Strohalm Foundation
Oudegracht 42
3511 AR Utrecht
The Netherlands
Telephone: +31 (0)30 2 314 314
Fax: +31 (0) 30 2 343 986
Email: partnerships@strohalm.nl

Strohalm's Innovative Approaches to Development

by

Henk van Arkel
Director
Strohalm Foundation

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Strohalm Foundation
Oudegracht 42, 3511 AR Utrecht, The Netherlands
Telephone: + 3130 2314314 Fax: + 31 30 2343986
www.strohalm.org

1. Introduction

Strohalm Foundation, established in 1970 in the Netherlands, was as one of the first NGOs actively committed to an integrated approach towards social, environmental, economic and cultural sustainability.

During the last 15 years, Strohalm has focused its research and intervention on **monetary themes**, driven by the evidence that the economic structure is determinant in the organization of all aspects of modern society. Within that economic structure, the role of the financial system and of the interest mechanism in particular, are determinant causes to poverty and social exclusion, stagnation of local trade and economic activity and, in general, the sub-optimal operation of local economies. In this period, the organization has become familiar with several innovative theories and has specialized itself in the creation of innovative approaches to economic and social development by developing interest-free complementary currency methods.

In the 1990s, Strohalm became one of the pioneers in Europe in the area of innovative local exchange systems, which were applied in several pilot projects, mainly in the Netherlands. Since 1997, Strohalm provides advice and training to complementary monetary initiatives in various countries in Latin America and Asia. Apart from being supported by private donors, Strohalm receives financing by some major donors such as the Dutch Ministry of Foreign Affairs, the Dutch Ministry of Environment, ICCO (Interchurch Organization for Development Cooperation), and the PSO- association for capacity building in developing countries and the Rabobank Foundation.

One of the initiatives that received follow-up from Strohalm was the Red Global de Trueque in Argentina, which started off in 1995 as a small group of un(der)employed neighbors who traded their products and services using their own, internal currency. In a few years, this group of bartering neighbors would grow into a popular movement, integrating more than 800 trading circles ("nodos") and an estimated countrywide membership between 2 and 5 million people, by the end of 2002. The membership of the movement would fall drastically after that, due to flaws in the design of the system (that were not corrected in spite of Strohalm's advice) and because of counterfeiting of the paper currency that circulated internally.

The Argentinean experience clearly showed, however, how complementary currencies can re-dynamize an economy where shortage of liquidity had paralyzed the use of existing economic capacities. The downfall of the Trueque movement has also showed that in order to activate the commercial and productive opportunities within a community in a sustainable way, a more professional approach is needed.

The development and adaptation of Complementary Currency Systems especially for less developed and emerging economies was therefore a logical step in Strohalm's expansion strategy. The innovative monetary methods conceived and developed by Strohalm's specialists have the potential to offer communities and countries in the South the instruments to build their own development more effectively.

The growth potential of complementary exchange systems depends on various factors, of which the main is the availability of unused productive capacity and the need to sell this capacity in order to survive as a business. In most countries with a need for economic development this is of course the case: unemployment and underproduction are synonymous to available unused productive capacity. In this sense, the most fertile ground for these methods is where the need from the economic point of view is higher.

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Oudegracht 42, 3511 AR Utrecht, The Netherlands
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2. Justification

2.1 The origin of money shortages

After years of experience in the search for sustainable social and economic solutions, Strohalm made the strategic choice to specialize in the area of complementary monetary systems. It is our conviction that the prevailing rules of the (international) monetary structure make it very hard, (if not almost impossible) for governments to correct the monetary imbalances at the regional and local scale. Economic and monetary policies are defined at the “macro” level and seem powerless in resolving the lack of access to exchange medium that persist at the local or regional “micro” level.

Within the present day’s monetary structure, all communities are confronted with a permanent outflow of liquidity (in the form of imports, interest payments to non- local financiers and “capital flight”). Seen within this perspective, poor communities are poor because they do not succeed in achieving a (net) inflow of money from their participation in the export market, to attract outside investment or "fresh" bank credits. As a result, there is a lack of purchasing power, investment capital and means of exchange for mutual transactions, thus forcing the community members into informal forms of economic organization, which are often less effective. This structural situation undermines most of the attempts to strengthen local economic activities.

It is impossible for a Central Bank to create an appropriate monetary environment for every local or regional level of economic activity, especially given the macroeconomic parameters by which the operation of these structures must be evaluated. This leads inevitably to a situation in which some sectors receive an excess money supply (resulting in capital flight or excessive speculation), while other sectors cope with a chronicle shortage. In countries with deficit on the balance of payment (often caused by interest-payments over public and private debts) and with limited possibilities to attract outside capital, the money shortage is often a national phenomenon: markets are structurally deprived from the access to financial means, be it for investments or for mere circulation.

The money shortage, both at the national and local level, can largely be explained by the fact that the financial means are extracted from the productive cycle in the form of interest-payments. This interest extraction sets in motion a vicious circle of local money shortages (lack of purchasing power), low returns on investments, lack of new money (investments) coming into the region. A large part of the interest payments find their way to the speculative sphere, instead of returning to the (real) economies from which they were extracted.

Money is the lubricant of the economy. A shortage of money means that many potential economic capacities remain unused, resulting in un(der)employment, poverty and exclusion, with all its social consequences. In industrialized countries with sufficient fiscal capacity, this imbalance in income distribution is artificially restored (to a certain extent) by income distribution schemes like welfare and unemployment benefits, (food) subsidies etc. that transfer money from the privileged to more disadvantaged sectors. In countries that do not have the fiscal capacity to implement this sort of corrective measures, the prevailing monetary system poses a structural obstacle to the development of large parts of the population.

In less developed countries, the widespread scarcity of money cannot be resolved in a structural way only through conventional approaches, such as (micro) credit, business development services etc. In a monetary system with a convertible currency (which is the case nowadays in most countries), the new liquidity introduced in the economy tends to disappear within a few rounds of circulation (in the form of capital flight or import). The

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consequences are the creation of "monetary deserts" in which it is difficult for any economic activity to survive.

