Commodity Resource Currency: History of an Idea

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Outline

1. Keynes' (1941) International Monetary Reform
2. Graham's (1944) International Monetary Reform
3. Kaldor's (1964) International Monetary Reform
4. International Commodity Corporation (ICC)
5. ICC Similarities, Differences, Problems
6. Smooth World Business Cycle
7. Global Imbalances – a periphery-core model
8. Exchange Rate Regimes Matter
9. Summary – A Vision for the Future?

Keynes in 1941
International Monetary Reform
and their watered down outcomes

1. International Clearing Union (ICU) (→IMF)
2. A reconstruction and relief organization (→WB)
3. International trade organization (→WTO)
4. International Commodity Buffer Stocks (↛ICC)

Keynes' 1941
Original International Clearing Union (ICU)

1. Moderate global imbalances by penalties ultimate confiscation

2. Promote trade by rebalancing surpluses to deficit countries

3. Capital controls & fixed but adjustable exchange rates

4. Endogenous Bancor supply in response to demand for imbalanced trade

5. Bancor is NOT backed by a basket of commodities or 'tabular standard'

Benjamin Graham's (1944) International Monetary Reform

Submission to Bretton Woods for a Commodity Reserve Currency (CRC) to complement Keynes' Bancor.

CRC goals:

1. Fixed exchange rates to CRC offer real exchange rate stability

2. Price stability, limit cost push inflation

3. Security and access to raw materials

4. Smooth the world business cycle

5. Expand World Growth

Benjamin Graham's (1944) International Monetary Reform

"[I]f surplus stocks do operate as a national liability rather than an asset, the fault must lie in the functioning of the business machine and not in any inherent viciousness of the surplus itself…Some means must be found to restore the Goddess of Plenty to the role of benefactress-in-chief that was hers without question under a simpler economy." (Graham 1937, pp.16-17)

Nicholas Kaldor's International Monetary Reform UNCTAD 1964

1964 Kaldor, Hart, Tinbergen CRC was called Bancor in honor of Keynes, and was a universal solution intended to:

- resolve the international liquidity crisis, endogenous production of reserves with 100% backing by commodity basket.
- provide an automatic stabilizer in world trade, injecting liquidity and effective demand during a period of low demand, and moderating cost push inflation and contracting liquidity when demand is high.
- create an international monetary system that allows national monetary and fiscal autonomy, and remove balance of payment constraints to commodity producers.
- stabilize global imbalances by allowing reserve creation not tied to trade deficits of key country, and targeting the terms of trade between commodities and manufactured goods.

Nicholas Kaldor's International Monetary Reform UNCTAD 1964

- increase the availability and democratic accessibility of food and raw materials necessary for accelerated industrialization: resource security;

- Stabilize commodity prices and income to producers, reducing excessive commodity speculation and creating a form of world fiscal policy where payments go to commodity producers during recessions; and

- bring economic progress to the world's poorest countries and balance the distribution of world growth.

- Many goals are possible with one instrument as outcomes are positively correlated

Nicholas Kaldor's emphasis on the developing world Periphery vs Core Countries

"While any given rate of expansion of primary production may be more than is required to support the industrial expansion of the countries which are *already fully industrialized*, it can be viewed as 'excessive' only if we ignored the possibilities of accelerated industrialization in all those areas which still have large labor reserves in agricultural sectors, and whose industrialization could be stepped up very considerably under favorable conditions"
(Hart, Kaldor, Tinbergen 1964).

Graham and Kaldor
Commodity Basket 15-60 commodities

Standardized and storable commodities for possible inclusion in an international commodity reserve currency.

Agricultural Raw Materials	**Edible Oils**	**Metals and Energy**
Cotton	Rapeseed	Copper
Wool	Canola	Zinc
Rubber	Palm Oil	Tin
Wood		Lead
Paper Pulp	**Food and Beverages**	Aluminum
	Sugar	
Wheat	Coffee	
Corn	Tea	Columbite-tantalite*
Rice	Cocoa	Natural Gas*
Soybeans	Pork bellies, frozen	Ethanol*
Oats	Orange Juice, frozen	Bio-diesel*
	Dried Milk	Carbon Permits*

*Commodities not in previous the Graham or Kaldor plans.

