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**SOCIAL ECONOMY AND CENTRAL BANKS: LEGAL AND REGULATORY  
ISSUES ON SOCIAL CURRENCIES (SOCIAL MONEY) AS A PUBLIC  
POLICY INSTRUMENT CONSISTENT WITH MONETARY POLICY**

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**Abstract**

In Brazil, the National Secretariat for Solidarity Economy has encouraged the establishment of Community Development Banks that issue “social currencies for local circulation”, and has struggled to set up a regulatory framework for the use of social currencies, by means of public policies for solidarity finance, at the federal, state, and municipal levels of governments. Can social currencies be regarded as public policy instruments compatible with monetary policy under the responsibility of central banks? With the aim of systematizing this question and allowing the Central bank of Brazil to elaborate a reference study on this subject, this essay defines social currencies on the basis of constitutional precepts; identifies and examines legal and regulatory issues and logistical and operational aspects relating to social currency systems; and investigates why social currencies should be regarded as public policy instruments for local development compatible with monetary policy.

## **Resumé**

Au Brésil, le Secrétariat d'État à l'Économie Solidaire stimule la création de Banques Communautaires de Développement, en les permettant d'émettre des « monnaies sociales pour la ciruclation locale » et s'efforce d'établir un cadre réglementaire pour l'usage de monnaies sociales au moyen de politiques publiques de finances solidaires sur les trois niveaux de gouvernement : pouvoir central, des états et des municipalités. Or, peut-on considérer que les monnaies sociales sont des instruments de politiques publiques compatibles avec la politique monétaire conduite par les banques centrales ? Pour systématiser cette question et permettre à la Banque centrale du Brésil d'élaborer une étude de référence sur ce sujet, cet essai commence par définir ce que sont les monnaies sociales sur la base des précepts da la constitution. Il identifie et examine ensuite les questions légales et réglementaires et certains aspects logistiques et opérationnels liés aux systèmes de monnaies sociales pour finalement montrer pourquoi les monnaies sociales peuvent être considérées comme des instruments de politiques publiques de développement local compatibles avec la politique monétaire.

## **Resumen**

En Brasil, la Secretaría Nacional de Economía Solidaria ha estado incentivando la creación de Bancos Comunitarios de Desarrollo para la emisión de “monedas sociales de circulación local” y está luchando por el establecimiento de un hito regulatorio para el uso de monedas sociales, mediante políticas públicas de finanzas solidarias en las tres esferas de gobierno: federal, estatal y municipal. ¿Podrán las monedas sociales ser consideradas como instrumentos de políticas públicas compatibles con la política monetaria bajo la responsabilidad de los bancos centrales? Con el objetivo de sistematizar la cuestión y permitir al Banco Central de Brasil a elaborar una investigación de referencia sobre este tema, este ensayo define lo que son monedas sociales a partir de fundamentos constitucionales; identifica y examina cuestiones legales y regulatorias y aspectos logísticos y operacionales relacionados a los sistemas de monedas sociales; y verifica por qué las monedas sociales pueden ser consideradas como instrumentos de políticas públicas de desarrollo local compatibles con la política monetaria.

**Keywords:** Social Economy; Central Bank; Social Money; Social Currencies; Community Currencies; Community Development Banks.

## 1. INTRODUCTION

The aim of Social Economy or Solidarity Economy<sup>1</sup> is to set public policies that are different from those relating to Public Economy and Private Economy, particularly as regards the State's efforts to combat poverty and foster development at the local level. In Brazil, the National Secretariat for Solidarity Economy has encouraged the establishment of *Community Development Banks*, as non-profit organizations responsible for issuing “*social currencies for local circulation*”, and has struggled to establish a regulatory framework for a solidarity financial policy through the use of social currencies at the federal, state, and municipal levels of governments throughout Brazil (MTE, 2006).

The Central Bank of Brazil, fully aware of events, and pursuant to its constitutionally-defined role of issuer of currency and regulator of the money supply and of interest rates in the Brazilian economy (art. 164 of Brazil's 1988 Federal Constitution), of supervisor of banking institutions (art. 192 of the Constitution and Law 4.595/64) and of regulator and supervisor of the Brazilian payments system (Law 10.214/01) is engaged in a project to research and evaluate the main theoretical and practical aspects of worldwide experiences with *social currencies*, with a view to creating mechanisms to enable permanent monitoring of developments in the field of issuing and use of *social currencies* in Brazil, in the light of the results of the research.

This brief paper presents the preliminary results of an investigation into social currency systems which, by means of systemic, functional, historical, and compared analysis, has sought to systematize the issue with a view to using it as a reference study currently being undertaken by the Central Bank of Brazil, by identifying the main legal and regulatory issues and relevant operational aspects relating to the use of social currencies, and by examining the reasons why social currencies should be regarded as public policy instruments for local development which are compatible with monetary policies to be taken under the responsibility of the Central Bank.

The paper is divided into four sections, an introduction and conclusions:

- What are social currencies.
- How social currencies work.
- Legal and regulatory framework.
- Why social currencies should be regarded as a public policy instrument for local development which are compatible with Central Bank's monetary policies.