2.2 How to solve local money shortages?

The globalization of the monetary and commercial context during the past decades has created two major dilemmas for governments. The Complementary Currency Systems promoted by Strohalm offer perspectives to solve these dilemmas.

Dilemma	Solution
(a) How to give enterprises the opportunity to increase their competitiveness gradually to world market standards, without falling back on protectionist policies?	Implement (semi-) closed complementary currency systems that concentrate purchasing power on local and regional enterprises. Enterprises that wish to grow beyond that potential will have to look for national or international markets.
(b) How to pursue an expansive monetary policy to stimulate the economy, while, at the same time, maintaining a stable national currency?	Only stimulate those sectors and regions that have excess production capacity. Complementary currency systems offer the possibility of a semi-open monetary environment in which stimulation policies on specific segments of the economy can be targeted safely.

Several economists and analysts worldwide have reflected over these problems and "dilemmas" and point in the direction of de-centralized monetary systems as a potential solution. Mervyn King, current governor of the Bank of England, shocked the financial world with his work, *Challenges for Monetary Policy: New and Old (1999)*, by forecasting the end of the economy as we now know it. Trade through the Internet would mean, in the long term, the disappearance of the system where central banks hold the monopoly over money and eventually that of central banks themselves. Barter dollars and other virtual means of payment would take over the role of the dollar or the Euro. In King's own words: the logic of electronic barter may imply that (…)" central banks in their present form would no longer exist, nor would money. The successors of Bill Gates could put the successors to Alan Greenspan out of business (…)". The evidence that about one-third of global trade is, in fact, intra-corporate trade *(Lietaer, 2001)* proves this tendency and reinforces the potential effects of private, decentralized monetary management. In the book *The Future of Money (Cohen, 2004)*, the author outlines the potential of private, decentralized monetary management. The same work also explores monetary regionalization as a central element of state policy.

The intervention of Strohalm by means of complementary currency systems is, to a certain extent, in line with these visions. One particular aspect is that Strohalm's program aims to use complementary currency systems as a tool for regional development. Complementary Currency Systems discourage or eliminate the possibility to spend purchasing power outside the own "circle", which creates a certain degree of "isolation" against structural leaks or external shocks.

Complementary Currency Systems are not only instruments that partly compensate the flaws in the macro-monetary system. They must also be seen as instruments that can improve the functioning, outreach and impact of financial institutions. The credit to small, local entrepreneurs in an economically stagnated environment, is often more expensive than in more dynamic and affluent regions, because of higher risks and administration costs per loan. The result is that small businesses in developing countries are forced to bare very high interest rates, up to a level that most companies in industrialized countries would never be able to generate. Strohalm has developed a method in which consumers are granted

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incentives to buy from businesses that hold (and repay) loans. By actively involving consumers, the cost of monitoring the loans issued and the risk of default coverage can be reduced.

The above does not imply that the conventional development instruments (such as micro-credit) are inadequate. However, the impact of these instruments on the intended target group would be much higher if being implemented with (or adapted to) Complementary Currency approaches in order to be able to resolve the structural obstacle of money scarcity.

Neither does the previous argumentation imply a rejection of export-oriented development strategies. Simply, the focus of Strohalm's methods is to encourage the circulation of locally available purchasing power with the aim to create a healthy and dynamic local environment on which to base further socio-economic development. An automatically protective environment is created at the local and regional level in which new entrepreneurs and economic activities have the opportunity to develop, unhindered by world market competition and artificial money scarcity. The most successful of these entrepreneurs will become exporters. Those who do not have this potential can focus their skills and talents on the local and regional market and, some of them, may use this environment to grow towards the outreach of the world market.

In summary, Strohalm's methodologies help:
- SMEs to reduce their financial costs, increase their sales and develop their skills in a favorable environment;
- Communities to enforce their self-awareness, strengthen the community itself, raise the level of knowledge and capacities and realize more specialization, more production and more consumption.
- Consumers to effectively allocate their purchasing power in a way that optimizes both the benefits of lower prices and of the generation of more employment opportunities;
- Governments to stimulate specific segments of the economy without creating monetary instability, with guaranteed results in terms of increased tax revenues.

A more detailed description of the theory backing the practice can be obtained through Strohalm's publications, available at *www.strohalm.org/materials.html*.

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3. Complementary Currency methods

Inspired by the above insights and based on its experience, Strohalm has developed a comprehensive program with economic, financial and social instruments. This program focuses on the development of both SMEs and local and regional economies as a whole, by means of trade networks, informal entrepreneurship and micro-enterprises (Community and Micro-enterprise Development).

We distinguish three main target groups:

Target group[1]	Method(s)	Goals
A. Informal businesses at community level	• 'Prosumer'-circuits[2]	• Activation of the existing local (productive) capacity • Creation of more social cohesion • Developing self-consciousness and sense of community • Stimulate cultural activities • Stimulate exchange and multiplication of knowledge and skills • Creation of a local environment focused on internal capacities (as opposed to focusing on external help)
B. Micro-enterprises	• Valuable Local exchange Circuits; • Modified Micro-credit innovations ("Fomento")	• Economic (and social) inclusion of persons that are excluded from formal markets, resulting in better living conditions and higher self-esteem; • "Incubation" of entrepreneurial capacities.
C. Small and medium enterprises	• Exchange and investment networks for businesses	• Reduce financial costs by increasing the efficiency of the use of (national) money; • Increase demand for products and services offered by the members.

The methods mentioned under A. and B. have both social and economic objectives, and are intended for interventions at the community level. The method mentioned under C. is directed at more formal businesses. In the following two sub-paragraphs (3.1 and 3.2), the background of both the Community Development (A. and B.) and the SME Development (C.) methods will be described briefly.

3.1 Community and Micro-enterprise Development

Community development programs that use innovative micro-credit systems, community exchange systems and a set of other methods, raise self-awareness and the sense of community among their target group. By making more effective use of the available purchasing power, pre-entrepreneurial skills are developed and specialization is stimulated. Some of these specializations can eventually grow to quality levels that meet world market standards; others will be able to thrive in the preferential environment of the local economy.