International Commodity Corporation (ICC)
Keynes, Graham, Kaldor
Similarities

1. Stabilize prices and promote investment in production of raw materials, increase productivity
2. Development of rural areas, reduce inequality
3. Create additional liquid assets
4. Promote robust growth for both commodity and manufacturing
5. Promote free trade in commodities

International Commodity Corporation (ICC)
Keynes, Graham, Kaldor
Similarities

6. Free and equal access to raw materials
7. Anchor commodity prices against harmful speculation (20% range)
8. Stabilize cost push inflation
9. Stabilize income of commodity producers
10. Automatic International Counter cyclical monetary policy

International Commodity Corporation (ICC) **Differences**

Keynes

1. Stabilize **individual** commodity prices (20% range)
2. Stock pile **individual** commodity stocks
3. Stocks must be financed (borrow from ICU)
4. Fixed but adjustable exchange rates with Capital Controls
5. Resolve Global imbalances through ICU rules

International Commodity Corporation (ICC) **Differences**

Graham and Kaldor

1. Stabilize an index of commodity prices, individual prices are flexible (10% range)
2. Stock pile a basket commodities in relation to world trade and production (10%)
3. Automatically financed by issuance of 'bancor'
4. Flexible or Fixed Exchange rates
5. Moderate global imbalances by stabilizing commodity-manufacturing terms of trade.

International Commodity Corporation (ICC)
Problems

All 3

1. Inventory mismanagement leads to excessive waste
2. Costly storage
3. Stocks must audited to be trusted
4. Need enough commodities to stop rising prices else a 'run' on ICC
5. Private businessmen's fears of stockpiles power to depress prices

Keynes Specifically

6. Excess stockpile of individual commodities
7. Costly to stockpile, need financing and donations

Graham and Kaldor Specifically

6. Excess stockpile of basket of commodities in ratio to industrial need
7. Stabilizing index can destabilize individual commodity prices

Smooth the World Business Cycle

- Commodity buffer stocks would act as an automatic stabilizer
- Through open market operations the ICC would buy commodities and inject reserves into the system when commodity prices were low and sell commodities and take money out of the system when commodity prices were high.
- With a much bigger multiplier than gold, it would stabilize incomes for all commodity producers in the world not just those who received reserves.

Global Imbalances and Commodity Volatility

- Export-led growth by devaluation to USD - Germany, Japan, China etc.
- These countries promoted competiveness of manufactured goods by rising market share, increasing returns to scale and Verdoorn's law which improves the 'efficiency wage'.
- Currency competition between export led countries: no trade off between rising cost of imported raw material inputs and competitiveness, as other (commodity producing) developing countries devalue to promote export of manufactured goods.
- Volatility in USD exchange rates since 1980s, and stronger dollar - lowers the terms of trade for commodity producers
- Beggar thy neighbor tactics, unrequited exports, exports unemployment to trade deficit countries (e.g. US).

Global Imbalances: Dilemma

"So long as countries preferred the benefits of fast growth and increasing competitiveness to the cost of part financing the United States' deficit (or what comes to the same thing, preferred selling more goods even if they received nothing more than bits of paper in return), and so long as a reasonable level of prosperity in the United States (in terms of employment levels and increases of real income) could be made consistent with the increasing uncompetitiveness of United States goods in relation to European or Japanese goods, there was no reason why any major participant should wish to disturb these arrangements. **But with the passage of time these preconditions became increasingly tenuous.**"

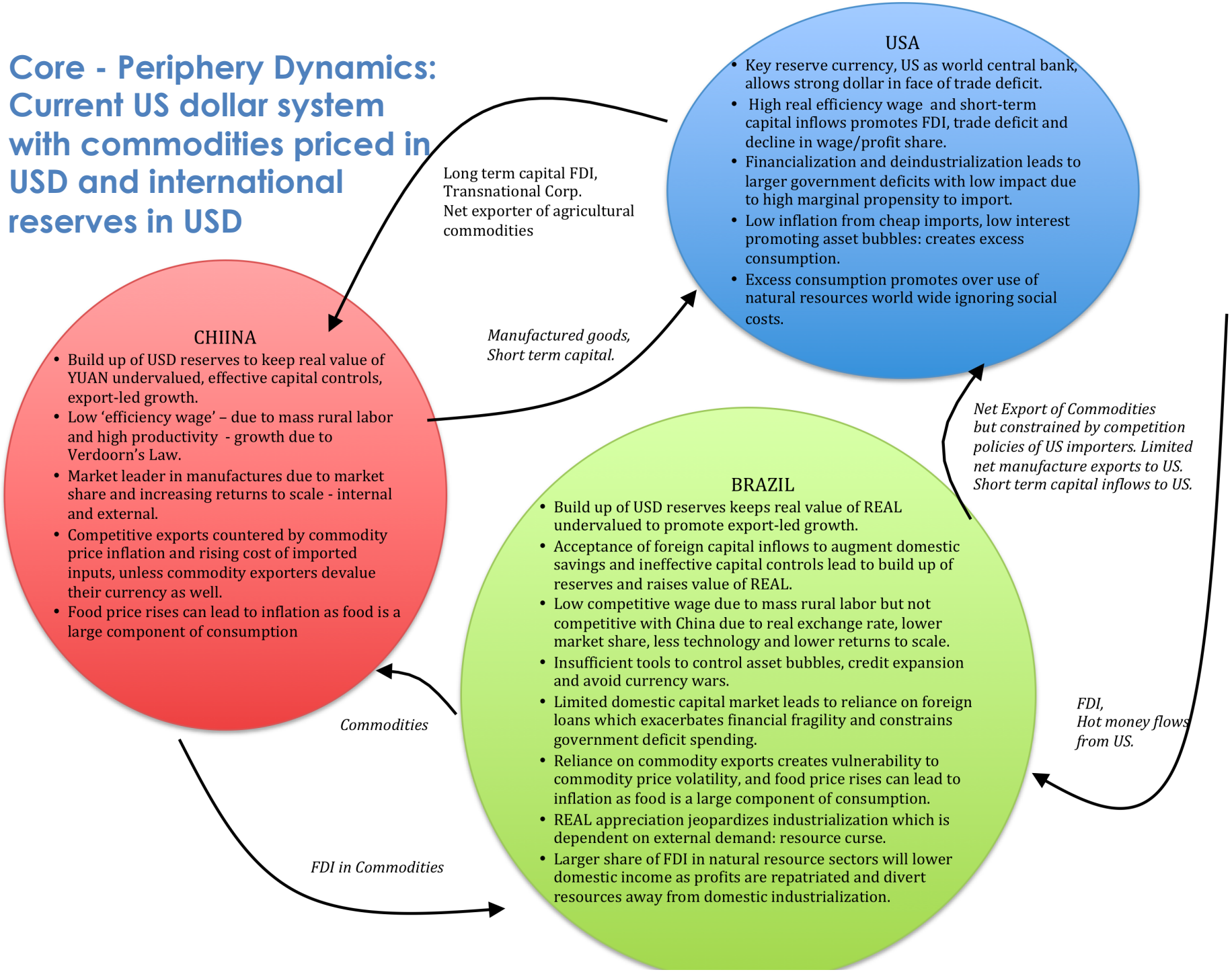
Kaldor, N. (1971) The Dollar Crisis, *The Times*

