MITMUNC – IMF Background Guide

Letter from Dais

Hello everyone,

My name is *Shadab Dawood* and I am currently a junior at MIT doing mathematics and economics. I love dancing, cooking and eating. I have been doing Model United Nations for almost 5 years now and have traveled to London, Beijing, Shanghai, Montreal and Seoul for it. That clearly implies that traveling is also one of my hobbies. I have been chairing for MITMUNC for two years and this is now my third year. I really like public speaking and debating, as the skill of persuasion comes naturally to me and it is always great to learn more about the world and current affairs. MUN also helps me to step out of my college bubble and listen to other people's perspective. I am really excited for this years MUN and cannot wait to meet all of you.

My name is *John William* and I am sophomore. I am from Egypt majoring in electrical engineering and computer science with a minor is mechanical engineer. So direct those nerdy questions towards me! In 2011 I represented Egypt in the World Robotics Olympiad and got 2nd place. I am very interested in artificial intelligence and I like putting things together. It is my first time doing MUN but I am really excited about learning new skills and meeting new people. It is definitely a great opportunity with a lot to offer. I am excited about meeting you all in February, till then, happy researching!

If you have any questions, feel free to email us at imf2014@mitmunc.org.

Thanks,
Shadab Dawood
John William

This topic of the International Monetary Fund (IMF) is intended to urge delegates to analyze the most imperative and determinant factors of the contemporary financial structure of the world, while expects delegates to produce solutions in the framework of reconstructing a new global financial architecture. This topic requires a high level of awareness and interpretation of the current global financial system. We have developing countries that need help but to what extent can their loans be forgiven? Questions like equity versus market equilibrium and value of human life would be a major discussion under this topic.

"Proponents of third-world debt relief were lobbying for complete forgiveness of loans to poor countries by the year 2009. Some go on to argue that the citizens of these nations do not even owe the debt because it was borrowed by past corrupt governments for political and military purposes. All point out the moral issues behind debt relief, for such nations are unable to spend enough on education, health care, welfare reform, and infrastructure because they are saddled with the oppressive burden of large external debt. There is no disagreement among economists that such a burden inhibits growth and impoverishes nations, but it would be naive to think that one only need classify the countries that need or deserve debt relief and then simply erase it without consequence. Someone will have to absorb the immense burden.

The size of this burden depends on how one defines a poor and financially troubled country. If we use the low-income ranking of countries as defined by the World Bank, long-term external debt stands at $3,469,415 million as of 2011. The main aim of the topic is to discuss ways of taking care of the moral and economic issues involved in this problem facing the world."

The developing countries require not only that aid be given in a way that helps their development but also that there be more aid. Relatively small amounts of money could make large differences in promoting health and literacy. In real terms, adjusted for inflation, the amounts of development assistance have actually been declining, and even more so either as a percentage of developed country income or on a per capita basis for those in the developing countries. There needs to be a basis for funding this assistance (and other global public goods) on a more sustained level, free from the vagaries of domestic politics in the United States or elsewhere. Several proposals have been put forward.

When the IMF was established, it was given the right to create Special Drawing Rights (SDR'S), a kind of international money. With countries today wisely putting aside billions of dollars into reserves every year to protect themselves against the vicissitudes of international markets, some income is not being translated into aggregate demand. The global economic slowdown of 2007-08 brought these concerns to the fore. Issuing SDRs to finance global public goods -- including financing development assistance -- could help maintain the strength of the global economy at the same time that it helped some of the poorest countries in the world. A second proposal entails using the revenues from global economic resources -- the minerals in the seabed and fishing rights in the oceans -- to help finance development assistance.

Recently, attention has focused on debt forgiveness, and for good reason. Without the forgiveness of debt, many of the developing countries simply cannot grow. Huge proportions of their current exports go to repaying loans to the developed countries. The Jubilee 2000 movement mobilized enormous international support for debt forgiveness. The movement gained the backing of churches throughout the developed world. To them, it seemed a moral imperative, a reflection of basic principles of economic justice.

The issue of the moral responsibility of the creditors was particularly apparent in the case of cold war loans. When the IMF and World Bank lent money to the Democratic Republic of Congo's notorious ruler Mobutu, they knew that most of the money would not go to help that country's poor people, but rather would be used to enrich Mobutu. It was money paid to ensure that this corrupt leader would keep his country aligned with the West. To many, it doesn't seem fair for ordinary taxpayers in countries with corrupt governments to have to repay loans that were made to leaders who did not represent them.

The Jubilee movement was successful in getting much larger commitments to debt forgiveness. But debt relief needs to go further: as it stands now, the agreements touch only the poorest of the countries. Countries like Indonesia, devastated by the East Asian crisis and the failures of the IMF policies there, are still too well off to be brought in under the umbrella."

Supporters of debt relief programs have often argued that new democratic governments in poor nations should not be forced to honor the debts that were incurred and mismanaged long ago by their corrupt and dictatorial predecessors. Certainly, some justice would be served if a legitimate and reformist new government refused to repay creditors foolish enough to have lent to a rotten old autocracy. But, in reality, there are few clear-cut political breaks with a corrupt past. The political factors that make governments corrupt tend to persist over time. How "clean" must the new government be to represent a complete departure from the misdeeds of an earlier regime?