However, development is not purely an economic phenomenon. Strohalm's concept of 'Integrated Development' means that all aspects of a community are seen as mutually re-enforcing. Strohalm's methods create a local market with enough 'currency' to remunerate

[1] The target group column gives an indication of the main intended beneficiaries. It does not exclude the participation of larger or more formal businesses. To the contrary: their participation is often beneficial for the intended target group.
[2] "Prosumer" is a contraction of the words *producer* and *consumers*. "Prosumers" fulfill both roles at the local (community) level.

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economic as well as social and cultural goods and services offered by the members of the community.

3.2 SME Development

Small and medium sized enterprises (SMEs) are an essential target group in any development approach that pursues a broad impact. Interacting clusters of businesses can encourage the internal circulation of the local purchasing power. Monetary Methods 'liberate' money from its circulation function, thereby making it available for investments. As a result, business opportunities increase, financial costs are reduced and market access improves (by facilitating an efficient exchange between businesses).

Strohalm adapted organizational structures such as business barter and vertical integration operations, widely used in industrialized countries, to meet the needs of SMEs under the specific conditions that characterize poorer regions. It created models of innovative networks in which consumers and businesses co-operate, exchange and invest for their own profit as well as their collective benefit, supporting more sustainability.

3.3 The LIDO program: instruments to Integrated Local Development

These two main strategic lines (Community and SME Development) form the base of the LIDO (Local Integrated and Sustainable Development) program that Strohalm has developed with the support of the Dutch Ministry of Foreign Affairs. Designed by the Strohalm Foundation, LIDO is a development approach, which offers a set of methods and instruments that can assist local communities and entrepreneurs to organize and develop themselves, by activating the local productive potentials. In the program, special attention is paid to a growing self-awareness and social cohesion within the community, to the formal and informal transfer of knowledge and skills, to the (nurturing of) entrepreneurship and the choice of an optimal level of specialization. Also important aspects are the access to micro-investment capital and the refinement of the instruments of attraction and circulation of purchasing power to (and within) the local market.

The LIDO program is an ongoing process of pilot projects, evaluation and adaptations resulting in a year-by-year accumulation of knowledge and experience. It offers an interesting and innovative approach, clearly distinguishable from other development strategies, which focus on larger-scale development, active export promotion or attraction of international capital, or social programs lacking a sustainable economic base. For more details on the LIDO local development program, please read: www.strohalm.org/materials.html

Within the LIDO program, pilot projects are realized which test the impact and applicability of innovative Complementary Currency Systems, in partnership with local organizations. Currently, Strohalm is involved in pilots in Latin America (Brazil, Honduras and El Salvador) and Asia (Indonesia and Thailand). Some of these projects are ready to be upgraded both in scale (number of SMEs attended) and quality (M&E, impact measurement, transaction software etc.), provided that sufficient funding is available to involve high-quality, specialized partners in the project.

Apart from conducting pilot projects, Strohalm maintains contacts with development organizations and researchers worldwide. Within this network, an active exchange of know-how on the most innovative experiences in the field takes place. These collaborations have

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made of Strohalm an international "think tank" and knowledge center over these themes, combining practical experience with theoretical analysis and reflection.

4. Complementary Currency Methods for Community and Micro-enterprise Development

4.1 Introduction

Within the present day's monetary structure, all communities are confronted with a permanent outflow of liquidity (in the form of imports, interest payments to non- local financiers and "capital flight"). Regarded from this point of view, poor communities are poor because they do not achieve to generate a (net) inflow of money. This inflow can consist of "export" earnings[3], attraction of outside investment or emission of "fresh"[4] bank loans. As a result, there is a lack of money: purchasing power, investment capital and media of exchange for mutual transactions, thus forcing the community members into informal forms of economic organization, which are often less effective. This structural situation undermines most of the attempts to strengthen local economic activities.

Strohalm has developed specific methods and instruments, designed to promote Community and Micro-enterprise development. The main methods of the LIDO-program that focus on this target group are:

- ***Prosumer* circuits**;
- ***Fomento*;**
- ***VLC* (Valuable Local Currency) method**.
- **Consumicro: Consumer Controlled Credit**

These methods will be briefly described in the following sections. More detailed descriptions can also be found at: www.strohalm.org/materials.html

4.2 **Prosumer[5] Circuit**

The Prosumer Circuit method is designed to stimulate local communities to pursue social and economic development by activating and optimizing the use of local resources

The introduction of a local medium of exchange compensates the shortage of money in poor local and regional communities, thus providing these with the means to activate the capacity, talents and skills that exist in the community and to expand investment and production. Communities are generally poor in money, but not in resources, talents and skills. A local exchange network can bring "prosumers" together in one market and allow them to exchange goods and services among themselves. Priority lays on local specialization (locally produced goods and services to supply the local market) and entrepreneurship, the strengthening of solidarity between neighbors and the creation of social relations in which the transfer of basic abilities and know-how are ensured.

[3] In this specific case, "export" does not necessarily refer to international sales, but can also include sales outside the community (but within the same country).
[4] "Fresh" bank loans stem from a money-creating bank as opposed to "recycled" loans that stem from savings and loan associations.
[5] "Prosumer" is a contraction of the words *producer* and *consumers*. "Prosumers" fulfill both roles at the local (community) level.

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This way, three basic elements of socio-economic development: *production*, *exchange of goods and services* and *transfer of know-how*, are activated by the Prosumer Circuits. In the longer run, also *investments*, another key element of development, can be realized.

Most Prosumer Circuits function as ‘mutual credit’ systems, which implies that a community member performs a service or delivers a good to another member and accepts, in return, a credit title as a form of payment, agreed upon by both parties. In a CCS (Community Currency System), this title can be used in transactions with any other member of the system. Because of these more complex arrangements than direct one-to-one barter, multi-reciprocal trade can be realized.

If people have needs and others have the possibility to supply them with the goods and services they need, why would these transactions not take place just because "global money" is not present? A local currency, administered by the community itself, can perform that function, thereby alleviating the problems caused by the absence of money without bringing the community into dependency relations. Members of a community organize themselves and create a ‘currency’ that only circulates among members and that is used as a medium of exchange to facilitate transactions between "neighbors"[6].