Global Imbalances and US Deindustrialization

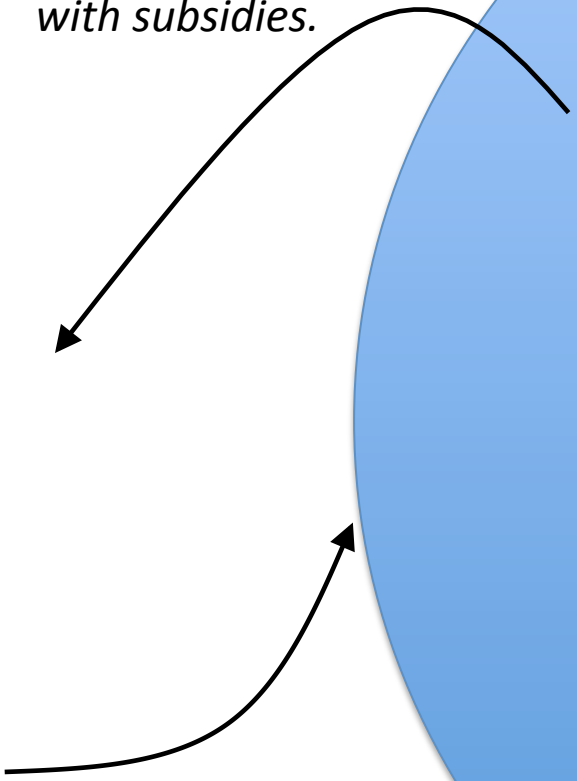
"[T]ransforming a nation of creative producers into a community of rentiers increasingly living on others, seeking gratification in ever more useless consumption, with the debilitating effects of the bread and circuses of Imperial Rome. In addition, the objectives on which successive American governments spent their freely-printed money appeared either so useless or morally repellent —lunar flights or Vietnam wars—as to arouse increasingly universal hostility against the System, both inside and outside the United States."

(Kaldor, 1971, p. 64, *The Times*)

Core - Periphery Dynamics: Current US dollar system with commodities priced in USD and international reserves in USD



Long term capital FDI, Transnational Corp. Net exporter of agricultural commodities with subsidies.



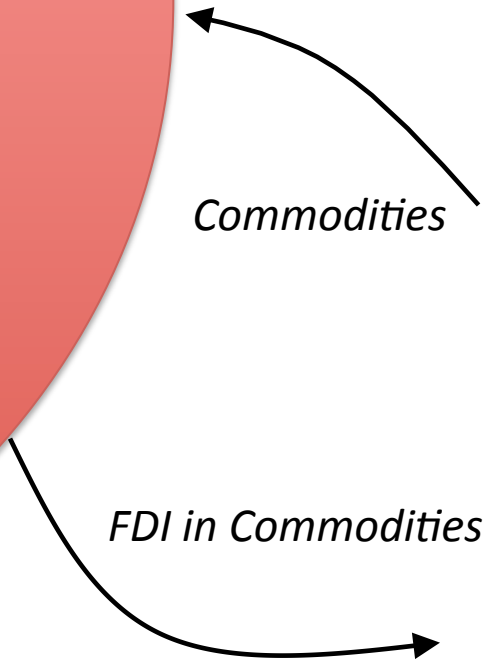
Manufactured goods, Short term capital.

