

## **Towards a Sustainable Global Financial System**

### **Assessing the Perspective of Special Drawing Rights Linked to Commodity Buffer Stocks**

#### **1) An Urgent Inquiry**

What transformations of the global financial system are required to ensure a sustainable development of humankind in the 21<sup>st</sup> century? The Institute for Advanced Sustainability Studies – IASS – in Potsdam has started an investigation of this question. To support this inquiry, it will organize a series of workshops together with the European research network Global Systems Dynamics and Policy, coordinated by the Global Climate Forum. The first such workshop will take place December 8-9, 2012, in Potsdam, Germany. It will be dedicated to an assessment of the proposal for a sustainable financial system made by the governor of the People's Bank of China.

This is the first long-term proposal made by a major figure in today's global financial system, and it builds on an impressive sequence of intellectual and political precedents. In a nutshell, the proposal envisages a transition from the present, Dollar-based system towards a system anchored in Special Drawing Rights (SDR) emitted by a suitably enhanced IMF. These SDRs, in turn, can be defined not in terms of consumer price indices as is the case with today's currencies, but in terms of a price index for critical resources the world economy relies on. Relevant goods could include coal as well as emission permits for greenhouse gases. Ultimately, buffer stocks of related commodities may complement the classical instruments of monetary policy. Clearly, the proposal has major geopolitical, economic and environmental implications, all worth careful investigation.

The Potsdam workshop will be the first systematic effort at assessing that proposal. It will do so in a sustainability perspective – a perspective all too often missing in financial debates. And it will be the start of a systematic inquiry on perspectives for a sustainable global financial system to be performed in the coming years.

#### **2) The Kick-Off Workshop of December 8-9, 2012**

The workshop shall gather a small number of people bringing together competences on very different aspects of the search for a sustainable global financial system. They shall come from different countries, including China, and include not only senior scholars and/or decision-makers but also several junior scholars with the potential to

develop new ideas in the years to come.

The workshop participants shall be embedded in a larger network of people that may be involved in various capacities in the inquiry that IASS will perform in the years to come.

The workshop will be based on an alternation between plenary discussions and small working-group sessions. The conversations will focus on input papers prepared by the organizers and/or workshop participants. Presentations will be the exception, not the rule, and comments on the input papers will be carefully documented. After the workshop, the organizers will synthesize the papers, comments and further material emerging from the workshop into a report on the Chinese proposal to be placed on the internet and published in a suitable format. The purpose is neither to advocate nor to dismiss that proposal, but to foster a competent debate about the long-term perspectives of the global financial system by offering the first comprehensive assessment of that proposal.

A key function of the workshop will be to identify questions that need further research and debate. IASS plans to establish a research group pursuing questions about a sustainable global financial system in the years to come. This may also happen in joint projects with workshop participants.

To facilitate participation by scholars committed to teaching, the workshop will take place during a weekend, on December 8 and 9 2012. An opportunity will be offered to stay on Monday, December 10, to those interested in contributing to the workshop synthesis.

### **3) Background**

The global financial crisis has highlighted with dramatic clarity that the current global financial system is unsustainable. The situation of the Eurozone is particularly worrying, but the global picture is not reassuring either: without far-reaching transformations of the system, even greater crises are likely in the coming decades. Their consequences may dwarf the historical disasters triggered by the great depression of the 1930ies. The required transformation, however, is not in sight, and seems hard to conceive in the framework of economics as we know it.

A whole range of measures are under discussion to overcome the financial crisis and its aftermath, as well as to make the financial system more sustainable. They include the Volcker proposals in the US, the Vickers proposals in the UK and the Liikanen proposals in the EU, but by now cover a much broader range, e.g.:

- Restore the separation of commercial and investment banking
- Introduce a Tobin tax to slow down speculative trading
- Increase the required equity ratio so as to limit leverage
- Split financial businesses that seem too big to fail into smaller units

- Use external or internal devaluations to reduce trade imbalances
- Implement austerity policies to achieve desirable interest rates
- Create incentives for investments in the real economy and green transition.
- Correct the incentives for individual financial operators to incur systemic risks

In the coming years, IASS will carefully analyze the different approaches. It will not try to do the job of existing institutes for economic policy analysis, but rather to emphasize the relation between such policies and the cause of sustainable development.

There is, however, one proposal for a more sustainable financial system that directly relates to global environmental conditions: the proposal by the governor of the Bank of China, Zhou Xiaochuan, to move from a Dollar based global financial system towards a new kind of Special Drawing Rights linked to commodity buffer stocks.