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<sup>1</sup> “Solidarity Economy is fruit of the organization of workers in the construction of new economical and social practices based on relations of solidary partnership, and inspired on cultural values where men and women are protagonists and the purpose of the economic activity, and not the private accumulation of wealth in general and capital in particular”. “In our country, the growth of the Solidarity Economy as a movement – going beyond isolated, independent actions, and organizing itself towards a common association, networks configuration and struggle - takes a significant leap with the World Social Forums, a privileged space where different actors, organizations, initiatives and solidarity economy enterprises were able to develop an integrated work that resulted in a demand presented to newly elected president Lula to create a Solidarity Economy National Secretariat (SENAES). Together with the creation of this Secretariat, the Brazilian Forum of Solidarity Economy was created during the III Solidarity Economy National Plenary that represents this movement in Brazil. We can say that these two organizations, plus the World Social Forum, led the Solidarity Economy in Brazil to a significant growth and structuring.” (FBES, 2006)

## 2. WHAT ARE SOCIAL CURRENCIES

Use of *social currencies* is not a new phenomenon (DeMeulenaere, 2000) and has been tolerated by central banks in various countries, with the argument that they promote development of local economies (Lietaer, 2001; Rösl, 2006; Schraven, 2001). Brazil too, like other countries, has had various experiences with social currencies (Melo & Magalhães, 2006; Soares, 2006; Silva, 2005).

The concept of social currencies tends to be immediately associated with currencies produced by society<sup>2</sup>, in contrast to the concept of legal tender<sup>3</sup> – an established national currency whose monopolized issue in Brazil (as is generally the case in most other jurisdictions) rests with the Central Bank of Brazil (art. 164 of the Federal Constitution)<sup>4</sup>. Hence, it is no coincidence that historically, social currencies have been at the center of a deep controversy among economists.

One extreme of economic thought regards the currency as an institutional element wholly subordinated to central controls established by monetary authorities, and that such controls must be the exclusive realm of central banks, that administer the money supply based on what is known as monetary policy (Lopes & Rosseti, 2005). On the other hand, another extreme of economic thought argues that the money supply need not be subordinated to central control, given that it is generated by the needs of the economy itself; and that, consequently, the Central Bank is incapable of controlling the money supply, which is a variable determined by society, that creates and destroys the currency, in accordance with its immediate needs and convenience (Lopes & Rosseti, 2005).

The truth of the matter is that, in all social circumstances and at any point in history, when the monetary authorities cease to issue sufficient currency to fulfill the needs of business, companies begin to issue various forms of credit securities (Lopes & Rosseti, 2005). This, in turn, results in:

- (a) creation of one or of many monetary systems, in parallel to the official currency;
- (b) a perception that parallel currencies are alternatives to national currencies;
- (c) discussions as to the need to rethink the role of the centralized monetary system, in favor of the development of local economies (Solomon, 1996; Swann & Witt, 1995; Douthwaite, 2006).

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<sup>2</sup> Social currency is defined as anything used for making payments in exchange of goods and services and accounting for debts and credits, created or produced outside of the centralized banking system. Social currencies can be created by non-profits (ex.: Banco Palmas), cooperatives (ex.: WIRBank, Switzerland), corporations (ex.: Bartercard) and even by governments (ex.: patacón, Province of Buenos Aires, Argentina and Labour Certificate at Wörgl, Austria). In Brazil, cooperatives are regulated and supervised by the Central Bank. There are no cooperatives and governments issuing social currency in Brazil.

<sup>3</sup> Tender is an unconditional offer of money or performance to satisfy a debt or obligation; Legal tender is the money approved by a country for the payment of debts, the purchase of goods, and other exchange for value.

<sup>4</sup> “Central bank means the bank or banking system in any country to which has been entrusted the duty of regulating the volume of currency and credit in that country; or in a cross-border central banking system, the national central banks and the common central banking system, the national central banks and the common central banking institution which are entrusted to such duty.” (BIS, 2005).

A review of the specialized literature, however, shows that social currencies are payment instruments or systems, created and administered by their users, by means of non-profit associations, on the basis of economic relations built upon cooperation and solidarity of the participants of certain communities, regardless of exercise of any form of financial intermediation activity (MTE, 2006).

From an economic standpoint, social currencies are considered a “market mechanism”, and thus, an institution of the economic order (art. 170, of the Federal Constitution) capable of fulfilling some of the functions of the social welfare system. From a social standpoint, social currencies are considered as an alternative means of promoting access to goods and services that would otherwise be inaccessible to their users, thereby constituting an institution of the social order that complements the official currency, at the basis of which lies the fruits of labor, and that aims to instill well being and social justice (art. 193, of the Federal Constitution).

From a functional standpoint, social currencies constitute a new way of promoting integration of people into the labor market (art. 203, III, of the Federal Constitution). Their use, even when stemming from public policies for combating poverty and promoting local development, is not to be confused with other programs for allocation of resources and income transfers from the richer to the poorer segments of the population (MTE, 2006), which should be perceived as a form of social welfare that should be provided by the State to those in need, regardless of whether or not they contribute toward social security (art. 203, of the Federal Constitution).

From a legal standpoint, social currencies promote access to social rights (art. 6, of the Federal Constitution) by means of a contractual agreement signed by members of a given community, grouped by regional or sectoral criteria. Social currencies are considered as personalized or customized currencies (or forms of money), in that they are legally-structured instruments or systems that advance the purposes and aims aspired to by participants of the social groups that use them (Lietaer & Hallsmith, 2006). Though they submit to the legal disciplines of Law of Contracts and Law of Obligations (one of the components of private law elements of the civil law system), social currencies have neither the status of legal tender, nor full settlement value assured by law. No one is (nor can be) obliged to accept a social currency or to participate in a social currency system. Like any other economic or social activity, social currency systems are subject to normative rules in situations foreseen in Law (art. 5 and art. 170, of the Federal Constitution).

Despite implications of higher costs and higher risks for the holders of social currencies, in relation to the official currency, the use of social currencies has multiplied as a reaction of local communities to the globalization process (Rösl, 2006). This phenomenon is associated to the fact that, when the official currency proves incapable of facilitating all potential exchanges within a local economy, a complementary currency may alleviate the problem (Schraven, 2001). Thus, even with higher transaction costs than those associated with use of the official currency, there is nonetheless an incentive for people to use social currencies in their day-to-day transactions in local economies (Schraven, 2001).