Prosumer Circuits have been used with success (and some with failure) during the crisis of the 1930s in the USA and Europe. A second surge took place in the 1990s in the Anglophone world (where the systems are commonly known as LETS[7]) and in Latin America (“Trueque”). Prosumer Circuits have been realized and researched in, among others, England, Austria, USA, Holland and Argentina. Reported results are sometimes impressive, but the sustainability of the systems remains a weakness. In Argentina, Complementary Currencies helped millions of people during the crisis to fulfill essential economic needs. In other countries, like Thailand, these systems proved to forge a better sense of community and internal solidarity.

The analysis of these experiences, in particular the Argentinean example, has taught Strohalm valuable lessons and has allowed the organization to develop more efficient tools and procedures, generating what can be regarded as a "second generation" community currency systems. An International Helpdesk for Prosumer Circuits has been created to systematize and share the lessons that are learned with communities around the world, which also wish to set up a local exchange system.

The accumulated experience have resulted in the conclusion that:
- Prosumer Circuits should keep their focus on one community;
- Prosumer Circuits should be seen as complementary and should be adapted in order to be supportive of the existing reality (instead of an ‘alternative’);
- Prosumer Circuits should be monitored by an agency that is capable to handle financial responsibilities, such as a formal micro-credit institution.

Strohalm identified two ways to create Prosumer Circuits that are both stable and effective:
- One is the so-called **Marketplace Currency System**, a very simple system that provides a method for issuing a medium of exchange for use in a marketplace in a secure and transparent way, allowing a good monitoring of the operation of the system.
- The second method is the **Controlled Community Currency System (CCCS)** in which the Local Units are issued as a loan to members, with the possibility of claims being ultimately "cashed" in national currency. This system is a result of lessons learnt in many countries. It includes a set of instruments that allow monitoring and intervening over the

[6] The term ‘community’ can refer to a neighbourhood, with personal relations, but also to less personal networks, such as groups of micro and small entrepreneurs.
[7] Local Exchange and Trade Systems

quantity of Local Units in circulation, avoiding internal inflationary episodes and loss of confidence.

4.3 Fomento: making triple use of development funding

In 2002 and 2003, a small-scale pilot project of the Fomento method was implemented in Conjunto Palmeira, Fortaleza, Brazil. The project was executed in partnership with a micro-credit institution ('Banco Palmas') and the local residents' association and yielded very positive results and important lessons. An external donation had been received for the construction of a school building. The construction project, in itself, constitutes already an investment in benefit of the local community but thanks to the Fomento method, the total local impact of the donation was considerably higher and more extensive.

The Fomento method combines the effect of three impulses which, when acting together, generate an **internal development dynamic** within the community. These are:

- Local social expenditures/ investments (construction of the school);
- The circulation of a Local Currency;
- A local micro credit program.

The operation of the project is as follows: there is available funding to build a school, for example. The local organization can however negotiate with the building company to only allocate the work upon agreement on a partial payment in local currency. The constructor is then driven to ensure that the larger part of the resources (labor, materials) to build the local school can be contracted locally and paid for in local currency (vouchers). In the meantime, the bank or credit institution that runs the program manages the majority of the funding (originally meant to build the school) and allocates it to its credit portfolio and uses it to grant credit within the community. If these and other loans held next to the bank or micro-credit institution can be repaid in the local currency, a generalized acceptance is created. All businesses that hold a debt will accept the locally circulating voucher, as will other businesses within the community.

In the case of the pilot project in Fortaleza, the construction company succeeded to cover 87% of the costs in Local Currency. This fact has, according to a research of the Bahia University, led to positive results:

- A 15% higher local income effect (in comparison with similar project using only money);
- 87% of the initial funding was made available for the microcredit program, which increased the production capacity of local enterprises;
- Sales of local enterprises have increased by means of the vouchers which were used to repay the loans;
- Extra trade between the workers and other suppliers of the construction project and other community members. (The research did not cover this, so it is unknown the dimension of potential extra purchases within the community).

In summary, **companies** have benefited from an easier access to (more) credit that led to an increased productive capacity. In addition, they also experienced an increase in sales resulting from the inflow of purchasing power in the community. For the **community**, the project resulted in more local expenditure, more employment, more investments and more competitive local companies.

The Fomento method has proven to be a very effective way to allocate donations or public funds at the community level. With the same inflow of money, more visible and sustainable results can be achieved: the construction of the school, the extra investments allowed by the

Strohalm Foundation
Oudegracht 42, 3511 AR Utrecht, The Netherlands
Telephone: + 3130 2314314 Fax: + 31 30 2343986
www.strohalm.org

additional money for the micro-credit program, the activation of the local economy and the familiarity and acceptance of a local currency. The method offers an effective tool to local development in the case of income transfers, public investments and micro-credit programs.

It must be noted that all these results were *extra results* created by the application of the Fomento method, and that the original result, the building of a school with it's own purpose and value, was also met. Of course there were also *extra costs* in realizing the project, such as the organizing of meetings with the local businesses in order for them to understand the project. These organizational costs determine that the method is to be more advantageous when applied on a more permanent basis in the same community. The organizational costs in a one-time Fomento project are normally higher than the economic benefit for the community.

The Fomento method is especially powerful in the creation of familiarity and acceptance of Local Currency and in supplying liquidity to the community. The method is preferably to be implemented in the form of a sequence of projects, provided that a permanent source of liquidity can be found, such as continuous community expenditures or local flows of government money. The Fomento method also plays an important role in a certain phase of the VLC method (see below).

4.4 Debt-driven local development (VLC)

The Valuable Local Currency (VLC) method is based on two observations:

1. Every economy in crisis is confronted with the monetary dilemma described in 2.2: *How to pursue an expansive monetary policy to stimulate the economy, while, at the same time, maintaining a stable national currency?* The solution would be to create a (semi) closed environment where extra fresh credit stimulates the economy and makes new and old debts more likely to be repaid.
2. Interest-bearing debts are the motor for economic innovation and a dynamic force behind economic activity. However, this dynamic has one important negative 'side-effect': interest payments function as a pump that continuously drains poor communities of its wealth. By removing or reducing interest payments, which drain wealth from the community, the local savings capacity increases and can be re- invested in productive investments also within the community.

