currencies, crowdfunding and community microlending

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Abstract

In the post-2008 world of high unemployment, government austerity, constrained personal finances and restricted access to credit, it has become a matter of considerable challenge for new entrepreneurs to obtain the financing they need in order to create viable livelihoods for themselves and other community members while building the sustainable business ecology of the future. The old methods of financing business enterprises have not yet caught up with the business models and types of the emerging new economy. Meanwhile, "financing the future" has become a question of considerable urgency as threats posed by economic instability, climate change and peak oil demand that communities act quickly to adapt and build resilience.

This idea paper presents the outlines of a new concept that we are coining as "covestment", an idea that we believe has the potential to transform the way sustainable enterprises and community projects are financed.

Covestment refers to a highly **co**llaborative, **co**nvivial, and **co**mmunity-based approach to the financing of new community enterprises. It weaves together the most exciting innovations in business-backed, mutual credit-based community currencies, crowdfunding and community-based microlending. It is designed to be highly beneficial to all stakeholders in the community economic ecosystem, of very low financial risk, and resilient to external financial shocks. This is possible thanks to a community currency designed to capitalise on the surplus capacity of local businesses, part of which is used to create a *community credit commons* in partnership with local citizens and consumers.

The challenge

In the post-2008 world in which we now find ourselves, communities are faced with the following set of challenges:

- How to create more vibrant and resilient local economies capable of withstanding external economic shocks in a world characterised by growing financial instability;
- How to develop economies that are sustainable and productive both socially (ample opportunities for meaningful livelihoods) and ecologically (economic activity observes biophysical constraints and preserves natural capital for future generations);
- In the face of constrained financial resources (government and donor cutbacks), how to finance the investments into social programs, infrastructure and sustainable enterprises that are becoming increasingly urgent.

The contradiction

The great contradiction of our time is that the tightening financial constraints faced by our society fly in the face of the fact that, materially and technologically, we live in one of the most abundant eras in human history – or at least *should*. Technology has increased the productivity of human labour many times over since the beginning of the Industrial Revolution, including a doubling the past four decades alone. An abundance of cheap energy means that the average First World citizen enjoys energy services equivalent to what would have required hundreds of human servants to provide a couple centuries ago.

In spite of tremendous unmet needs in our society, our economic system leaves growing segments of the population unemployed, underemployed or misemployed, in what is perhaps the greatest misallocation of resources ever perpetrated. The difference between our current economic situation and a society in which all of its members are contributing to the common good at their full potential is just one measure of the latent, untapped resources available to society to be applied to the tackling of its greatest challenges. Often the only thing standing in the way of a more efficient application of human effort is a monetary and financial system poorly suited to the needs and realities of society.

On rare occasions throughout history, the mismatch between, on the one hand, the human and material potential of a community and, on the other hand, the inadequacy of the prevalent monetary and financial paradigm to properly coordinate and direct that potential towards useful ends has become apparent enough that members of those communities undertook to resolve the contradiction through the adoption of more appropriate monetary and financial technologies.

One early example of such an insight took place on the English Channel island of Guernsey, which in 1812 found its trade-dependent economy greatly depressed in the wake of the Napoleonic War. The island urgently needed a new market house to develop its own domestic economy, yet lacked the financing to build one. At that point, a few observant islanders noted that, in reality, the island had everything it needed to build the market house, from lumber and other building materials to skilled labour, but lacked only the money to bring all of these resources together. The answer, therefore, was to create the money that they needed. The Guernsey government proceeded to issue Guernsey Pounds which enabled not only the market house to be built, but other infrastructure including roads and schools as well. Guernsey Pounds were in use to positive effect until 1832 when private banks from England, jealous at the loss of their money-issuing monopoly, successfully sued in the English courts to quash the island currency.

Other, more recent examples of community currencies being effectively used to address the market failures of the dominant national currencies include the Wörgl Schilling, a scrip issued by the Austrian town of Wörgl during the Great Depression to restore some measure of prosperity in the local economy and accomplish a number of public infrastructure projects; the LETSystem mutual credit currency (see below) invented by Michael Linton in British Columbia's Comox Valley in 1982 at a time when sky-high interest rates and the loss of the local air force base meant that circulation of conventional money had virtually ground to a halt; and the Deli Dollars issued by a Massachusetts deli owner in 1989 to finance, with the help of his customers who purchased scrip that could later be redeemed for meals, a move to a larger location for which the banks would not lend him money.