By adopting as a reference the classification of alternative forms of wealth used in the quantitative theory of money approach developed by Milton Friedman, according to which total wealth is also comprised of human wealth, and not only of material wealth – money, variable-income securities, fixed income securities, physical goods, property and other material assets (Lopes & Rosseti, 2005) – it is possible to define social currencies as non-

financial wealth, related to application of human wealth in the production process and in the process of circulation and distribution of physical goods and services produced by human labor.

### 3. HOW SOCIAL CURRENCIES WORK

By complementing lawful fiat money, the issuing of which is underwritten and monopolized by the State, and which has the status of legal tender and full settlement value assured by law (Lopes & Rosseti, 2005), and private banking money (bank deposits), created by commercial banks, which account for a major portion of the means of payment employed in accordance with the conventional concept of money used in almost all countries (Lopes & Rosseti, 2005), *social currencies* can present significant variability of form and of denomination, depending upon the specific purposes for which they were created.

In dealing with legal business compacted by a collective group of people, who are subject of individual rights, the three essential elements for establishment and functioning of a social currency system are: people; choices; and rules. To be valid, capable agents, a determined or determinable legitimate purpose, and a form prescribed or not forbidden by Law are required (art. 104 of Law 10.406/02).

Based upon the concept of freedom to contract and, in principle, established according to standards that govern atypical contracts (arts. 421 and others of Law 10.406/02) it is not possible to speak of *one* ideal model for a ground and sound functioning of social currency systems. The ideal design for a ground and sound functioning of the system depends upon a series of variable circumstances of fact and of law, conditioned by social realities of the context in which the social currency is implanted and, particularly, by the way in which the local population makes its livelihood (Lietaer, 2001; Schraven, 2001).

In practice, all models for a ground and sound functioning of social currency systems have some characteristics that are advantageous in certain situations, but that may be perceived as being not advantageous in others (Lietaer, 2001). Nonetheless, theoretically, most models of social currency systems share certain common characteristics:

- (a) They function legally in over 35 countries: social currency systems tend to be established where constitutional, legal, and regulatory standards allow space for private enterprise; or where there are gaps in financial, banking, and monetary regulation or legislation (DeMeulenaere, 2000; Lietaer, 2001; Schraven, 2001).
- (b) Social currencies are issued to associate members that have accounts in the social currency system, and are known as participants.<sup>5</sup>

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<sup>5</sup> While this situation is very clear in community currency systems such as LETS, Time Dollar and WIRBank that requires users to have a debt-credit account, this is still to be true even in some initiatives, such as Chiemgauer in Bavaria, Germany, Ithaca Hours in New York, United States and Banco Palmas in Fortaleza, Brazil, when we consider the unit of account function of money. In these latter cases the use of a common unit of account by participants defines their membership to a same monetary space or community. "Using a unit of account sets up a relationship between each economic agent and the society [community] of traders as a whole" (Aglietta, 2002). One should avoid the "tendency to confuse *specific forms* of money – metal, paper, electronic impulses, etc. – with the *generic properties of money as measure and bearer of abstract value*. As expressed in the opening lines of Keynes's *A Treatise of Money*: 'Money-of-account, namely that in which debts and prices

- (c) They are controlled by the participants by means of representative organizations.
- (d) Social currencies circulate only in a given or limited geographic or sectoral area defined by the associates or participants of the system, and can only be used or spent and accepted within said areas.
- (e) Social currencies do not fulfill all functions of the legal tender currency, but rather, only those associated with the goals of the particular system.
- (f) The essential characteristic of social currencies is (or ought to be) reciprocity, whereby the costs and benefits of the system are (or ought to be) fairly distributed among the participants, coordinators, and managers of the system, in accordance with the level of participation of each, so that no one benefits (or appropriates) unforeseen advantages at the cost of the labor of others.
- (g) Since they are complementary, transactions in social currency generally function (or ought to function) in a counter-cyclical manner, both in relation to monetary policy, and to employment levels in the formal economy. Thus, when the official money supply expands, transactions in social currency decline; and when the official money supply declines, transactions in social currency expand. Likewise, when the level of employment in the formal economy expands, transactions in social currency decline; and when the level of employment in the formal economy declines, transactions in social currency expand.<sup>6</sup>

Aside from these common characteristics, the functioning of social currency systems depends upon logistical and operational aspects that contribute toward economic efficiency of the system (Lietaer & Hallsmith, 2006), and which are established by basic contractual clauses of the legal framework that differentiate the various social currency systems. Such aspects are listed and briefly commented upon below:

### **3.1. Requirements for participation and rules for coordination and management of the system.**

One of the most important aspects for a ground and sound functioning of a social currency system relates to the quality of the participants in the social group, and of individual members

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and general purchasing power are *expressed*, is the primary concept in a theory of money' ... These qualities are generated by the *social relation* between the issuer and the user. ...*Monetary spaces* are created by social and political relations that exist independently of the exchanges between transacting economic agents. The *form* of money and its *mode of transmission* are of secondary importance" (Ingham, 2002).