USA

- Key reserve currency, US as world central bank, allows strong dollar in face of trade deficit.
- High real efficiency wage and short-term capital inflows promotes FDI, trade deficit and decline in wage/profit share.
- Financialization and deindustrialization leads to larger government deficits with low impact due to high marginal propensity to import.
- Low inflation from cheap imports, low interest promoting asset bubbles: creates excess consumption.
- Excess consumption promotes over use of natural resources world wide ignoring social costs.

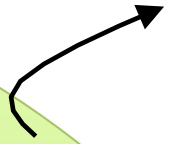
CHIINA

- Build up of USD reserves to keep real value of YUAN undervalued, effective capital controls, export-led growth.
- Low 'efficiency wage' – due to mass rural labor and high productivity - growth due to Verdoorn's Law.
- Market leader in manufactures due to market share and increasing returns to scale - internal and external.
- Competitive exports countered by commodity price inflation and rising cost of imported inputs, unless commodity exporters devalue their currency as well.
- Food price rises can lead to inflation as food is a large component of consumption

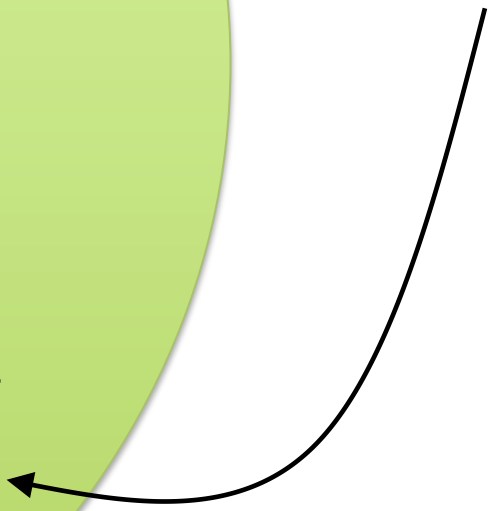


BRAZIL

- Build up of USD reserves to try and keep real value of REAL undervalued to promote export-led growth.
- Accept foreign capital inflows to augment domestic savings. Ineffective capital controls lead to build up of reserves and appreciate REAL.
- Low competitive wage due to mass rural labor but not competitive with China due to real exchange rate, lower market share, less technology and lower returns to scale.
- Insufficient tools to control asset bubbles, credit expansion and avoid currency wars.
- Limited domestic capital market and reliance on foreign loans which exacerbate financial fragility and constrains government deficit spending.
- REAL appreciation jeopardizes industrialization which is dependent on external demand: Dutch Disease
- Larger share of FDI in natural resource sectors will lower domestic income as profits are repatriated and divert resources away from domestic industrialization.
- Reliance on commodity exports creates vulnerability to commodity price volatility. Food price rises can lead to inflation as food is a large component of consumption.