The contours of a solution

Might not we, in our time, enjoy similar insights to those experienced by the people of Guernsey, Wörgl, the Comox Valley and elsewhere, and develop monetary and financial technologies equal to our current challenges?

In what follows, we shall introduce a couple of concepts that will prove useful in understanding the historical, theoretical and practical underpinnings of covestment, the community monetary and financial technology that we are proposing.

Mutual credit

Mutual credit is the term used for credit extended by the members of a network to each other for the purpose of mediating transactions among members of the group. Mutual credit has distinct advantages over bank credit because it is typically interest-free and is not dependent on third-party approval. It has advantages over the dominant means of exchange as well, because it functions as an informational currency with a self-regulating supply that expands or contracts according to the transactional needs of the mutual credit network's participants. Simply put, money in a mutual credit system is information (like a score) as opposed to a medium in finite supply (like gold).

The mutual credit model that has been most widely templated around the world is the LETSystem, designed by Michael Linton in the Comox Valley, Canada in 1982 and since propagated (with variations) thousands of times globally. In a LETSystem, members begin with accounts with balances of 0, and through transacting with other members can come to carry either positive or negative balances. If A makes a purchase from B, A's account in the system is debited and B's is credited. A can then satisfy his commitment to the system by providing goods or services to other members of the network, while B can spend her credits with any other member.

Community Way

The Community Way model of community currency is a later invention by Michael Linton, and represents a systems design approach to community currency with the aim of driving widespread adoption by mainstream businesses, contributing a major solution to the funding crunch experienced by non-profit community services organisations, and having a significant effect on the patterning of local economies by introducing a persistent currency that remains in circulation in the community and creates financial incentives for a shift towards (more sustainable and convivial) local procurement and consumption choices.

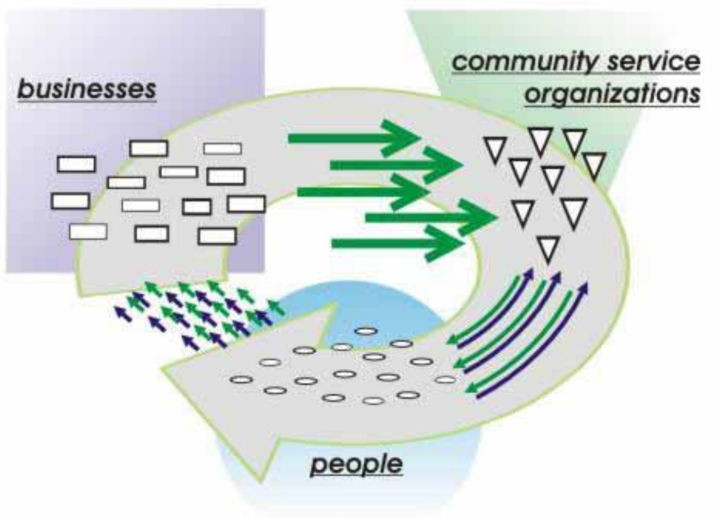


Figure 1 A schematic diagram of the Community Way model for community currencies. In this diagram, the green arrows represent the flow of community currency while the blue arrows represent the flow of conventional money.

Community Way works as follows:

1. **Local businesses** become the underwriters of the local community currency, i.e. they give value to the community currency by making an agreement to honour that currency as (usually partial) payment for their goods or services (typically for the portion of the price that represents the business' own local value-added).

As underwriters of the currency, businesses are entitled to *issue* a specific quantity (depending on their size or other indicators of their capacity) of the currency into circulation.

2. The community currency enters into circulation by being gifted by the issuing businesses to **local community service organisations**. Non-profits can use the community currency they receive to make purchases from participating businesses, pay staff or reward volunteers. But their best option is to:

3. **Change money!** Non-profits are encouraged to reach out to their supporters and ask them to contribute cash in exchange for an equivalent value in the community currency. This way, the non-profits have cash resources that they can use for their work, while their supporters still have a currency that they can spend at local businesses. This ability to support non-profits without losing spending

power with local businesses makes it possible for individuals to augment their support for non-profits in ways not previously thought affordable.