<sup>6</sup> "A quantitative study on the *direct evidence on this issue* was conducted by Dr. James P. Stodder, Professor at the well-respected Lally School of Management & Technology at Rensselaer University. It is based on the high quality data from the Swiss WIR system. His conclusion: '*The WIR system is counter-cyclical, rising and falling against, rather than with, the business cycle... because... credit advanced by the WIR is highly counter-cyclical, correlated against GDP*' (Stodder, 2000). '*This contributes measurably to the stability of the Swiss economy, because WIR credits automatically expand when the economy turns down, i.e., when credit in conventional Swiss Francs dries up*' (Stodder, 2000). Furthermore, the WIR system also stabilizes employment. '*Growth in the number of WIR participants has tracked Swiss Unemployment very closely, consistently maintaining a rate of about one-tenth the increase in the number of unemployed*' (Stodder, 2000). This means that when the conventional Swiss Franc economy slows, job losses are partly avoided by having more people getting involved in the WIR economy". (Kiuchi, 2004)

of the team responsible for its coordination and management. It is necessary that participants be actively engaged in the selection of goals and in the design of the legal framework of the system. Members of the coordination and management team, for their part, must have the capacity to assist the group in attaining its selected goals, by maintaining contact and engaging with the target public, and by adopting a posture aimed at expanding the system by means of finding and incorporating new members that add value to the group. To this end, it is very important that the rules that establish the rights of participants and dispute-resolution mechanisms be clear and well understood by all.

### **3.2. Objectives for which a social currency is created.**

From this aspect, social currency systems may have:

3.2.1. *Commercial objectives* – when their purpose is to effect payment among businesspeople (*Business to Business – B2B*); between businesspeople and consumers (*Business to Consumer – B2C*); among consumers (*C2C – Consumer to Consumer – C2C*); or between consumers or businesspeople (*Consumer to Business – C2B*);

3.2.2. *Sectoral objectives*, when they pursue social ends without commercial nature, such as assistance to the elderly, education, environmental protection, nurturing cultural activities, combating unemployment, strengthening local economies, reinforcing the collective identity of a social group, or any of a great number of other social purposes; or,

3.2.3. A combination of *commercial objectives* with *sectoral objectives*.

### **3.3. Mechanisms for functioning of the system,**

The mechanisms for functioning of the system involve definitions with respect to:

3.3.1. *The medium of support by which the social currency is represented*, which may be a given good, metal, or paper (as is the case of official paper currency, bonds, or coupons); a system of records (on paper or electronic medium, that may or not involve specific software applications for social currencies); or a mix of these media. It should be noted that, regardless of the medium of support used to represent the currency, or the functions it performs and the procedures related to its issuing (that will be examined shortly), any kind of currency may be considered a credit instrument that corresponds to an abstract indicator of economic value – or of exchange value in the real economy (Cozer, 2006) –; the same being true for social currencies.

3.3.2. *Functions of a social currency*. All currencies can be classified in accordance with the three most important functions of a currency in classical economics, namely: accounting units; medium of exchange or payment; and standard of value or store of value. Generally, social currencies are not expected to serve as a store of value, the monopoly for which is left to the official national currency. Thus, in general, the accounting units of social currencies are set at a standard value, pegged to the unit of the official currency (e.g. *Palmares* and *Rubi*, in Brazil; *LETS*). There are, however, certain exceptions, such as currencies based on time (hours or minutes – e.g. “Time Dollars System” and “Japanese Fureai Kippu”) or on

physical units (e.g. KWh of renewable energy, generated by popular cooperatives, e.g. *WAT* in Japan and the *Wara* currency, used in Germany between 1920 and 1930).

*3.3.3. Rules for issuing a social currency.* Although the various systems may present different legal procedures for the issuing of social currencies, when basic issuing rules and monetary systems are considered, they can be broken down into three broad categories, associated to the guarantees and risks involved in the use of the social currency and thus, to the costs of the social currency system. According to these categories, a social currency may be: (a) a *fiduciary currency* (or *fiat money*) – issued and administered by a central authority and based upon the confidence that a community has in itself (e.g. *Ithaca Hours*); (b) a *backed currency* (*currency backed by an external reference or a medium of exchange*) – when such exchanges are conducted as a function of products and services, directly (direct exchange) or indirectly by means of vouchers, coupons, or a points system convertible into a given quantity of products or services (e.g. *e-Barter* and *mileage programs*); and (c) a *social currency in a mutual* (or *reciprocal*) *credit system*, under which a unit of the social currency account can be referenced by the unit of the official currency (e.g. *LETS*, *ROCS*) or by some other agreed unit (e.g. *Time Dollars*). Whereas a *fiduciary currency* (*fiat money*) presents a greater risk of non-controlled issuing, and a *backed currency* presents no major risk of non-controlled issuing, it can be observed that social currency systems that function as a *mutual or reciprocal credit systems* have the capacity to adjust to the money supply, in an endogenous manner, as the participants carry out their transactions (Schraven, 2001). This is the principal characteristic of the use social currencies in *mutual or reciprocal credit systems*.

#### **3.4. Circulation system.**

When considered in relation to the circulation system, social currency systems are different to, and maintain a certain independence from, the financial intermediation system controlled by the Central Bank, in which creation and multiplication of the currency are related to the process of attracting deposits from the public by means of financial intermediaries, for subsequent lending, with the application of interest rate charges. To achieve success as a complementary currency, a social currency needs to “be *circulated in a circle*”, forming a closed loop, that involves only participants in the system, both with respect to exchanges of the social currency for goods and services, and exchanges of goods and services for the social currency. Even in social currency systems with a legal framework that allows the social currency to be exchanged for the official one, such exchanges occur (or ought to occur) in a manner similar to the exchange of national currency for foreign currencies, and should thus not characterize a banking or financial intermediation activity.

Many social currency systems fail in this aspect, by totally neglecting the need to close the monetary circle (or loop) between participants in the system. In such cases, the social currency system tends to deteriorate or to cause effects that are undesirable in terms of the objectives of monetary policy; by frustrating the aims of users of the social currency; or by requiring intervention by the central bank. When there is a physical support medium (paper, metal, or goods) circulating in the social currency system, there is a greater risk of leakage from the closed loop and thus, although the initial implantation costs are lower, the long-term risks and costs of sustaining the system are greater. Conversely, when there is no physical support medium circulating in the social currency system, but only a set of recorded information relating to transactions carried out by participants in the system (e.g. in a business ledger, or by means of software with computerized records, that may be on-line or

off-line with the use of smart cards). In such cases, aside from facilitating monitoring and inspection by the public authorities and by participants in the system, the initial costs of implantation of the social currency system are greater; however, the long-term risks and costs of sustaining the system are reduced.