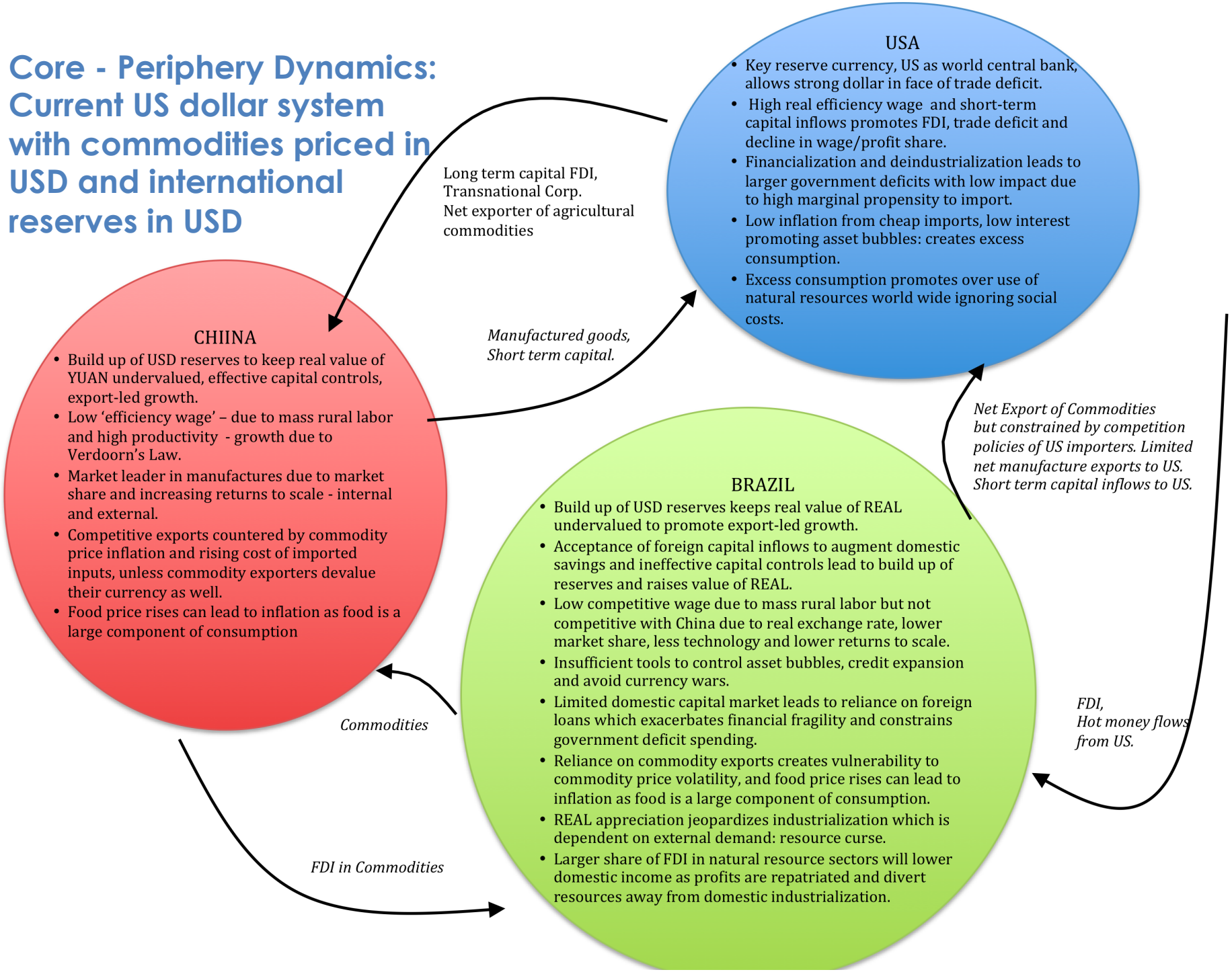


Net Export of Commodities but constrained by competition policies of US importers. Limited net manufacture exports to US. Short term capital inflows to US.



FDI, Hot money flows from US.

Core - Periphery Dynamics: Current US dollar system with commodities priced in USD and international reserves in USD



Core - Periphery Conclusions

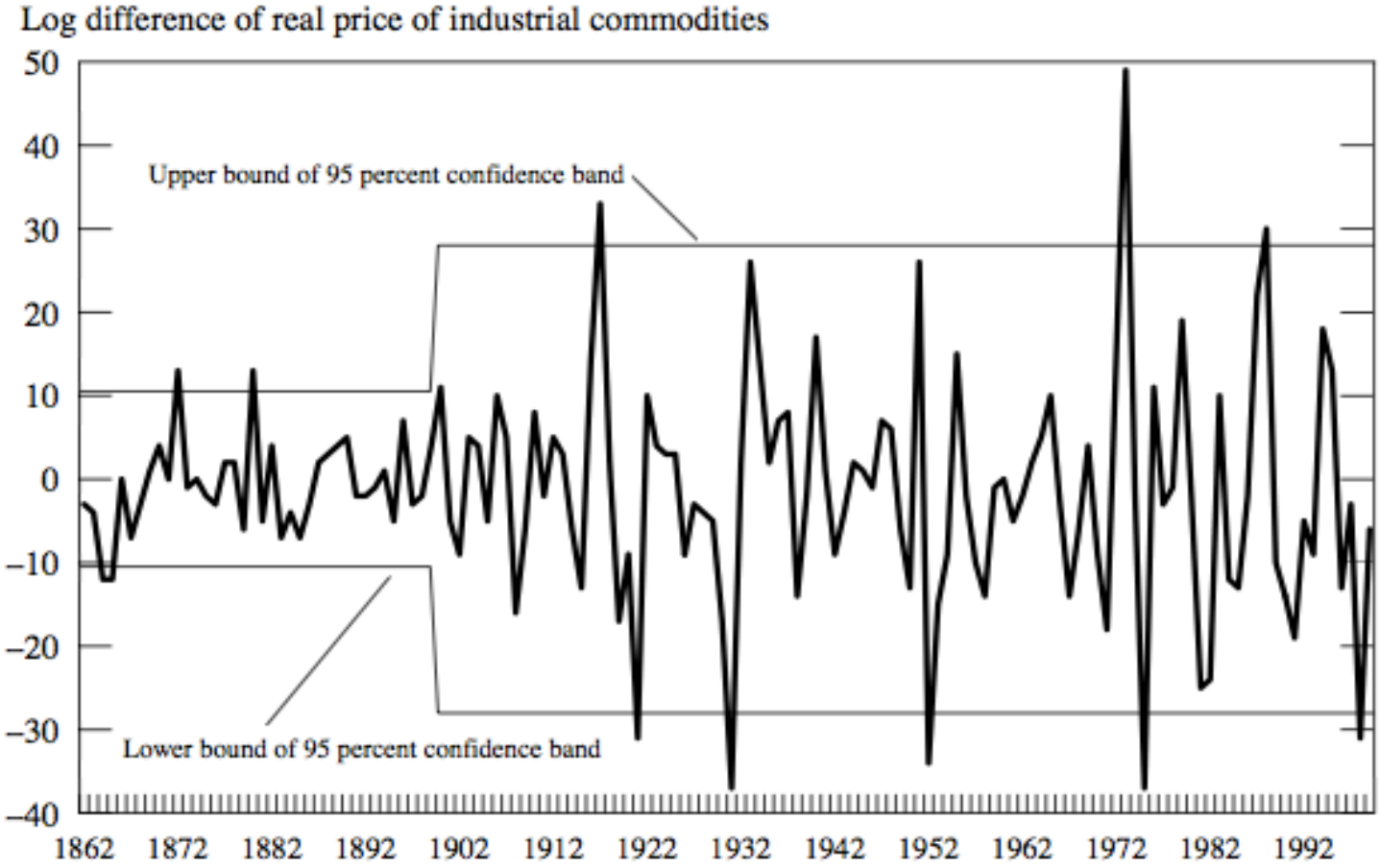
- Build up of global imbalances
- US financialization and deindustrialization
- Overconsumption and excess pressure on natural resources
- Dutch Disease or Resource Curse due to rising commodity pricse and currency appreciation. Double down with increase in capital inflows.
- Manufactures are fix-price and flex-quantity markets, (Price changes of manufactures occur based on changes in cost of inputs - labor or raw materials. Inventory cycle or capacity utilization is variable that allows stable prices). Commodities are flex-price and fix-quantity markets.
- Inequality is due to positive feedbacks and 'Cumulative Causation'.
- Monopoly controls over supply chains leads to political tensions.