Striking evidence shows that this investment does take place within the global financial system, but it happens far away from the communities that have sacrificed their consumption in order to bear the interest burden. The effect for poor communities would be quite different if these "savings" were to be reinvested in the same place from where they originate. One of the fundamental goals of community banks is to avoid the "poverty spiral" from being set in motion. What the VLC system offers is the possibility to do this in a far more effective way by integrating it into a local currency program.

Basically, the VLC method operates in a way similar to the international financial structure where consumers in countries that are highly indebted are forced to consume less than they produce in order to pay the interest costs. At the global level this leads to a net transfer of resources from debtor to creditor countries. With the VLC system at the local or regional level, this same "interest-pressure" mechanism can be used to transfer resources from consumption to investment, thus setting in motion a self-strengthening economic growth cycle.

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Some may argue that this can also be achieved with other development solutions such as donations, direct transfers and investment and conventional credit programs. However, unlike these systems, one of the crucial ideas of the VLC method is the confidence it deposits in the potential of the local economy. This aspect is visible in two genuinely innovative features of the method: the "debt-driven" cycle and the inclusion and empowerment of local economic agents as stakeholders and well as "shareholders" of the community development process.

The VLC system has the potential to create a social climate where the community, as a whole, and each economic agent in particular, participates in the common development. The compulsory contribution to a community development fund that is requested to those who receive a VLC loan is a good example. All agents can be granted a share of the benefits of the growth that the community can reach.

The debt and exponential interest cycle should be interpreted not as an accumulation of debts of local entrepreneurs but as an investment in the capacity of local companies and producers to grow. The system does so by granting credit beyond the initial proceeds of the business, beyond their initial credit capacity but based on their ability to grown into a viable and competitive company, with higher revenues. By doing so at the aggregate level of the community, the system ensures that the local economy, as a whole, does in fact grow to activate all its talents and resources. This dynamic will, in turn, result in an increased capacity of businesses to repay the loans they were granted.

In operational terms, the program starts off with loans to entrepreneurs in national currency, with interest payable in Local Currency. Enterprises are offered (partial) refinancing for these local currency interest debts. As the Local Currency debt builds up (and has to be repaid), the expenditure possibilities for the Local Currency increase, as will the demand for (low-cost) loans in local currency. The interest mechanism will make sure that the demand for Local Currency always exceeds supply, thus guaranteeing its stable value. The term 'Valuable' relates to this process: the acceptance and desirability of a Local Currency is created and the Local Currency, even with its limited spending opportunities, will still be as valued as the national currency, especially to those who are indebted in this Local Currency or those who are close to the debtors in the production chain.

This program can be strongly enforced by marking the interest-payments as investments shares in a community fund. Social control between entrepreneurs and consumer-involvement (if buying local also leads to obtaining shares) will stimulate the local orientation and local expenditures as well as mutual help.

The VLC method demands professional expertise to manage both demand and supply of the Local Currency, as well as the regular activities of management of credit portfolios. For this reason, the participation of a formal financial institution is required. The financial institution is not only involved in the starting and expansion of the "debt cycle", but also in administrating a Fomento component. When the debt cycle is still in the phase of "accumulation", it is possible and even necessary to introduce liquidity in the system by spending in public programs through the Fomento method.

4.5 *Consumicro*: consumer controlled micro-credit

The relative costs of micro-credit schemes are high. Even if microcredit programs show that small entrepreneurs are capable of paying interest and cost charges up to 40% per year, the (poor) communities in which they live and work still lose a considerable amount of energy. Two main elements of these costs are:

Strohalm Foundation
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Telephone: + 3130 2314314 Fax: + 31 30 2343986
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- The costs to analyze the credibility of the clients
- The costs caused by situations in which clients fail to repay their credits or are not willing to.

In micro-credit programs these costs are relatively very high since the amounts lent are low, while the activities to evaluate credit proposals request are often almost the same as with larger loans.

In the analysis of Strohalm it is of major importance to allow credit-capitals (and the subsequent interest-payments) to support investments in local community development as long and as much as possible. Micro-credit programs must not be allowed to become 'pumps' that collect liquidity in poor neighborhoods and send them to institutions that are outside the local community, resulting in drainage instead of an injection of credit-capital of credit capital in the community.

Even if a certain micro-credit institution has been successful in getting the initial capital free of charge or against very favorable interest rates, the handling-costs and the risk assurance costs remain very high. So high, in fact, that the local entrepreneurs become, through the payment of these costs, intermediaries in bringing money (purchasing power) out of their community in larger quantities than the quantity of hard currency brought in by the initial credit.

This is the reality in all micro-credit programs that are not run by the community itself. The result of this is a pressure to raise the productivity in the community (resulting from the capital-investment) to very high levels in order to have a long-term positive effect on the community as a whole. Only if the raise in productivity is so large that the costs of the credit can be countered by the extra sales that result, and only if these extra sales are realized outside the community, can the community as a whole balance the drainage of liquidity that was caused by the capital in the first place.

For this reason, Strohalm has started a research program, in order to find a way to reduce the above-described costs and/or to have as much as possible of the payments remain in circulation locally and in service of the community. Can such improvements be achieved to the techniques of micro-credit in order to allow a further successful growth of the concept and be a sustainable tool to enforce the positive effects of micro-credit?

In this research we were inspired, amongst others, by probably the earliest and successful micro-credit program in the 50' s-60, introduced in Egypt by the late Professor Al Naghar. This program, a micro-credit program 'avant la lettre', used in an extremely interesting way, the Islamic concept of financial risk sharing, rewarding capital only when the borrower of the (micro-) credits realizes a productive profit. Prof. Naghar initiated over a thousand village-banks that basically looked similar to credit unions but in which the savers were involved in a unique way with the entrepreneurs, becoming mini-shareholders in the gains of credit. Unfortunately, the initiative of Professor Al Naghar was taken over by the government and would eventually fall in the hands of corrupt bureaucrats that misused the concept.