By adopting as references: (a) *participation of a providing entity* (creator or provider) of a social currency in the monetary loop; (b) the *currency cycle*, consubstantiated by the way in which the social currency is created (originated), distributed, issued (put into circulation) and redeemed (withdrawn from circulation);<sup>7</sup> and (c) *responsibility for redemption* of the social currency; circulation systems of social currencies can be classified into three broad categories, listed below, based upon which distinct legal and regulatory issues will subsequently be more closely examined:

*3.4.1. Direct participation of the provider:* The provider of the social currency participates directly at all stages of the social currency cycle (i.e., in the process of its creation, distribution, issuing, and redemption). The provider of the social currency receives official currency, financial assets, or goods and services in the real economy, and uses the social currency that he issues (securities, bonds, or notes) to pay for them, based upon the confidence that the participants have with respect to the functioning of the system. Responsibility for redeeming social currencies lies with their providers and issuers, and said social currencies are redeemed when they are accepted as payment for goods and services provided in the real economy (e.g. advertising and dissemination services) or in exchange for official currency or financial assets held by the provider. If there is no adequate supply of goods and services in the real economy to meet the demand for payments in social currency and if no adequate provision of official currency is made, as capital fund or reserves for the social currency system for effecting redemption, the system will go into collapse, in the same way as the official monetary system would; and there will be obligations in official currency to be settled by the provider and issuer of the social currency.

*3.4.2. Indirect participation of the provider:* Although the provider of the social currency coordinates and manages activities of the social currency system, he does not participate directly in the process of issuing and redeeming the social currency. He merely acts as an agent of the issuer, creating and distributing the social currency to direct participants in the system that issue it, putting it into circulation, for use as a means of payment or exchange against purchases of goods and services that take place in the real economy. The issuer receives social currency from the provider of the social currency, and uses social currency that he himself issues to pay for it. This is possible because, generally, the direct participants in the system (who issue social currency) believe that there is surplus idle productive capacity for the provision of goods or of services in the real economy, which could be put to better use. Responsibility for redemption of a social currency lies with the issuer, who is a direct participant in the system, and the social currency is redeemed when it is accepted in payment for goods and services provided by the issuer in the real economy. If there is no adequate supply of goods and services in the real economy to meet the demand for payments in social currency, the system will also enter into collapse. However, this will not occur in the same way as it would with the official monetary system, nor in the same way as it would in a direct participation system. In this case, there would merely be obligations to produce or deliver

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<sup>7</sup> A distinction is made between the process of creation of a currency and the process of issuing the currency: whereas the former refers to “production” of the currency or to the form whereby the currency originates, the latter refers to placement of the currency in circulation. Redemption, on the other hand, refers to withdrawal of the currency from circulation.

goods and services in the real economy to be settled by the participant issuer, and there would be no obligations in official currency on the part of the provider of the social currency.

*3.4.3. Community system:* Under a community system, the provider of the social currency who coordinates and manages the activities of the social currency system, once again, does not participate directly in the process of issuing and redeeming the social currency, but merely acts as the agent of non-profit organizations that participate in the system, by creating and distributing social currencies, so that they (the non-profit organizations that participate in the system) can issue or put the social currency into circulation for use as payment for goods and services provided even by other categories of participants in the system (e.g. volunteers, workers and entrepreneurs). This is thus different from the system of indirect participation because the issuer (non-profit organizations that participate in the system) receives the social currency created by the provider of the social currency, on the basis of donations that the issuer (or the social currency system) receives from other participants (entrepreneurial participants). Issuing of the social currency in this case is also based upon the belief that there is surplus idle productive capacity for the provision of goods or of services on the part of some of the business participants in the system in the real economy, which could be put to better use by the participants in the system. In a community system, creation of a social currency is associated to donations from certain entrepreneurial participants (generally companies with a sound financial position) to non-profit organizations that are also participants in the system, and that take care of its issuing. Responsibility for redemption of the social currency in this case is shared by all the business and people participants in the system, who assume a commitment to receive social currencies as payment for goods and services that are provided by them in the real economy. Thus, the social currency is redeemed when it is accepted as payment for goods and services provided by any of the participants in the system, even if they are not the issuer. If the commitment to supply goods and services in the real economy against payment in social currency is not fulfilled, the system will also enter into collapse, however, not in the same way as would occur with the official monetary system, nor in the same way as would occur in a direct or indirect participation system. In the case of a community system, also, there is merely the obligation to make or deliver goods and services in the real economy, but no obligation in official currency to be settled by the provider of the social currency, as there is in the indirect participant system. However, the obligation to make or deliver goods and services in the real economy may be settled by any of the direct participant in the system, regardless of whether or not he is the issuer.

### **3.5. Financing and cost-recovery system.**

All systems used to effect payments entail costs in official currency and in social currency in order to keep them in operation (corresponding to costs of remunerating people and operational infrastructure expenses). When costs in conventional currency are very high, it is difficult for the system to remain functioning. Rules for recovering costs can be based upon non-variable tariffs (periodic charges, entrance fees, fees for associated services, etc); tariffs per transaction; low interest rates or devaluation of the face value of the social currency; or other time-related charges; or a combination of such items. If the system fails to set adequate financing and cost recovery rules, it will become unsustainable over time. Aside from cost recovery rules, it is important that there be incentive mechanisms so that participants can conduct their transactions using social currencies, and such incentive mechanisms should be aligned to the objectives of the system. Also, rules for appropriation of revenues and

provision of resources (e.g. capital funding or reserve requirements) to cover non-paid debts by the participants need to be set.

