The Power of Folk Banking
Why Homespun Financial Services Will Not Disappear Any Time Soon

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For decades, “formalization” has been the hue and cry of financial inclusionistas. A manifesto has emerged, blending fact, fiction, and wishful thinking into a declaration: formal services, supervised by regulators, are better bets for the world’s poor than informal services.

What we should be reviewing is not whether the service is regulated but whether it is safe, legible, useful, fair, dignified, and familiar.

Familiarity breeds contentment

Let us start with familiarity, an element often under-rated by inclusionistas. As a person, rich or poor, you likely do what your family and friends do when it comes to money services. If they are using Western Union to transfer money, then you will use Western Union. If they are using hawala, so will you. If they are purchasing clothes from the local shop in installments, you will too. You want to make as few financial decisions as possible. Money management is intimidating, and thus fatiguing. You want to turn to sources you can trust, that are there for you when you need them, and that seem familiar. In finance, familiarity breeds contentment.

Speaking of family, let us take a look at Our Family Social Credit Union, with its 511 members in 22 states. If you deposit $5 along with a 25-cent handling fee, you can become a member - with one more condition: You must be part of the Cain family. Manley and Lucy Cain started the credit union in the 1950s. Today, family members find its services crucial and turn to Sue Cain, who manages OFSCU, when they need to borrow for a new car, prepare for a new baby, or fund college expenses. That this pool of family funds is state-regulated seems less important than members’ familiarity with the service and its procedures.

We may already know about Rotating Savings and Loan Credit Associations (ROSCAs), distant cousins of the credit union, which are ubiquitous in some parts of the world. For instance, in Egypt, finding an adult who is not part of a gam’iya (the generic name for the local ROSCA) is a challenge. In Syria, I met rural Bedouins routinely saving $1, as well as urbanites saving $5,000 a month. Rich and poor, members in such clubs used the same formula – the rich using the gam’iya to fund purchases of second homes and the poor using it to buy sheep. Every member
regularly put in the same amount of money and each meeting a different member took the money home. This went on until everyone had a turn. One paper indicates clear rejection of formal credit on religious grounds in favor of the gam‘iya. The rich of course use formal credit and have various savings and investment accounts.

These local clubs thrive in the US as well. Harvard Square thrums with the ROSCA system, with money in yellowed envelopes passing in and out of cab windows. Haitian taxi drivers use the Sol to save up for their children’s school or to buy a second cab. Logan airport booms with similar action: Ethiopian taxi drivers depend on their iqub as a cash-lumping device.

But not all clubs of these kinds work in the same way. For instance, New Jersey, sub-clubs self-unify to form their Tanda, the generic name for a ROSCA in parts of Mexico. In this version, privacy is crucial. No single member of the Tanda knows the identity of all members. He or she only knows sub-club members. The manager works to protect the secrecy of its membership, and even she does not know the identity of many sub-club members.

Accumulating savings clubs (ASCAs as we call them), where members borrow from pooled savings, flourish in other parts of the world. In villages in lower Assam, one of India’s northeastern states, individuals take part in multiple ASCAs, with households in one village belonging to an average of four such clubs. The ones I visited had formed as silk-weaving clubs. Members deposited weaving income into their Xonchois (their term for an ASCA). They then borrowed from their Xonchois to purchase musical instruments, each member owning and mastering a different one. Members performed at local ceremonies as a troupe, earning money as they did so. New income was churned back into the ASCA to upgrade musical instruments, to purchase weaving equipment and raw silk, or to fund important family events.

The ASCA need not be confined to picturesque scenes of bamboo-rimmed ponds and rice paddies. The concept has gone cyber. Take Puddles.IO, which functions as an online ASCA. If you are on Facebook, you are eligible to join. Through Paypal or another payment service, you can deposit as little as $10. The rules of your club (who can borrow at what interest rate for which purpose) are determined by the Founder of each Puddle. If you don't like the rules or the people in your Puddle, feel free to convene a new one. In just two months, Puddles.IO has established 60 financial clubs with 300 members. Thus far, members have used funds to start a coffee business, purchase a bicycle, and buy furniture.
But is folk banking – banking with neighbors and co-workers – really enough?

Don’t people, however poor, want real bank accounts? Don’t they want to watch their savings grow without their neighbors leaning in and demanding a piece of the action? Don’t they want their interest to compound while they sleep, or to dip into an overdraft facility every now and then? Naturally, they would want a fairly priced home mortgage or a student loan.

Yes, of course. Folk banking is not enough. Poor people want more but the More that gets served up to them is typically not better, however formal it may be. The More they get is often fee-laden, unfamiliar, or simply unsafe. The 1999 Ugandan banking crisis wiped out smallholder savings. It was a formal system. The successive collapses of the Soviet and Russian banking systems fleeced depositors, leaving them unnerved by the memory and the prospect of vanished savings. Again, they were formal systems. How would you feel if you were a formal, low-income saver today in Ukraine? In Cyprus? A little nervous, I imagine.

Even without formal sector collapses, the poor must often choose between high-priced formal credit or none at all. Banco Compartamos, dedicated to serving the poor and a member of the SMART Campaign (in which participating institutions pledge fair pricing), is famous for its APR well above 70%, and above 100% if tax is taken into account. With all its subsidies, Compartamos still does not bother to offer savings services. What kind of inclusion is this? It’s the kind that goes for the Achilles Heel of the poor – debt on your doorstep and in your face, offered at any price. That Compartamos is regulated probably does not matter to the millions of users gathered into its fold. That it seems slightly familiar - local in a groupish way – probably does.

Wild profiteering masked as “inclusion” aside, how does trust evolve within folk banking, mobile money, or regular banking?

With savings, transfers and insurance, the user must believe that someone, some institution, or some system is controlling the underlying conditions of trust: Safety, usefulness, legibility, fairness, dignity, and familiarity. In a well-run financial system, these elements can be found
outside of the user’s immediate control. And if not found outside the user’s immediate control, the user reaps them in closer to home: Into the local hawala, into the folk-banking cash box, or closer still, beneath the mattress.

With credit, users are far more elastic in their demands. The service need not be so safe, useful, legible, fair, dignified, or familiar. It only needs to exist, at least up to some undefined threshold of abuse – an abuse of trust – at which point users fight back as they already have in India, Nicaragua and the United States; and as they might still in Chiapas. When faith in formal services crests, users refocus on the familiar safe-havens of the ROSCA, the neighbor with spare cash, and the mattress.

Yet, just when we might have given up on the formal system and its various occlusions, along comes Pan American Bank with its Citizenship Loan, a legible, very useful, fairly priced loan of $1,000 for immigrants hoping to finance their US citizen application fees. Keep up these kinds of nice surprises, formal sector, and watch cash travel from the familiar mattress into your unfamiliar vault.