The 'consumicro' methodology builds on the knowledge of the research program, but also incorporates special methodological developments and innovations.

The methodology developed out of this research will be tested in pilots. One of the most promising approaches is one in which local consumers are involved in the process of analyzing the credit-worthiness of local entrepreneurs, and enforcing the payments of the micro-credits, simply by their consumptive behavior. In this way the relatively excessive costs

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Oudegracht 42, 3511 AR Utrecht, The Netherlands
Telephone: + 3130 2314314 Fax: + 31 30 2343986
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of evaluation and enforcement, which are high in comparison to the amount of the micro-credits, will be seriously cut.

So, the local consumers both select the entrepreneurs that have enough credibility and support the repayment of the credit, plus the interest. Consumers are rewarded for these services, receiving back most of the interest revenues, thus being made shareholders in the possible returns. This fact makes them literally *interested* in this process. In this way the local consumptive behavior is directly linked to the success of the micro-credit.

A typical ”win-win” situation will result from such a system:
- The consumer will get a bonus if he or she buys locally and thereby supports the loan-process,
- The entrepreneur will have a more interesting offer to the local customer and hence better chances to repay the loan and realize the interest-payments,
- From the point of view of the provider of the original capital the result will be a more viable and active local economy, and thus a better credit-worthiness of the local ‘clients’,
- Local authorities will see their community becoming more sustainable.

Hypotheses that will have to tested during the pilots are:
1. Will consumers be able to contemplate the credibility of businesses by buying there?
2. Will the instruments to measure this be effective?
3. Are consumers effectively capable to realize pressure on the entrepreneurs to pay their interest and credit repayments? And is the promise that they will share in these payments sufficient reason?
4. Will the pilot-projects be capable to develop a way of introducing and support the process in a way that the costs are still considerably less then the costs of the loans?

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Oudegracht 42, 3511 AR Utrecht, The Netherlands
Telephone: + 3130 2314314 Fax: + 31 30 2343986
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5. Consumer - Business Networks as an innovative tool for SME development

5.1 Introduction

Strohalm has been working with Small and Medium Enterprises (SMEs) since 1996 developing specific methods and instruments designed to address their needs. The main method resulting from this is called C3 - Consumer and Commerce Circuits. The C3 can be considered as an improved version of the Commercial Barter concept (to be explained in more detail in 4.2.1), extended with the methodology of vertical integration often practiced by transnational corporations (see 4.2.2) and with state of the art consumer-involvement.

The C3 concept focuses on:

- Creating a network that is conducive for business-to-business relationships;
- Helping markets to work better (providing detailed information about supply and demand);
- Giving members better and cheaper access to investment capital.
- Stimulating local circulation of consumer purchasing power (optimizing the combined effect for both local consumers as local producers)

5.2 Existing Complementary Currency Systems for enterprises

Before going in-depth into the functioning of a C3, it will be clarifying to look at two existing 'techniques' on which the method is based. These are Barter Networks and Vertical Integration. Both are forms of realizing commercial and productive transactions without the use of money.

5.2.1 Enterprise Barter Networks

The analysis of the organization and operation of Barter systems is of great interest to Strohalm as it materializes many of the ideas supported by the organization. Barter is a good example of how companies have created a sustainable tool that provides access to credit, and markets. In a brilliant example of market vision and initiative, companies have organized themselves in networks with an internal transaction system and an internal 'Transaction Unit', which is used to realize investments and buy and sell their goods and services.

Corporate barter is a relatively young industry that started to spread in the 1970s and was "boosted" by the advances of Information and Communication Technology. The phenomenon of Corporate Barter has grown to reach worldwide dimension, with some 16 billion US$ in trades conducted annually in North America alone and an estimated growth rate of 10 to 15 percent per year[8]. Today in the United States, some Barter Networks facilitate trade for hundreds of thousands of businesses. Other examples of Barter Networks are older, such as the Swiss *WIR-Wirtschaftsring*, founded in the 1930s, which has reached the impressive yearly turnover of 3 billion dollars, generated by its more than 70,000 members.

In the early 1990s Strohalm recognized the growing importance of Barter because of both the fast growing opportunities in the field of computer and Internet and its applicability as a development tool to support specific sectors of the economy in countries in which entrepreneurship is blocked by (unnecessary) monetary scarcity. Today, Strohalm promotes

[8] Data from IRTA- International Reciprocal Trade Association, 2001

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Oudegracht 42, 3511 AR Utrecht, The Netherlands
Telephone: + 3130 2314314 Fax: + 31 30 2343986
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and supports the creation and dynamisation of Barter networks for SMEs in Central and South America.

Evidence shows that the three most important factors pointed out by small companies as causes for their underdevelopment are: limited access to market information, difficult access to (cheap) credit and lack of purchasing power of (potential) clients. To these companies, barter systems can offer **a network**, a **portal to new markets** and an **access to low-cost finance**. Also, by creating more liquidity in the network, it creates **purchasing power for clients**.

Barter Networks can be seen as a network of businesses based on a common economic interest. Barter Networks provide a closed circulation of units, in which the units one company spends are very likely to return after some time to that same company as income. The participation in a Barter system expands the network of a company and, thanks to new Information and Communication Technologies, allows them to reach new markets, even outside of their region of operation. Barter is clearly complementary: companies operate in their original markets using national currency and make use of "Internal Units" to achieve extra trade. Since fixed costs are covered by a larger volume of sales, operational efficiency increases. In other words: Barter activity can often be realized against marginal costs, which makes it highly efficient.

Barter Networks provide low-cost credit lines and allow companies to replace their scarce (and expensive) money by "Internal (Trade) Units", thus alleviating their liquidity problems. Barter is an innovative option in the sense that companies are able to finance their purchases from *future* additional sales of their own product, instead of from *existing* sales or credit capital.

In summary, the **advantages for enterprises** that participate in a Barter Network are:

- Increased possibilities and viability of SMEs;
- Access to new suppliers and clients (broader markets),
- Access to a large network of companies (and consumers);
- Access to (cheap) credit (in Internal Units),
- Increased liquidity (in national currency),
- Rising sales;
- Reduction of unused capacity,
- More operational efficiency.