4. **Individuals** with community currency obtained from non-profits start patronising the local businesses that seeded the gift to begin with, drawing more business to local, community-minded businesses and giving them a distinct advantage over less locally-rooted corporations. Businesses can then use the community currency that they earn to make purchases from other local business or individuals, or they can use the community currency to augment employee wages or to provide additional support to their favourite community groups.

In addition to creating a more resilient, localised and sustainable economic ecosystem, Community Way is a win-win-win partnership for all stakeholders:

Businesses do well by doing good; they get to support the community in ways they may previously have been unable to afford, using a currency that in fact drives customers back to their business. Marketing and customer loyalty without price-slashing and discounts!

Non-profit community service organisations can easily raise funds through contributions of community currency from local businesses, and the exchange of community currency for cash with individual community members. This promises to free non-profits from expending significant resources on more costly and time-intensive fundraising methods, including grant writing.

Individuals get a double use of their money by being able to both support their favourite community groups AND go shopping locally with the same dollar, while knowing that in doing so, they are helping build a more resilient and vibrant local economy with a currency that persists in local circulation.

For an animated depiction of the Community Way model as applied to Seedstock Community Currency in Vancouver, Canada, please see: http://www.youtube.com/watch?feature=player_embedded&v=2Bctk7KGSGs or visit www.seedstock.ca.

Covestment defined

Covestment is a term coined by Michael Linton to describe a distinct and powerful new opportunity for community and network financing, utilising the tools of mutual credit and the design of the Community Way model. "Covestment", as the reader might guess, is a variant on the word *investment* with the Latin prefix *co-* replacing the *in-* in order to emphasize the collaborative nature of this particular financing model.

How does ***covestment*** differ from ***investment***?

Classically, ***investment*** refers to an arrangement whereby a person or institution contributes financial or other capital to an enterprise or project. Because investors are assumed to be deferring gratification into the future by investing scarce resources rather than consuming them, and to be taking a risk that they may never see those resources again, investment typically comes with an expectation of returns – not only of interest or dividends, but of the original investment principal. Often investment entails the purchase of equity in the enterprise being invested in, and in any case almost always provides the investor with a legal claim on the enterprise's assets and income stream.

Furthermore, Linton notes that in cases where various types of inputs are invested into a project or enterprise (eg. money, materials, time, creativity), there is typically an in-built assumption of the primacy of financial investment over other forms of investment. Thus, if an enterprise should fail, those who had in some manner invested in the enterprise financially often have legal recourse available to attempt to recover their investments. Meanwhile, those who had *merely* invested time and effort in the enterprise usually have no such recourse, even though it can be argued that their loss is the greater, time and effort being of absolutely finite and inelastic supply, and completely unrecoverable once expended.

Covestment, on the other hand, is a new collaborative and community-based financing method being proposed here which weaves together some of the most cutting-edge innovations in community-based economics to create a powerful new community economic development tool. These innovations include **community currencies**, **crowdfunding** and **community microlending**:

- **Community currencies**. Community currencies have enjoyed a renaissance of late in much of the world, especially in the wake of the 2008 global financial crisis, however it must be noted that not all community currencies are created equal. Most of the community currencies now in circulation are in reality simply cash-backed "proxy currencies" that provide only marginal incentives to "buy local", do not functionally increase the money supplies of their communities or appreciably change money flows, and have more of a novelty, touristic or "pride-in-place" value and function than an economic one.

  In this paper, on the other hand, the kinds of community currencies to which we are referring are business-backed currencies as opposed to the cash-backed variety, that is to say that they have value, not because they can be redeemed for cash, but because they are underwritten by local businesses who have agreed to redeem them for goods and services. An example of a business-backed currency is Michael Linton's *Community Way* (www.communityway.ca) model, described above.

- **Crowdfunding**. Since crowdfunding was made popular and accessible by the advent of websites such as Kickstartr and Indiegogo in 2009 (they have since been joined by hundreds of others, including the free Vancouver-based platform Weeve (www.weeve.it)), billions of dollars have been raised for creative, technological, business and social good projects via crowdfunding.

  Crowdfunding taps into previously untapped sources of financing by making it easy for hundreds or even thousands of people to collaboratively finance a project (sometimes by contributing as little as $1). While most crowdfunding platforms include built-in features that allow project leaders to reward contributors with various non-monetary tokens of appreciation, securities regulations in most countries do not make allowances for crowdfunding campaigns to provide contributors with ownership equity in their projects in exchange for contributions.