### **3.6. Form of social organization.**

The most adequate form of social organization for each social currency system depends on a background set of logistical and operational aspects that set the legal regulations for the social currency system and determine the applicable legal and regulatory framework, including whether or not the system needs to be authorized by the Central Bank of Brazil (e.g. Law 4.595/64, and Law 10.214/01) or by some other public authority (e.g. Law 5.678/71, that sets standards for protection of the popular economy, and is regulated by Decree 70.951/92).

## **4. LEGAL AND REGULATORY FRAMEWORK**

Specifically with respect to the legal and regulatory framework to which social currency systems are submitted, as is also the case in other jurisdictions, many aspects remain open to discussion (Kuttner & McAndrews, 2001). For example: the legal and regulatory framework itself, by virtue of its various legal structures; consumer protection law (or rights of the participants); dispute-settlement mechanism; guarantee mechanisms relating to on-line deposits of providers of social currencies; the need for a reserve system; incorporation of transactions in monetary aggregates for the purposes of monitoring by central banks, etc.

In view of their conventional (contractual) nature, social currency systems tend to be legally structured in compliance with legal standards, within spaces in which the Law grants freedom and private autonomy in each social context. In Brazil, the relevant legislation for an in-depth study on social currencies includes certain provisions of the Constitution of the Federative Republic of Brazil, of Law 4.595/64, of Law 10.214/01, of Law 8.697/93, of Law 6.385/76, of Law 5.678/71, of Law 4.511/64, of Decree-Law 3.688/41, of the Civil Code, of the Penal Code, of Fiscal Legislation, of the Usury Law (Dec 22.626/33, MP 2.172-32/01), of Decree-Law 857/69, of Law 8.024/90, and of sundry other standards.

Analysis of these provisions, in the light of concrete experiences with social currency systems observed in Brazil, is currently underway and, as yet, no final position or legal report of the specific aspects to be examined in this paper are applicable to concrete cases. Thus, the following commentaries remain open to review.

Under Brazilian legislation, in principle, not-for-profit non-government organizations (NGOs), Organizations of Civil Society in the Public Interest (OSCIPs), and Municipal Funds do not require authorization from the Government or from the Central Bank to carry out projects entailing social currencies. Municipal Funds, however, are subject to limitations under the Fiscal Responsibility Law (Enabling Law (LC) 101, of 2001), particularly with respect to the assuming of obligations within the scope of social currency systems.

If social currencies are linked with microfinance programs, both NGOs and Municipal Funds are subject to limitations under the Usury Law (Dec. 22.626/33), whereas OSCIPs are not (Executive Order (MP) 2.172-32/01). The situation is different when social currencies are established for profit-making ventures. In this case, it would be generally necessary to obtain

authorization from the Government or from the Central Bank<sup>8</sup>. For example, a benefits program involving the issuing of bonds or vouchers that serve as a social currency might require an authorization by the Ministry of Finance (Law 5.678/71), whereas a Credit Society for Micro-businesses or a Credit Cooperative that wishes to issue a social currency must seek authorization from the Central Bank.

Based on the definition of social currencies as systems created and administered by social groups to effect payments, exchanges, or the transmission of legal monetary obligations among members of a given community, it can easily be perceived that, to some extent, social currency systems relate to the payments system of the national economy. In Brazil, Law 10.214/01 sets regulations for the authorization of clearing houses and providers of compensation and liquidation services, within the scope of the Brazilian payments system, and art. 2 of the law states that: “the Brazilian payments system (...) comprises entities, systems and procedures relating to the transfer of funds and other financial assets, ... the processing, compensation and liquidation of payments in any of their forms”.

Establishment of social currencies based on mutual or reciprocal credit systems that conduct multilateral compensation of obligations is, thus, acceptable under Brazilian law by force of art. 3, of Law 10.214/01, provided that such compensation is carried out within the scope of a single provider of services for settlement of obligations and consists of a procedure whose aim is the settlement of bilateral balances of debts and credits of each of the participants in relation to others. In such cases, the National Monetary Council, the Central Bank of Brazil, and the Brazilian securities and exchange commission (CVM – *Comissão de Valores Imobiliários*) may issue standards and instructions relating to the functioning of social currency systems within their respective spheres of competence, with the aim of ensuring compliance with legislation that disciplines the Brazilian payments system (art. 10 of Law 10.214/01).

The presence of monetary effects or systemic risks as a function of the volume or nature of the business conducted is sufficient to justify action on the part of the Central Bank in relation to this issue (Art. 164 and 192 of the Federal Constitution, Law 4.595/64 and Law 10.214/01), especially since the banking legislation (art. 17 of Law 4.595/64) holds it responsible for exerting permanent vigilance over the financial and capital markets, and over companies that, directly or indirectly, interfere in these markets, and also over the operational modalities that they use. Likewise, operators of social currency systems that engage in activities that are reserved for banking and financial institutions are subject to (preventive and punitive) control, exercised by the Central Bank (art. 17 of Law 4.595/64).