The **advantages** of a barter system **for a developing country** can be summarized in the following points:

- Activation of local economies (increased trade volume);
- Increased competitiveness of small and medium sized businesses, thereby increasing their income and employment possibilities of the population;
- Access to a large network of companies (and consumers);
- Reduction of the total amount of liquidity needed;
- Providing a semi-open (but also semi-protected) "incubating and nurturing" environment in which business talent can gradually adapt to world market standards;
- Providing a channel for local and regional investment programs

It is clear that the potential of the barter technique has much to offer to SMEs also in poor areas. However, five main obstacles hinder its proliferation in developing countries:

- The <u>financial volume</u> per transaction of SME's in poor countries <u>is</u> considerable <u>smaller</u> then that in rich countries. Since the main income of barters derives from sales

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Oudegracht 42, 3511 AR Utrecht, The Netherlands
Telephone: + 3130 2314314 Fax: + 31 30 2343986
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commissions, the profitability of intermediation (brokerage) is considerably lower in poor countries.

- Trade and production chains in poor countries are often short, because commodities are not transformed and many industrial products are imported. Within the EU and the USA trade chaines are generally much deeper. This has important implications for the volume of Internal Units that can circulate continuously within the network.
- Lack of adapted know-how. Few business-programs know about this opportunity and Strohalm is the only organization that makes an effort to adapt this methodology to a low-income environment.
- Initial promotion costs. As long as only few companies are members, the chances to spend positive balances without the assistance of professional brokers is rather small, making the network labor intensive and costly.
- Lack of appropriate and accesible software. There is no high-quality, open-source transaction software available. The software cost forms an insuperable obstacle for many interested starting networks. Instruments such as the software and hardware to integrate both vouchers[9] and Internet-based transactions are very important for the implementation of these systems in less developed markets, but they lack commercial attractiveness[10]. Vouchers are, in turn, needed in areas where Internet is not yet easily accessible by many people or for illiterate populations.

Strohalm has developed solutions to overcome these obstacles by adapting the Barter-concept to a low-income environment. This new model is called C3: Consumer and Commerce Circuits. Basically, C3 combines the concept of Barter Networks with that of administrative integration used in Transnational Corporations.

5.2.2 Administrative integration in Transnational Corporations

The internal organization of Transnational Corporations (TNC's) has undergone important changes during the past 30 years. Just like Barter Networks, the different branches of these conglomerates have integrated their accountancy systems both horizontally and vertically, often with the help of a contracted bank ("house bank"). Through this integration into a joint transaction system, most of the "administrative money" (money that is used to administer transactions between one branch and another becomes superfluous. This "liberated" liquidity is used for investments or to reduce debts.

TNCs have two advantages over Barter Networks:

- TNCs have a direct relation to the consumer market and the cash that flows in through this segment;
- The companies can optimize their total performance because they have access to detailed information about supply and demand of the different branches.

Strohalm has integrated the advantages of the TNC approach into the Corporate Barter concept, thus making the advantages of vertical integration enjoyed by TNCs available to independent Small and Medium Enterprises.

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[9] The term "voucher" is here used for Internal Units that have the form of a paper currency.

[10] Very much comparable to microcredit that in many cases successfully attends a target group that 20 years ago was considered "unbankable".

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Oudegracht 42, 3511 AR Utrecht, The Netherlands
Telephone: + 3130 2314314 Fax: + 31 30 2343986
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5.3 Consumer and Commerce Circuit (C3)

5.3.1 Description of the C3 concept

The C3 method is, in many ways, similar to the operation of Barter systems: like a Barter, the C3 organizes a network of independent companies and like a Barter, it makes use of an internal Transaction Unit to perform and register payments within the system.

However, the C3 also shows important differences in comparison with Barter Networks:

(a) the **inflow of consumer money**, which permits:
- the (total or partial) **convertibility of Internal Units** into money, guaranteed by a financial institution; and
- a **low-cost credit program** (in money) to finance investments by the member companies.

(b) The involvement and combination of professional partners such as a bank and a marketing/barter company that make earnings according to their turnover and a member structure that allows involvement on the level of targets. The board of the C3 is chosen for by the members. Members are both the consumers and businesses that have signed a membership agreement with the system. This board decides on how benefits are distributed.

Moreover, the C3 method foresees instruments of internal dynamisation, which are completely new to Barter Networks or most other trade or financial organizations. The two innovations are:

- a **charge on positive balances** (“demurrage” or “liquidity tax”) to stimulate and accelerate transactions within the system. Positive balances are taxed with a 1/30% *liquidity tax* per day. The liquidity tax not only accelerates the circulation of the Internal units, but also generates an income for the system, that pays for the professional partners, to reduce the risk premium on loans to members or for social community projects.
- A ***bonus/malus*** **system** to attract purchasing power in cash (national currency) and to discourage conversion from Internal Units into cash. Members of the Network buy the Internal Units, at a 1:1 rate, and by doing so gain extra Units as a bonus. This bonus attracts the inflow of money, and is equilibrated by a “malus” that will be charged to whoever converts the Units back to money, thus stimulating continued internal circulation.

For every Unit in circulation, there is 100% backing (in credit titles and national currency), that is kept in a savings account of a financial institution. The C3 has an agreement with this financial institution that - on the base of these savings - grants interest-free[11], low-cost loans to the business members. Initial external (brokerage) support is needed to ensure that the holders of positive claims are always able to purchase items. As the system (and the availability of products) grows, spending within the network will become easier and less brokerage is needed. At the same time more consumer money will flow into the system creating a pool of cash that is partially used and from which with help of the bank interest-free loans can be realized.

[11] *Interest* is here defined as the remuneration for capital providers who put their savings at the disposal of the system. Within a C3, money is withdrawn from circulation and substituted by an internal currency. In this way, the C3 can attract money without compensating any savers.