Crowdfunding therefore amounts to a method for raising community-sourced, non-repayable grants for projects and enterprises.

In addition to providing a valuable alternative method of financing independent of banks, stock and bond markets, crowdfunding can serve as a useful means of engaging and informing the community about a project, and of gauging public demand for or interest in the project or product being proposed. By virally spreading awareness, crowdfunded projects can pick up collaborators, ideas, leads and customers in addition to financing.

- **Community microlending.** Microlending, the concept of granting unusually small loans to non-traditional loan recipients (poor people without collateral or credit history), was pioneered by Nobel Laureate Muhammad Yunus of Bangladesh, who founded the Grameen Bank dedicated to microlending in Bangladeshi villages in 1983. Microlending has since been widely transplanted to developing countries all over the world.

  In 2006, an organisation called Kiva Microfunds (www.kiva.org) launched a website that revolutionised microlending by making it possible for anyone with an internet connection and a credit card to find entrepreneurs in any country and lend as little as $25 towards the fulfillment of their loans. Lenders are then reimbursed, without interest, over time as borrowers repay their loans.

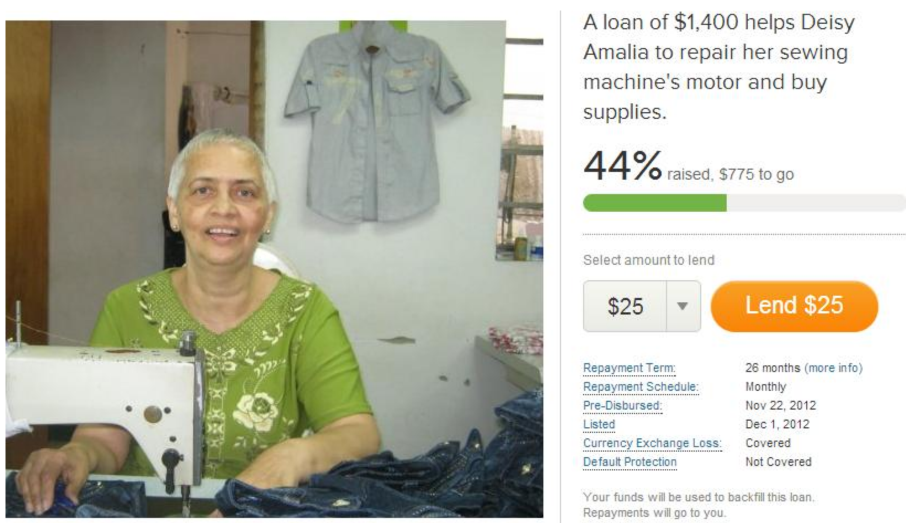


Figure 2 A sample of Kiva's easy-to-use microlending platform, connecting borrowers and lenders across the globe.

  Although popularly associated with developing countries, microlending has lately been making inroads into First World countries as well, accelerated by the needs that have emerged in the post-2008 economic climate of high unemployment and barriers to traditional sources of credit. Thus, in 2010 Kiva added the United States to its roster of countries whose entrepreneurs could seeks loans using the website. Another example of First World microlending is the Community Microlending Society (www.communitymicrolending.ca) based in Victoria, Canada, founded in

2009. Community Microlending facilitates small loans of $500 and up between community members and local entrepreneurs with barriers to traditional credit, while also matching loan recipients with mentors from the community to help ensure that their businesses get off to a good start.

It should be noted that the “innovations” named above are not brand new concepts, but very old practices that have been resurrected for our time (“the new old way”). Throughout history, communities have used their own currencies, whether they have taken the form of physical tokens, more or less formalised systems of mutual credit, or the social currency of the gift economy. Crowdfunding has its antecedent in the old-fashioned “barn-raising”, in which many community members combine labour, materials, money and other resources to quickly assemble a barn for a neighbour or a community project such as a school or place of worship. Microlending, too, has existed in one form or another throughout history, although it had been largely stymied and complicated in more recent times with the widespread adoption of securities laws that make it for the most part illegal for non-high net worth individuals to lend to or invest in a business not controlled by a close friend or family member.