The roots of this proposal go back to a suggestion made in 1943 by E.F. Schumacher. He is well-known in the environmental movement for his book “Small is Beautiful. Economics as if People Mattered”. Less known is the fact that after the global depression of the 1930ies he proposed a commodity backed currency (building on work by Ben Graham, teacher of Warren Buffett). And less known is the fact that Keynes built on this idea in his contribution to the Bretton Woods conference.

To quote Zhou: “Keynes had already proposed to introduce an international currency unit named ‘Bancor’, based on the value of 30 representative commodities. Unfortunately, the proposal was not accepted.” Instead, the Dollar became the global reserve currency.

It is quite likely that by the end of the 21<sup>st</sup> century the Dollar will no more play that role, and the fate of the global financial system – and thereby of the world – will hinge to a considerable degree on how the Euro and the Renminbi will fare in the transition to a new system. Under these circumstances, two things are remarkable about Zhou’s proposal. First, he does not push for a displacement of the Dollar by the Renminbi, but rather a reconsideration of the road not taken at Bretton Woods. Second, his proposal – despite cautious endorsement by important committees of the IMF and the UN – is ignored in public debates about the fate of the Euro, the Dollar, and the current financial system as a whole.

An institute like IASS is ideally suited to fill that void. The possibility of a commodity based global reserve currency may or may not be the way forward, but it certainly lies at the interface of the global financial system and the environmental conditions humankind is faced with on Earth. This is highlighted by the fact that amongst the commodities that might be used to back such a currency we may see grains (offering opportunities to dampen speculation with foodstuff), fossil fuels (raising questions about the transition to a low-carbon economy), carbon credits (perhaps answering those questions), and more.

What better way to investigate the prospects of a sustainable world economy than to carefully look into Zhou's suggestion and explore its possible implications in a variety of different dimensions?

#### 4) Workshop Programme, as of Dec. 5, 2012

## Towards a Sustainable Global Financial System Assessing the Perspective of Special Drawing Rights Linked to Commodity Buffer Stocks

December 8-9, 2012

IASS – Institute for Advanced Sustainability Studies

Berliner Strasse 130

14467 Potsdam, Germany

### Day One: Saturday, December 8

09.00 – 09.30 **Registration**

09.30 – 09.45 **Sustainability and Global Finance**

Prof. Klaus Töpfer, Director, IASS

09.45 – 10.30 **Introduction of the Participants**

Chair: Ulf Dahlsten, IASS and Global Climate Forum

10.30 – 11.30 **Zhou, Keynes, and Sustainability**

Prof. Carlo Jaeger, Beijing Normal University and Global Climate Forum

11:30 – 12:00 **Coffee Break**

12:00 – 13:00 **The Reserve Currency Issue in a Broader Monetary Perspective**

Input: Prof. Yu Yongding, Institute of World Economics and Politics, and Chinese Academy of Social Sciences, Beijing

13:00 – 14.00 **Lunch**

14.00 – 15.00 **Instabilities of the Present Financial System**

Input: Prof. Michael Kumhof, IMF

15.00 – 16.00 **Commodity Resource Currency: History of an Idea**

Input: Prof. Leanne Ussher, City University of New York

16.00 – 16.30 **Coffee Break**

16.30 – 17.30 **Sustainable SDRs?: Possible Pros**

Plenary Discussion, Chair: Moritz Remig, IASS

17.30 – 18.30 **Sustainable SDRs?: Possible Cons**

Plenary Discussion, Chair: Dr. Falk Schmidt, IASS

18.30 – 22:00 **Dinner**

## Day Two: Sunday, December 9

### Morning Session: Key Financial Issues

Chair: Ulf Dahlsten, IASS and Global Climate Forum

09.00 – 09.30 Morning Coffee

09:30 – 10.00 Money Creation and Liquidity Traps

Input: Josh Ryan-Collins, New Economics Foundation

10.00 – 10.30 Dollar, Euro, Yuan, SDRs? On the Evolution of the International Monetary System

Input: Dr. Ulrich Volz, SOAS, University of London & German Development Institute

10.30 – 11.00 Coffee Break

11.00 – 12.30 Open Discussion on the Possibility of Sustainable SDRs

Chair: Dr. Armin Haas, IASS and Global Climate Forum

12.30 – 14.00 Lunch

14.00 – 15.30 Insights and Open Questions

Chair: Prof. Carlo Jaeger, Beijing Normal University and Global Climate Forum

15.30 – 16.30 Next Steps for Research, Debate, and Policy

Chair: Prof. Klaus Töpfer, IASS

16.30 – 18.00 “Ausklang”

## Day Three (optional): Monday, December 10

09.00 – 12.00 Workshop Synthesis

### Venue:

IASS – Institute for Advanced Sustainability Studies

Berliner Strasse 130

14467 Potsdam, Germany

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