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Oudegracht 42, 3511 AR Utrecht, The Netherlands
Telephone: + 3130 2314314 Fax: + 31 30 2343986
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These new possibilities build into the C3 model allow to tackle the five main obstacles that hinder the spreading of the barter technique in developing countries:

- Automated registration of transactions (through internet-based software) and an incentive based on Bonus/Malus instead of brokerage makes the C3 sustainable, even in the situation of low volume per transaction.
- The availability of cash within every C3 provides the possibility to allow and stimulate international trade between C3's in different countries. At the same time for this international trade is subject to a tax (according to Keynes' *Bancor*-concept) that allows every nation to optimize their capacities. This increases the possibility to keep purchasing power with in the C3 system, even if local trade chains are short.

The realization of pilots and the adaptation to various circumstances should be able to make this methodology a recognized opportunity for SME stimulation in a low-income environments

In most situation a "hybrid" model between C3 and Barter is a powerful tool to start a network: in that case Units are partly backed by money (emitted when Units are purchased with money, or if garantee-capital is available for to back the internal credit given to the members). Another part of the units are backed by sales and production capacity in the network (emitted as credit and depending on the depth of the local economy and the differentiation of the members at the horizontal level). The emission of Units in the form of credit of course affects the convertibility of the Units, but on the other hand increases the possibility to create extra liquidity.

The following table resumes the characteristics of the three models, combining features of Barter and C3:

Characteristic	**Barter**	**Barter/ C3**	**C3**
Participants	Enterprises	Enterprises and consumers	Enterprises and consumers
Way of emission of Internal Units	100% credit	(a) Mutual credit and credit backed by cash guarantees (b) Selling Internal Units for money	100% selling I.U.[12]s for money
Credit facilities for members	Only in Internal Units (I.U.)	Only in I.U.	In I.U. convertible in national currency
Backing	Guarantees of the debtors	Partly money, partly guarantees of debtors	100% money
Convertibility of I.U. into money	None	Selected enterprises can convert up to certain amounts	All I.U.s can be redeemed against the *Malus*-fee
Instruments to stimulate internal circulation	Intensive intermediation by brokers	(a) Brokers (b) "Liquidity tax" (c) "Bonus / Malus"	(a) "Liquidity tax" (b) "Bonus / Malus" only initially some brokers and training

One of the structural malfunctions of present day' s monetary system is that it does not provide consumers with the signals or incentives about the chance that their purchasing power will return to them, as employees (salary) or entrepreneurs (sales). In other words: for the individual consumer it might be attractive to buy external goods, but for the local economy as a whole (including the consumer) this purchase will be harmful, because money

[12] I.U. = Internal Unit

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(purchasing power) drains form the community. This is an especially relevant issue in developing communities where purchasing power leaves economies and regions extremely fast. A C3 system **does** give these signals, and stimulates local consumption because the Internal Units can only be spent with members. The *Malus* discourages convertibility of Units into Money stimulates internal consumption, thereby realizing that purchasing power has the preference to come back to the consumer.

The "chicken-egg" dilemma plays an important role in the development of these networks: enterprises expect access to new clients and low-cost loans, while consumers participate because they expect lower prices (resulting from reduced financial costs of the enterprises and the lengthened circulation of purchasing power). However, if both sides wait for the advantages before participating, the cycle will never be activated. The solution is an initial external provided rotating fund that creates the possibility to offer participating enterprises access to low-cost loans from the very outset. The rotating fund can be either an interest-free loan or donation.

The C3 is a modern and competitive business solution that is perfectly fit to operate within market conditions. Competition and specialization are features that characterize both the C3 and the market economy, only at a different scale. Inter-C3 exchange between different regional networks is also a possibility. This way, competition does not only take place within the C3, but also between enterprises of different C3s. Enterprises that are willing and able to grow beyond the regional (C3) level are granted a privileged channel to external markets, which is an incentive to further increase their competitiveness. A set of rules, based on Keynes' Bretton Woods ("Bancor") proposal to balance international monetary and financial relations, governs inter-C3 trade.

The operations within the C3 system are registered and administrated by the C3 software, especially designed by Strohalm's specialists. C3s can operate with internet-based transaction software as well as with paper vouchers circulating within the membership structure. In the latter case, the software registers withdrawals and deposits of paper vouchers. The software also offers the possibility to connect several C3 networks, operating under similar rules, enlarging the spending possibilities within the network and prolonging the internal productive chains. The C3-model is relatively easy to replicate if software and training are available and suitable (financial, consumer and/or enterprise) organizations exist.

In summary, the **advantages for enterprises** that participate in a C3 are:

- Enlarged possibilities and viability of small and medium seized businesses;
- Access to new sources and clients/ broader markets,
- Access to a large network of companies (and consumers);
- Access to (cheap) credit,
- Incremental sales;
- Increased liquidity,
- Reduction of unused capacity,
- More operational efficiency;
- The possibility of a joint strategic effort to penetrate external markets;
- The benefits of participating in a joint consumer program.

5.3.2 Consumer and Commerce Circuit in practice

The C3/ Barter is a flexible tool that gives every group of participants the possibility to adjust it to their specific needs. Several small-scale pilot projects that test the C3 concept in Brazil and El Salvador are in its preparation or execution phase of :

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- El Salvador: *FADEMYPE*[13]*'s Red Empresarial de Trueque* (RET), a Barter Network of 150 small companies representing many different sectors in San Salvador, uses the C3 methodology to expand and enhance its activities.
- Brazil: C3 circuits with partners such as FIEP (chamber of industry of Parana), SEBRAE, UBEM (Brazilian Empretec) are under construction to create new business opportunity.
- Brazil: the *Municipal government of São Sepé* in Southern Brazil prepares a project in which part of the expenditure of the municipality is channeled through a C3, thus boosting the local economic activity.

In all these situations Strohalm, together with its local partners, plans or executes pilot-projects that will generate practical results in the medium run.

Strohalm offers these partner organizations:

- Know-how: development and adaptation of the method into a project that fits in the specific circumstances,
- Consultancy, advisory and training services in the operational implementation and improvement of the project/ method,
- Software solutions,
- Upgrade to other methods,
- Connection with other networks.

[13] *Fundación para el Autodesarrollo de la Micro y Pequeña Empresa* (Foundation for the Self-Development of Micro and Small Enterprises).

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Telephone: + 3130 2314314 Fax: + 31 30 2343986
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