Global Balance with a CRC

- A stable terms of trade between commodities and manufactured goods: anchor real price of commodities
- Devaluing will raise the cost of raw material imports and the cost of producing manufactured goods for export.
- There is a trade off between between terms of trade and competitiveness, and beggar thy neighbour devaluations are less likely by commodity importers.
- We see pressure occurring now in China, …. but this has taken a long time to arrive as competing exporters also devalue their currency. China also stock piles commodities in times of low prices.

Exchange Rate Regimes Matter

Increasing Volatility of Real Price of Industrial Commodities, 1862–1999

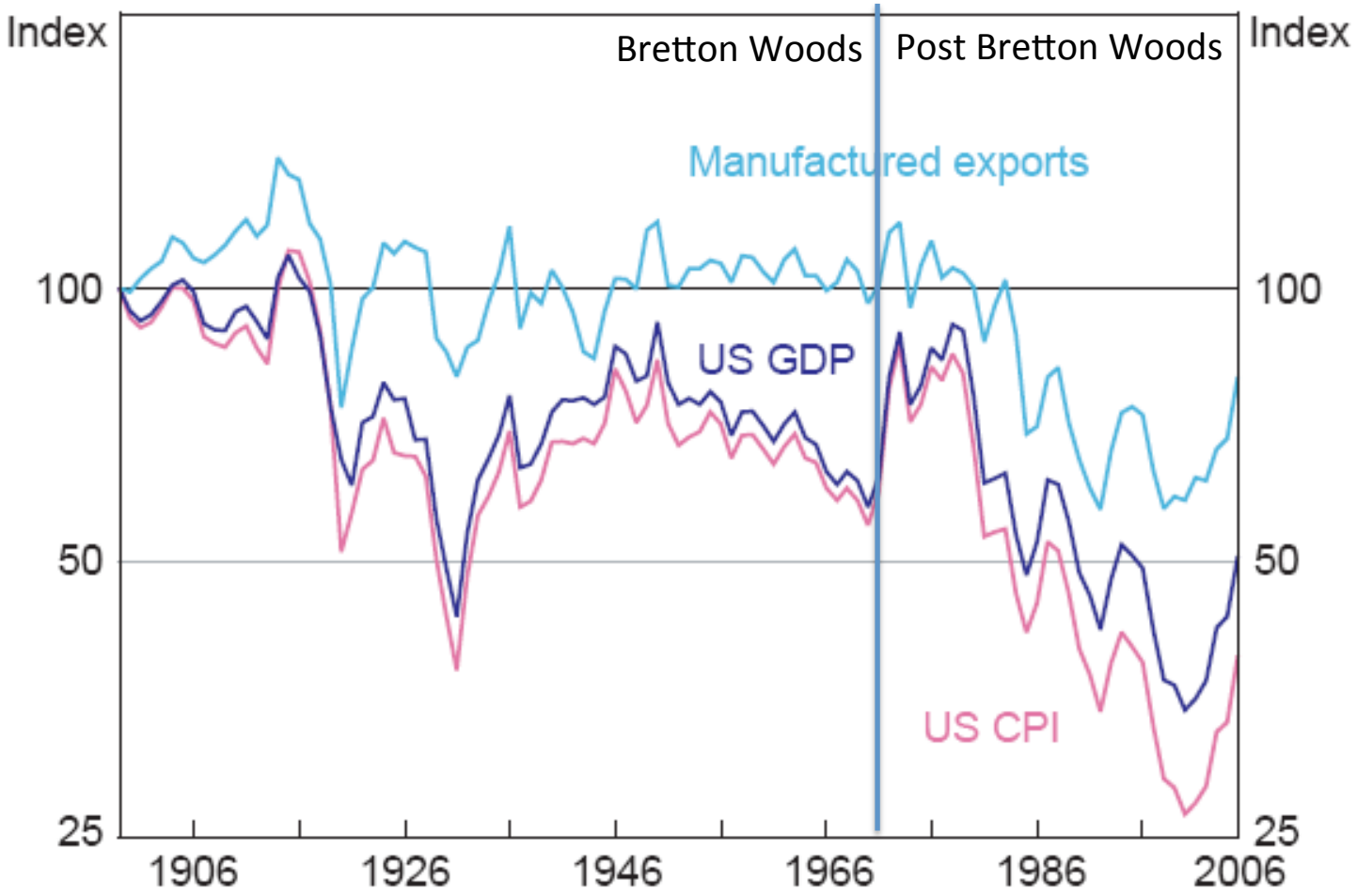


Source: Cashin and McDermott (2002)

Exchange Rate Regimes Matter

Real Commodity Prices

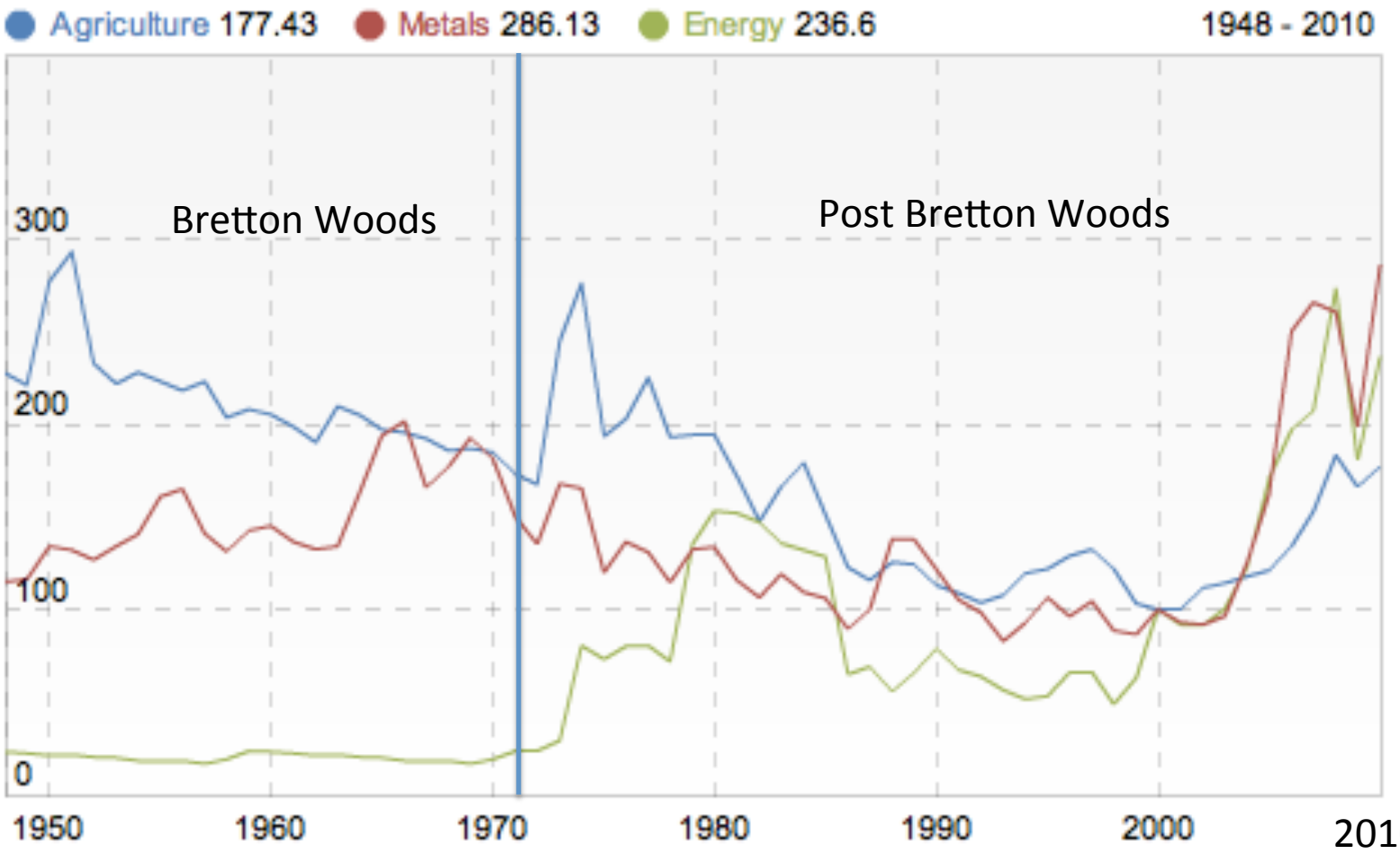
1900=100, log scale, deflators as indicated