In a manner to be detailed below, **covestment** will combine aspects of all of the above innovations and constitute a powerful alternative to traditional modes of investment and financing characterised by the following:

- Credit will be issued, not by financial institutions, but by value-added businesses in the community. As such, covestment financing is largely insulated from external financial volatility and is grounded in the real economy of a community or region.
- Credit will enter the community via the projects being funded in the form of business-backed community currencies. Covestment will thus augment rather than displace spending power in the community. Because community currencies are only useful within the communities that issue them, they are guaranteed to remain in circulation within their communities. This has the beneficial effect of encouraging a shift towards more localised sourcing and consumption patterns while more efficiently employing the human and physical capital of communities towards the satisfaction of local needs.
- Covestment will not require covestors to defer spending power, but rather to shift spending power to a local network of community-minded businesses.
- Covestment will effectively shield covestors from financial risk should the projects they covest in fail. It does this by creating a resilient *community credit commons* capable of absorbing risk.
- Because of the above two characteristics (no deferral of spending power and little or no financial risk), covestment can take place on an interest-free basis.
- By immediately including new business enterprises in the community currency network (and permitting the repayment of loans in community currency), and by engaging many members of the local business community and the public in the covestment project, new enterprises are born into a supportive economic and social ecosystem that drastically improves their chances of success.

How will covestment work?

Covestment is an “ecological” approach to collaborative finance that involves several different actors in the community playing different roles, which shall be outlined below.

Figure 3 In this schematic depiction of the community covestment process, community currency is represented by the seed-shaped logo for Seedstock, a community currency in Vancouver, Canada.

1. Local businesses covest by underwriting community currency

Here, local businesses play essentially the same role as they play in the classic Community Way model: they are the underwriters of the local community currency. That is to say, they give value to the community currency by making an agreement to honour that currency as (usually partial) payment for their goods or services (typically for the portion of the price that represents the business’ own local value-added).

As underwriters of the currency, businesses are entitled to *issue* a specific quantity (depending on their size or other indicators of their capacity) of the currency into circulation. In the classic Community Way model, this currency enters into circulation by being gifted by the issuing businesses to local non-profits. The covestment model provides for the additional possibility that businesses may contribute the community currency that they underwrite to a Community Covestment Fund, or specifically to a local entrepreneur that they wish to support.

A Community Covestment Fund may operate such that covestments of community currency by businesses are treated as donations to the fund, creating a permanent endowment (a community credit commons), or as temporary loans of community currency to the fund, to be retired over time.

As issuers of the community currency, businesses are responsible for honouring the community currency at the declared terms for at least as long as they have an outstanding commitment to the network (i.e. currency that they have issued but not yet re-absorbed back into their business). This is analogous to a business' responsibility for honouring gift certificates or other forms of promissory notes that it may issue for as long as they are outstanding.

Motivations for businesses to covest

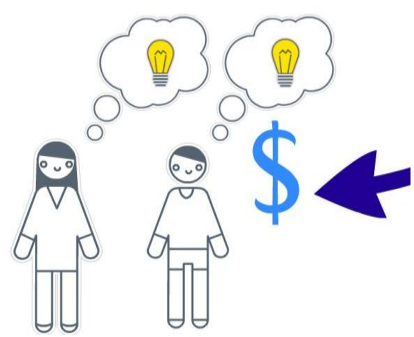
Businesses have all the same motivations for covesting as they enjoy under the classic Community Way model, namely:

- They get to use money they didn't know they had to support community investments that they care about. In some cases, the entrepreneurs seeking covestment funds may be personal friends or family members of local business owners, providing a more personal motivation for involvement. In all cases, businesses seen to be covesting in the community will enjoy significant public relations benefits.
- By participating in the community currency network, local business will attract new customers without undercutting the value of its goods or services by slashing prices or handing out discounts. By accepting partial payment in the community currency, businesses not only attract customers with community currency to spend, but they themselves can spend and receive value from the currency that they earn.

