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Greetings and salutations, delegates!

Welcome to the International Monetary Fund 2010 for the 11th conference of the Academy Model United Nations. Though AMUN has been running for 11 years now, this is the first AMUN conference to ever hold an IMF committee. The IMF is the premier global institution concerning economics and finance. Among the IMF's many tasks include financial regulation, managing the global finance structure, global trade, economic development, and resolving economic crises, such as the one we face today.

Please have a working knowledge of the IMF and the global financial system prior to the beginning of this year's AMUN conference. Research your assigned country and identities thoroughly. This will enable you to represent the financial and monetary interests of your nation and accurately represent your characters. Not only will you be able to better participate in debates and policymaking, but you will also impress us and increase your chances of earning an award. We look forward to working with you to make AMUN 2010 successful for everyone. Please do not hesitate to contact us with any questions or concerns. Backgrounds for the first and second topics follow below. Best of luck!

Sincerely,

Your Chairs,

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A Note on Voting

The voting system of the IMF is based on the *quota*, which is essentially a measure of each nation's monetary contribution to the IMF. In committee, for the sake of expediency and fairness, each nation will simply be given one vote.

TOPIC III: THE IMPENDING COLLAPSE OF THE DOLLAR

Introduction

Of all the world's currencies, the United States' Dollar (hereafter referred to simply as "the dollar") is by far the most important in terms of its implications for the global economy, global finance structure, and the amount of attention it receives worldwide. As the closest thing to a universal currency available, the dollar serves as a universal metric of value, and the market value of a nation's goods and services, oil, gold, and various other commodities are often stated in dollar amounts in international markets. Thus fluctuations in the value of the dollar are at least partially responsible for the constant fluctuation in commodity prices. Furthermore, because the United States has the largest economy in the world, fluctuations in the value of the dollar have a profound impact on all trade and foreign exchange conducted by the United States, which accounts for a sizable portion of the global economy. The value of the dollar can be compared against itself over time via price indices such as the Consumer Price Index (CPI), a common measure of inflation, or it can be compared against other currencies via an exchange rate. Both are important in ascertaining the current value of the dollar. In the long run, both will reflect the same long-term trend in a currency's valuation, even if there may be some discrepancy in the short-run owing to the fact that these two indices concern different sectors of the economy.

Fluctuations in Currency Values

Why does the value of the dollar fluctuate? This is due to several reasons which will be discussed in this section, but the shortest

answer is that the current currency regime of the dollar is a floating currency regime, a system in which the currency fluctuates by definition. Like any item on the market, the value of the dollar is determined by supply and demand for the dollar, and because these factors continuously change, so does the value of the dollar.

Unlike most goods and services on the market, however, the dollar, and any other currency for that matter, has no intrinsic value. Currency is the only good or service on the market that has a value which vastly exceeds its intrinsic value – even the value of the lowly dollar bill vastly exceeds the value of the paper and ink which it is physically composed of. For coins it is absolutely imperative that they are worth more than their intrinsic value, since otherwise people would simply melt the coin down to its constituent elements.

This value of money, which no longer derives from gold, is instead determined by the federal government by fiat, and as a result it is called fiat money. In the United States, the Federal Reserve is charged with the responsibility of determining the value of the dollar. As the nation's central bank, the Federal Reserve has an absolute monopoly over the supply of dollars and constantly changes the nation's money supply for various reasons. This directly impacts inflation, one measure of the relative value of the dollar. If the Federal Reserve decides to increase the money supply (typically by lowering the Federal Funds Rate), then as an increased quantity of money chases an unchanged quantity of goods and services, prices generally increase. Thus higher inflation is correctly

associated with a weaker dollar value, as inflation lowers the dollar's purchasing power. Inflation is typically associated with the domestic economy, as is the money supply, which places much more importance on the Federal Reserve's manipulations than the foreign exchange markets.

The other measure of the relative value of the dollar concerns the foreign exchange markets. The foreign exchange market exists for a variety of reasons, the primary one being that people need to exchange their currency into another type when traveling or conducting business internationally. Because the value of currencies fluctuate, the foreign exchange markets are also an excellent venue for arbitrage, an excellent example being the carry trade of the Japanese Yen. The foreign exchange markets are the very markets that determine the exchange rates between different currencies, and these rates are constantly fluctuating as a function of the supply and demand for a given currency in these markets. Currency speculators, private businesses involved in imports and exports, investors and governments are all involved in this process. As we will see, exchange rates are a far more important measure of the relative value of the dollar to the IMF. Clearly, one of the reasons is because the IMF concerns itself with international trade and finance, but another important reason is that the foreign exchange markets have been a primary driving force, along with international trade, of the global economy.

The Dollar and the Foreign Exchange Markets

The dollar has played an extremely interested role in the foreign exchange markets lately. Throughout the 90's and up until very recently, when the United States briefly experienced a rapid reduction in its

trade deficit a few months ago, the value of the dollar has sustained a long-term downward trend due to China's rapid expansion into the global market, especially through its sudden explosion of exports to the United States and other developed nations.

The impact of international trade on exchange rates in the foreign exchanges markets is crucial to this discussion. Whenever any nation experiences an increase in exports, market forces immediately begin to work against that trend through exchange rates. For example, the increase in China's exports, which enjoyed an explosive boom during the 90's and well on into the new millennium, automatically resulted in a strengthening of the Chinese yuan and weakening of the US dollar. This is because a nation pays for its imports in its own currency and conversely receives payment for its exports in the importing nation's currency; as a result, when a nation imports, the supply of its own currency in the foreign exchange market increases. The strengthening of the Chinese yuan makes Chinese exports more expensive in dollar terms, discouraging the growth of Chinese exports to the United States.