Although the monetary effects of social currency systems may not be very significant (Lietaer, 2001; Schraven, 2001), it is probable that some form of regulatory treatment is

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<sup>8</sup> According to the current law, authorizations are necessary when profit-making corporations are *issuers* of social money, and this rule is not the same when the social money is issued by a NGO (such as Banco Palmas). At the other hand, there is no provision addressed to regulate either profit-making corporations or non-profit agents (coops/NGOs/OSCs) as users of social money. The National Secretariat for Solidarity Economy has struggled to establish a regulatory framework for a solidarity financial policy through the use of social currencies, within which the regulatory body should be the Central Bank or other governmental agency. There is no formal or official position of the Central Bank yet, but it should work together in cooperation with the National Secretariat for Solidarity Economy to deal with matters arising from the use of social currencies by non-profit Community Development Banks (such as Banco Palmas).

needed (Kuttner & McAndrews, 2001), particularly with respect to: convertibility of social currency into the official currency; forms of cooperation/integration among providers of social currency and banking institutions; and the possibility of use of the social currency by correspondent banks. Moreover, whenever the legal structure of the social currency system is found to be in breach of legal and regulatory standards, those responsible for its creation and administration are subject to penalties foreseen in administrative, civil, or penal legislation.

Given that these are operations and business of a subsidiary, complementary, or accessory nature to activities exercised within the scope of the national monetary system and of the financial, capital, and securities markets, they are under the responsibility of the National Monetary Council (cf. Law 4.595/64, Law 10.214/01, Law 5.678/71 and MP 2.172-32 of 2001) which, within the scope of its attributions relating to social currency systems must:

- (a) restrict their limits and modalities, and discipline operations or prohibit new issuing;
- (b) demand guarantees or formation of technical reserves, special funds, and provisions, without prejudice to reserves and funds determined by special laws; and,
- (c) ward off applicability of provisions of Executive Order (MP) 2.172-32, of 2001, that establish nullity of usurious or abusive stipulations in civil and commercial contracts; reverse the burden of proof in actions that plead nullity of such usurious or abusive stipulations; and set the scope for application of legal limits to interest rates in private contracts.

## **5. WHY SOCIAL CURRENCIES SHOULD BE REGARDED AS A PUBLIC POLICY INSTRUMENT FOR LOCAL DEVELOPMENT COMPATIBLE WITH MONETARY POLICY**

In various national contexts, social currencies are regarded as an instrument for local development, as they create conditions for development of local economies, with an insignificant or negligible macroeconomic impact, depending upon the total value and volume of the transactions conducted in social currencies (Kuttner & McAndrews, 2001; Rösl, 2006; Schraven, 2001; Arnone & Bandiera, 2004), and also upon the form of legal structure adopted.

The major concern of central banks in relation to social currencies relates to the effects that the creation of purchasing power outside the official monetary system may have on aggregate demand and on the capacity of the Central Bank to control the money supply. Nonetheless, although the use of some social currencies (e.g. airline companies' mileage programs) may have a positive effect on aggregate demand, the role of purchasing power created by the use of such systems is very limited, both with regard to fungibility and to the transferability of the social currency. For this reason, the use of social currencies poses no serious threat to the role of central banks in relation to national payment systems, nor to the stability of the financial system (Arnone & Bandiera, 2004).

On the contrary, as some empirical studies have shown, when adequately structured, aside from displaying anti-cyclic behavior in relation to both monetary policy and to employment levels, social currency systems may reduce the need for currency (cash, checks or demand

deposits) without generating systemic risks due to the repressing of circulation of social currencies in a given area or sector that functions in isolation or independently from the banking system (Lietaer, 2001; Schraven, 2001).

From the legal standpoint, a deeper analysis of social currencies must encompass an examination of the legal structures that differentiate the variables of social currency systems, considering the factual context and the specific regulatory environment in each social reality. Special attention should be devoted to points of intersection referent to relations between: (a) social currencies and the density of transactions; (b) social currencies and electronic money; (c) social currencies and public policies for microfinance; (d) social currencies and public policies for local development; (e) social currencies and monetary policy under the responsibility of the Central Bank.

To this end, without neglecting the particular characteristics of each social currency system, it is suggested (as a theoretical reference for legal analysis) that an ideal model of social currency be adopted, based upon a legally-structured mutual credit system to effect multilateral settlement of obligations (consisting of procedures aiming to verify the balance of bilateral debits and credits of each participant in relation to others in the system). Firstly, because this model is expressly accepted under the Brazilian law (i.e., the aforementioned provisions of art. 3 of Law 10.214/01). Secondly, because this type of social currency system raises legal and regulatory issues and operational aspects that need to be addressed by monetary authorities, both now and in the future (Vartanian, Ledig & Bruneau. 1998), although they are in effect procedures used by businesspeople since the most ancient civilizations (Rome and Babylonia) and in the middle ages, in compliance with the legal standards of each social reality, to mitigate scarcities of currency – i.e., cash (Giovanoli, 1997).

Indeed, in such social currency systems (mutual or reciprocal credit systems) techniques and methodologies are used to ensure the synchronization between flows of receipts and of payments within local economies, thereby reducing demand for official currency for transactional purposes and promoting organization (or reorganization) of local production, circulation, distribution, and consumption, as a function of a labor market that is also local, corresponding to a given region or sector in which the social currency is used.

When the social currency system is legally structured in the abovementioned manner, or in another manner that produces the same effects, any increase in the amount of social currency (or expansion of the social money supply) always corresponds to an increase in the volume of transactions conducted by participants in the system, in the real economy of reference, and is naturally limited by this volume of transactions. For this reason, some scholars of social economy associate the social currencies with abundant money supply to conduct transactions in the local economy, in counterpoint to the conventional monetary systems, known by the scarcity of money supply to conduct transactions in the local economy.

In practice, however, there is neither scarcity nor excess in the supply of social currencies, when systems are designed within the law and aimed at fulfilling demand for currency by a given social group that comprises a single local labor market. What happens in this situation is that monetary resources corresponding to the goods and services used, produced, marketed, and consumed by participants of the system in the local economy are repressed into *closed monetary loops*, organized in function of the local social realities of the labor market.