2. Local entrepreneurs apply for loans from the Community Covestment Fund

The Community Covestment Fund will be specially geared towards the financing of community projects and enterprises that contribute to the common well-being of the community. Priorities may differ in every community, but some examples might include:

- Farming and other local food enterprises
- Community renewable energy utilities
- Home retrofitting programs
- Affordable housing
- Small, sustainable businesses
- Collaborative consumption initiatives such as tool libraries, car-sharing co-ops, etc



An interesting feature of the Community Covestment program is that it will automatically integrate new enterprises into the community currency network; the new enterprises will not only accept community currency as part payment for their goods and services, but will be able to repay their loan from the Community Covestment Fund in community currency as well.

The Community Covestment Fund may create an online portal where applicants and their projects are featured, making it easy for potential covestors (local businesses and community members) to find and support local entrepreneurs.

3. Community members covest by changing their money

Now that local businesses have seeded the Community Covestment Fund with business-backed community currency and local entrepreneurs have applied for loans, the next step is to convert the community currency in the Covestment Fund into the national currency that entrepreneurs will need to get started. This is where anyone in the community can step in.

We envision an online platform very similar to what one would see on a crowdfunding website or on the Kiva.org microlending site. The platform would allow individuals to find entrepreneurs based on locality or enterprise type, and it would feature profiles of the entrepreneurs as well as details of their proposed projects/enterprises and the amount of funding being sought.

Very similar to a crowdfunding or microlending site, individuals can covest in projects and enterprises that they like with amounts of perhaps as little as $10 or as much as the total amount being sought by the entrepreneur.

Where covesting differs from traditional crowdfunding, however, is that instead of being offered a token reward for their contributions, covestors will be offered an amount of community currency equivalent to their cash contributions. The community currency can be spent at a whole network of participating businesses, which means that effectively, covesting in a local entrepreneur costs nothing; it simply requires an exchange of one form of money for another, the latter being one exclusive to the local economy. By covesting in a local entrepreneur, therefore, individuals not only help to establish new sustainable enterprises providing useful services and meaningful livelihoods in their communities, but are contributing to a larger community economic ecosystem as well, driven by its own internally circulating currency.

Covesting differs from traditional microlending as well, in that covestors are not actually making loans to entrepreneurs, but are changing their money in a way that happens to directly contribute to the fulfillment of loans. This is what we refer to as a **community credit commons**; no individual in this scenario is left bearing the risk of default on the part of the entrepreneur, and entrepreneurs owe their repayments, not to private individuals, but to the community credit commons as represented by the Community Covestment Fund.

Covesting and securities regulations

A problem that bedevils peer-to-peer lending schemes in many countries is securities regulations which make it illegal for individuals who are not “accredited investors” to lend money to or buy equity in a private business that is not controlled by a close friend, family member, or business partner. In Canada and the United States, accredited investors include financial institutions, stockbrokers and individuals with a net worth of $1,000,000 (excluding the value of their home) or an annual income of at least $200,000.

An additional advantage of the covestment scheme described above is that it works around the securities regulations very effectively. Individual covestors do not in fact lend money to entrepreneurs, but purchase community currency from the Community Covestment Fund so that the funds can then be lent to entrepreneurs. In some jurisdictions (including British Columbia, Canada) it is legally permitted for an incorporated society to lend out money for purposes in keeping with the society’s constitution (which may include microlending). It may therefore suffice for a Community Covestment Fund to be incorporated as a society whose purpose is to administer loans to local entrepreneurs.

In cases where it is legally problematic for an incorporated society to engage in microlending, another option would be to partner with an accredited lending institution such as a credit union, which can administer the loans in its own right.

Summary

In this idea paper, we have introduced a new concept that we are called *covestment* – an idea that, we believe, can transform the way communities finance new enterprises and community projects for which traditional financing methods are either too expensive or unavailable.

Covestment promises to be a powerful community economic development tool, weaving together three successfully demonstrated financing technologies: business-backed community currencies, crowdfunding and community microlending. It utilises the ability of businesses to create money underwritten by the value of their goods and services to add an additional community monetary layer on top of the conventional money economy. It then leverages this new layer to create a *community credit commons*, financing loans to local entrepreneurs and community projects by encouraging individual community members to change some of their money for community currency, which they can then spend at local businesses. Local businesses benefit from this arrangement by attracting more (and more loyal) customers with the community currency, while individual community members enjoy a concrete, effective and yet easy way to effect positive change in their communities without losing spending power in local businesses. Covestment allows anyone to invest in his or her community – regardless of means, and without falling afoul of securities regulations.