Exchange Rate Regimes Matter

Commodity Price Indices

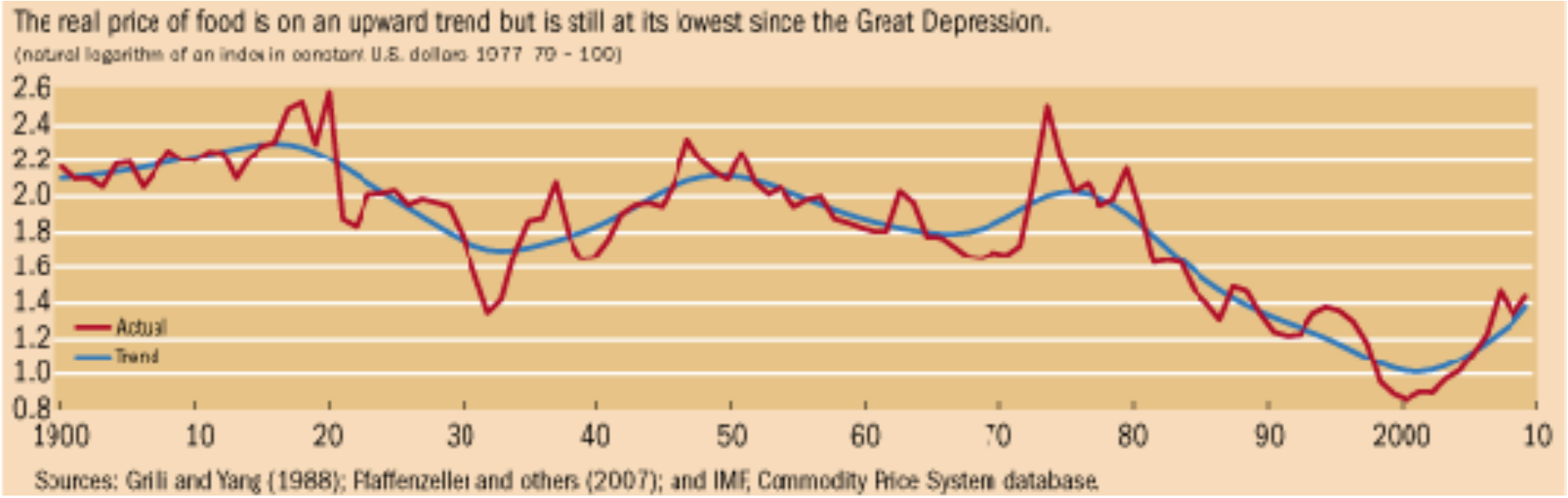
(Real, MUV deflated) (2000 = 100)



Source: World Bank, Development Prospects Group

Exchange Rate Regimes Matter

Real food prices remain historically low



Is CRC A Vision for the Future? Summary

- Automatic Stabilizer to smooth international business cycle
- Flexible exchange rates with an anchor allows independent national counter cyclical policies
- Promote Growth: circular cumulative causation
- Create new privately held liquid reserves
- Reduce Inequality by reducing rural poor
- Reduce global imbalances and promote aggregate world demand
- Resource security: create a buffer stock of materials essential to economic industrialization and growth, with equal access
- May even be room to include renewable and green commodities into the index.

Is CRC A Vision for the Future?

John Maynard Keynes' response to Graham and Hayek's international CRC proposal

"I have no quarrel with a tabular standard [commodity basket] as being intrinsically more sensible than gold. My own sympathies have always fallen that way. I hope the world will come to some version of it some time. But the opinion I was expressing was on the level of contemporary practical policy; and on that level I do not feel that this is the next urgent thing or that other measures should be risked or postponed for the sake of it.... The right way to approach the tabular standard is to evolve a technique and to accustom men's minds to the idea through international buffer stocks. When we have thoroughly mastered the technique of these, which is sufficiently difficult without the further complications of the tabular standard and the oppositions and prejudices which this must overcome, it will be time enough to think again" (Keynes 1943).