Thus, the wealth produced in the local economy benefits, firstly, the people that participate in the social currency system, and each social currency system forms what could be called an *optimum monetary area*, in which demand for local goods and services can be fulfilled by the local supply of goods and services before the surplus of these goods and services is exported to other areas and sectors not served by the social currency in question. In other words, with the establishment of a social currency system, creation of wealth in the local economy based upon resources that are available locally and in small trade regions is targeted toward serving needs as yet unmet by the official currency in such localities.

As a consequence of such targeting, the *closed monetary loop* functions as a *virtuous cycle*. On the one hand, the wealth of participants in the social currency system increases and, consequently, so do the potential tax revenues of municipalities (Tax on Services (ISS), taxes, and charges for improvements). For their part, municipalities can participate directly or indirectly in the social currency system in various ways by stimulating activity within the currency system since, in this manner, they are also promoting increases in their potential tax base.

Thus, on the other hand, it is both possible and necessary to promote integration or forms of cooperation among the various social currency systems and the traditional banking system, so as to trigger one or many *virtuous cycles*, by means of which exchanges can be conducted with other local economies, with the national economy, and with the international economy. Consequently, surplus local production can be exported, resulting in a redistribution of resources within the national economy and, at the same time, development of local economies and of domestic, inter-municipal, interstate, and inter-regional trade.

In this context, it is of particular relevance to ensure that circulation of the social currency occurs within *closed monetary loops*, in cases of integration and cooperation among social currency systems and banks, since there is a natural tendency on the part of banking institutions to invest bank deposits from local economies in operations elsewhere since, from a financial standpoint, in the short-term, these offer higher yields to banks than any monetary earnings that could accrue from maintaining reserves for social currency systems.

However, by ensuring that bank deposits of the participants of social currency systems remain in *closed monetary loops* within local economies, in the medium and long term, banking institutions that are partners of organizations that use social currencies, awaken to the advantages of keeping bank deposits applied in investments in the local economy. After all, when adequately structured from the legal standpoint, each social currency system can function as a small-scale clearing house for payments among participants in the system and, as a result, there is a natural tendency towards the formation of small local stock exchanges and the generation of new business and partnership opportunities for banks in the market for microfinance, and credit for micro and small businesses within the local economy.

Such circumstances potentialize the adoption of an effective compulsory deposits policy tailored to the credit needs of local economies (art.10 of Law 4.595/64) without increasing inflationary pressures, thus making it possible to affirm that social currencies also have great potential for use by monetary authorities as an instrument to guide execution of monetary policy, with the aim of: (a) improving control or monitoring of the scope of Central Bank decisions at the microeconomic level; (b) improving distribution of bank credit to local economies and; consequently, (c) reducing the cost of credit for micro and small companies; thus contributing toward the development of an efficient credit market, in line with the needs of local economies and of the national economy.

## 6. CONCLUSIONS

Social currencies, created and administered by their users by means of not-for-profit associations, based on economic relations of cooperation and solidarity among participants of given communities, to enable payments or transmission and settlement of legal obligations in local or sectoral economies, regardless of the exercise of any form of financial intermediation activity, are an important area of interface between Public Economy and Social Economy and merit deeper attention on the part of researchers and of 21<sup>st</sup> Century public policy makers.

Although many of the legal and regulatory issues remain open to discussion in almost all jurisdictions, when the logistical and operational aspects of their functioning are examined, it can be perceived that, since they are based upon the freedom to contract, social currencies have much greater flexibility than governments and banks have attributed to coins, bills and national currencies (*fiat money*) in the past two millennia. Indeed, the contractual clauses that constitute the legal frameworks that underpin the various types of social currency systems, aside from determining logistical and operational aspects of the functioning of social currency systems, also serve to determine the currency cycle (creation, distribution, issuing, and redemption of social currency) and to define the legal and regulatory framework applicable to the specific system in question.

As this paper has shown, each social currency system corresponds to a particular set of legal and contractual arrangements that acknowledge common interests and establish mechanisms for participation of members, and the methods for coordinating and managing local economic activities, thus enabling individuals to exercise greater control over the creation and use of the social currency, in accordance with the political will of the community. In view of this potentiality, it becomes possible to legally structure social currency systems in various ways, including some that are compatible not only with the objectives of monetary policy and with banking regulations, but also with public policies for solidarity finance, targeted at generating jobs and income, fostering social inclusion, and promoting solidarity and fair local development.

Furthermore, as this study has shown, the use of social currencies neither affect the power of central banks to control the money supply nor poses a serious threat to the role of central banks in relation to national payment systems, nor even jeopardizes the stability of the financial system. On the other hand, the use of certain social currency systems (particularly those that have an endogenous capacity to adjust the social money supply, in response to transactions conducted by their participants) may endow greater effectiveness to a differentiated compulsory deposits policy implemented in line with the credit needs of local economies, and thus contribute toward a better distribution of the supply of credit within the national financial system and, consequently, toward lower costs of bank credit for self-employed workers and micro and small businesses within the local economy.

Thus, the creation of a necessary and adequate regulatory framework for the development of public policies for solidarity finance through the issuing of *social currencies* may prove an essential condition for reducing social and regional inequalities observed in Brazil, and contribute toward the eradication of poverty. It is, for this reason, important that there be close coordination between initiatives of the National Secretariat for Solidarity Economy and those of the Central Bank of Brazil, so that, apart from compliance with the Law and compatibility with monetary policy under responsibility of the Central Bank, the issuing of

*social currencies* in Brazil remains to be based upon free enterprise and the dignity of human labor, so that all Brazilians can enjoy dignified livelihoods, in accordance with the precepts of social justice and of the constitutional economic order.

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