

Towards a Sustainable Financial System

Armin Haas

Biography:

Armin Haas is co-leader of the Economics & Cultures program at the Institute for Advanced Sustainability Studies, Potsdam (IASS), and leads the research line Integrated Risk Governance of the Global Climate Forum (GCF). At IASS his main research focus concerns the economic, ecological and social sustainability of the financial system. At GCF, his research focuses on innovative approaches for the management of large-scale complex uncertainties. He holds a Ph.D. in economics from the University of Karlsruhe, Germany. Before joining IASS, he worked as senior scientist at the Potsdam Institute for Climate Impact Research (PIK) and headed the research group Bayesian Risk Management. Armin Haas is co-founder and treasurer of MCII, the Munich Climate Insurance Initiative.

Biographie :

Armin Haas est co-responsable du programme « Économie et culture » à l'Institute for Advanced Sustainability Studies, Potsdam (IASS), et dirige le thème de recherche "Integrated Risk Governance", auprès du Global Climate Forum (GCF). À l'IASS son principal sujet d'étude porte sur la soutenabilité économique, écologique et sociale du système financier. Au GCF, ses recherches sont centrées sur des approches innovantes de la gestion des **incertitudes complexes de grande envergure**. Titulaire d'un Ph.D. en économie de l'université de Karlsruhe. Avant de rejoindre l'IASS, il a travaillé comme senior économiste au Potsdam Institute for Climate Impact Research (PIK) et dirigé le groupe de recherche « Bayesian Risk Management ».

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The financial system has basically three tasks: i) To safeguard the savings of world citizens; ii) to finance investments in the real sector; and iii) to efficiently allocate risks. The challenge is to work towards a *sustainable* financial system. Sustainability comes in three dimensions: economic, ecologic and social sustainability.

| The economic sustainability is the condition *sine qua non* for addressing the other sustainability dimensions: A dysfunctional financial system will not fulfil its task of financing real investments, neither conventional nor green ones.

The past decades have seen a progressive decoupling of the financial system from the real sectors of our economies – the financial system became more and more self-referential. Remarkably, what many generations of critics of capitalism complained about, i.e. the mechanism by which money is used for making money with no substantial reference to the stakes of world citizens, actually only became virulent large scale in recent decades. There is much reason to believe that decoupling poses two major threats: i) By making the financial system self-referential, it debases and destabilises it. ii) It no longer sufficiently finances real world projects. This leads us to the straightforward question of how we can achieve a recoupling of the financial system and the real sectors of our economies.

An ecological sustainability transition could play a decisive role for achieving this recoupling. It will require large-scale investments in the real sectors of our economy, in particular in building and energy infrastructure. Investors will be willing to finance this ecological sustainability transition if they can identify reasonably attractive business cases. In particular, these business cases must come with risk-return profiles that meet investors' preferences.

A key question will be how societies can orchestrate a process of social learning for developing and shaping such green business cases. Or, in other words: Can open democratic societies change course towards societally favoured investment opportunities? It should be a guiding design principle that the way how green business cases and their respective financing schemes are developed should help recouple the financial system and the real sectors, and not contribute to a further decoupling.

In some of the suggested schemes for creating and financing green business cases, central banks play a crucial role. As central banks seem to become increasingly attractive to perform whatever kind of functions for whatever overarching purpose, it seems to be wise to have a closer look at them. According to Bagehot's principles, central banks should only take solid assets into their asset books. Solid in this respects means that an asset has intrinsic value that is determined by asset markets, and the prospects of future evaluations being such that the central bank has the option to get a specific asset off its asset book under *all* practically conceivable circumstances without making a loss. A specific aspect of such a setting is that the central bank, at least under ordinary circumstances, does not interfere with the *pricing process* of asset markets. A further aspect of such a setting is that central banks should be careful when being confronted with asset market bubbles. Ideally, they should work hard in order to keep asset market bubbles in check, which means nothing different but hindering financial markets from decoupling from the real sectors.

The contrasting approach would ensue when it is the very operation of a central bank that *creates* or stabilises the value of a specific asset. This would be the case when a central bank establishes itself permanently as guarantor of a specific price level for a given asset. Such an approach should be carefully deliberated. At one hand it might play a constructive role in an ecological sustainability transition; on the other hand it might contribute to a further decoupling of the financial system from the real sectors. It would not be yielding if a supposedly helpful measure concerning the ecological dimension of the sustainability transition would negatively impact the economic dimension. In contrast, it will be key for the global sustainability transition that the measures taken in the respective sustainability dimensions, i.e. the economic, the ecological, and the social dimension, complement and reinforce each other. Only this will turn out to be truly sustainable.

Short summary of the contribution:

It will be key for the global sustainability transition that the measures taken in the respective sustainability dimensions, i.e. the economic, the ecological, and the social dimension, complement and reinforce each other. As central banks seem to become increasingly attractive to perform whatever kind of functions for whatever overarching purpose, it seems to be wise to have a closer look at them. It would not be yielding if a supposedly helpful measure concerning the ecological dimension of the sustainability transition would negatively impact the economic dimension. It is the gist of sustainability that no dimension can be expanded on the expenses of the others.

Keywords: Sustainability dimensions; recoupling; central banks; Bagehot's principles; social learning.