The Chinese government combated the market forces that dragged down its export growth by reversing the effect of yuan appreciation through intervention, the deliberate depreciation of the yuan through an increase in the money supply. The Chinese government also accomplished this in the foreign exchange market by exchanging yuan for dollars in large quantities, i.e. selling yuan and buying dollars. This counteracted the effect of a strengthening yuan and weakening dollar, thereby reversing the market forces which threatened to hinder China's export growth.

The process of buying dollars left China with a massive foreign currency reserve, which it primarily invested in US Treasury securities. Among other factors, this massive purchase of treasury bonds was a leading cause of the sudden reduction in long-term interest rates that ultimately lowered mortgage rates in the United States, a major cause of the ensuing housing bubble. The resulting global recession we now face is only one example of how unstable the current trade and currency imbalance between the United States and China is, and why it is imperative that the IMF solve this imbalance.

China, which has been left relatively unscathed by the recent recession, nonetheless has a serious dilemma to deal with regarding the current trade imbalance between itself and the United States. China, like the United States, realizes that their current relationship is unsustainable. Though China continues to buy into treasury securities to help the United States continue to maintain its export boom, it also realizes that the longer it does this, the further the dollar will depreciate due to the United States' import glut, and the further China's portfolio of US government securities will deteriorate. Similarly, the United States realizes that the benefits of cheap, Chinese imports comes at an ever-increasing risk of a gradual reduction in the value of the dollar suddenly becoming a free-fall if China were to ever withdraw from the current relationship and sell all its holdings in the treasury.

A World in Crisis

Let us imagine, for the sake of this session, that China did in fact engage in a massive liquidation of its US Treasury holdings. Willing to accept a large loss on its investment now, rather than see the value of

the securities slowly decline over time, the Chinese government begins dumping Treasuries by the hundreds of billions. Faced with a huge increase in supply, and the expectation of further increases, the market price of the securities declines rapidly, while the interest rates skyrocket. Meanwhile, the value of the dollar quickly increases, due to the expectation that the Chinese currency manipulation regime will be discontinued. Economists predict that the US should see a reduction in its current account deficit, though consumption will be severely dampened by the sudden expense of credit and exports will only make modest gains due to the deconstruction of the US manufacturing sector. The US Congress convenes an emergency budget resolution session to address its large deficits in the face off unthinkable borrowing costs. Overall, it seems that the massive capital disruption will worsen the US and global recessions, while causing other macroeconomic disturbances around the world.

You have been called to the IMF headquarters in Washington to help resolve the crisis. How can the international community dampen the catastrophe? Building on your experience with the revision of the IMF charter and the redefinition of the SDR program, you and your counterparts have been tasked with identifying prudent policy goals for the international currency bank.

Objectives

Your goal for this IMF summit is to promote international policies that are in line with the macroeconomic objectives of your sending nation. Most countries will find the disturbance troubling, even if they do not trade directly with the US, due to secondary effects translated through US trading

partners. Some countries may perceive an advantage in allowing the dollar to crash, but are short sighted. It is clear that the crisis threatens to intensify and prolong the first Global GDP-reducing recession since World War II.

The key question for each country to assess is which policies to use to support the dollar and the US Treasury. An emergency expansion of the IMF SDR facility would reduce the importance of the dollar as a foreign reserve currency and therefore dampen the pressure on central banks. Purchases of Treasuries and dollars by finance ministries and central banks would also help relieve the tension in the international capital market. Clear communication from monetary authorities would help ease sentiment and create expectations of a stabilizing dollar. Regardless of the strategy used, it is clear that coordinated action will be needed to make an real effect. Therefore, it is imperative that the greatest diplomats work together toward a united resolution.

Any resolution passed by this committee should also address the root cause of the crisis and seek prophylactic policies. Sanctions and censures are certainly available options for member countries to consider.

As a delegate, you represent your country, and therefore may have motives that differ greatly from those of your counterparts. Remember that brinkmanship can be a great tool in this setting—other states may be so desperate to set a policy that they may agree to your high diplomatic price. If your country is relatively isolated from the catastrophe because it conducts very little foreign trade and has an obscure currency, you may be free to peddle your vote. If your country has high exposure to the crisis, your

superiors will be furious if you leave the summit without an adopted policy plan. This crisis could mark the end of your career.

Good luck and buy gold!

Example Country Positions

Vietnam: The former Communist state's highly dollarized economy and large exports to the United States increase its exposure to the crisis. A complete collapse of the dollar would threaten to further widen the trade deficit while devaluing the savings and working capital of its citizens. Internal policy goals of Vietnam would include: de-dollarization of the economy by building confidence in đồng and reigning in inflation. Vietnam other major trading partners include the other nations in the SDR currency basket, and would therefore be amenable to conducting more foreign exchange using the financial instrument. Vietnam has negligible holdings of gold and dollars, and would be unable to intervene in global capital markets. These policy recommendations are largely in-line with the official goals of Vietnam.

Japan: With nearly \$1 trillion invested in the US Treasury, Japan is particularly exposed to the turmoil created by China's snap decision. This huge foreign reserve holding was largely built to protect the Yen and promote exports to the US. Japan continues to rely heavily on the US to satiate the Japanese manufacturing sector. With the collapse of the dollar, Japan would be forced to write off its Treasury holdings and would experience severe industrial underutilization. To rescue the dollar, Japan might expand the SDR program while using its considerable presence in international capital markets to restore stability.

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Another interesting article on the US current account

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A very clear, informative, and comprehensive explanation of the gold standard by Rutgers University professor Michael D. Bordo

http://www.ny.frb.org/research/global_economy/policyresponses.html

A very useful timeline which attempts (and does a decent job) of keeping track of all the crazy stuff happening with the economy right now