Consider President Yoweri Museveni of Uganda, about the strongest possible example of a change from the past—in his case, the notorious past of Ugandan strongman Idi Amin. Yet even Museveni's government continues to spend money on questionable military adventures in the Democratic Republic of the Congo. Would Museveni qualify for debt relief under the "good new government" principle? And suppose a long-time corrupt politician remains in power, such as Kenyan President Daniel Arap Moi. True justice would instead call for such leaders to pay back some of their loot to development agencies, who could then lend the money to a government with cleaner hands—a highly unlikely scenario.

Making debt forgiveness contingent on the supposed "illegitimacy" of the original borrower simply creates perverse incentives by directing scarce aid resources to countries that have best proved their capacity to mismanage such funds. For example, Ivory Coast built not just one but two new national capitals in the hometowns of the country's previous rulers as it was piling up debt. Then it had a military coup and a tainted election. Is that the environment in which aid will be well used? Meanwhile, poor nations that did not mismanage their aid loans so badly—such as India and Bangladesh—now do not qualify for debt relief, even though their governments would likely put fresh aid resources to much better use.

Finally, the legitimacy rationale raises serious reputation concerns in the world's financial markets. Few private lenders will wish to provide fresh financing to a country if they know that a successor government has the right to repudiate the earlier debt as illegitimate. For the legitimacy argument to be at all convincing, the countries in question must show a huge and permanent change from the corruption of past regimes. Indeed, strict application of such a standard introduces the dread specter of "conditionality," i.e., the imposition of burdensome policy requirements on developing nations in exchange for assistance from international financial institutions. Only rather than focusing solely on economic policy conditions, the international lending agencies granting debt relief would now be compelled to make increasingly subjective judgments regarding a country's politics, governance structures, and adherence to the rule of law.

However, some argue that the foreign debt of poor countries has always been partly fictional. Whenever debt service became too onerous, the poor nations simply received new loans to repay old ones. Recent studies have found that new World Bank adjustment loans to poor countries in the 1980s and 1990s increased in lock step with mounting debt service. Likewise, another study found that official lenders tend to match increases in the payment obligations of highly indebted African countries with an increase in new loans. Indeed, over the past two decades, new lending to African countries more than covered debt service payments on old loans.

Second, debt relief advocates should remember that poor people don't owe foreign debt—their governments do. Poor nations suffer poverty not because of high debt burdens but because spendthrift governments constantly seek to redistribute the existing economic pie to privileged political élites rather than try to make the pie grow larger through sound economic policies. The debt-burdened government of Kenya managed to find enough money to reward President Moi's home region with the Eldoret International Airport in 1996, a facility that almost nobody uses. Left to themselves, bad governments are likely to engage in new borrowing to replace the forgiven loans, so the debt burden wouldn't fall in the end anyway. And even if irresponsible governments do not run up new debts, they could always finance their redistributive ways by running down government assets (like oil and minerals), leaving future generations condemned to the same overall debt burden. Ultimately, debt relief will only help reduce debt burdens if government policies make a true shift away from redistributive politics and toward a focus on economic development.

Pro-debt relief advocacy groups face a paradox: On one hand, they want debt relief to reach the poor; on the other, they don't want rich nations telling poor countries what to do. "For debt relief to work, let the conditions be set by civil society in our countries, not by big world institutions using it as a political tool," argued Kennedy Tumutegyereize of the Uganda Debt Network. Unfortunately, debt relief advocates can't have it both ways. Civil society remains weak in most highly indebted poor countries, so it would be hard to ensure that debt relief will truly benefit the poor unless there are conditions on the debt relief package.

Attempting to square this circle, the World Bank and IMF have made a lot of noise about consulting civil society while at the same time dictating incredibly detailed conditions on debt relief. The result is unlikely to please anyone. Debt relief under the World Bank and IMF's current HIPC initiative, for example, requires that countries prepare Poverty Reduction Strategy Papers. The World Bank's online handbook advising countries on how to prepare such documents runs well over 1,000 pages and covers such varied topics as macroeconomics, gender, the environment, water management, mining, and information technology. It would be hard for even the most skilled policymakers in the advanced economies to follow such complex advice, much less a government in a poor country suffering from scarcity of qualified managers. In reality, this morass of requirements emerged as the multilateral financial institutions sought to hit on all the politically correct themes while at the same time trying hard to make the money reach the poor. If the conditions don't work the World Bank and IMF can simply fault the countries for not following their advice.

During the last two decades, the multilateral financial institutions granted "structural adjustment" loans to developing nations, with the understanding that governments in poor countries would cut their fiscal deficits and enact reforms—including privatization of state-owned enterprises and trade liberalization—that would promote economic growth. The World Bank and IMF made 1,055 separate adjustment loans to 119 poor countries from 1980 to 1999. Had such lending succeeded, poor countries would have experienced more rapid growth, which in turn would have permitted them to service their foreign debts more easily. Thirty-six poor countries received 10 or more adjustment loans in the 1980s and 1990s, and their average percentage growth of per capita income during those two decades was a grand total of zero.

Moreover, such loans failed to produce meaningful reforms, and developing countries now cite this failure as justification for debt relief. Yet why should anyone expect that conditions on debt forgiveness would be any more effective in changing government policies and behavior than conditions on the original loans?

Partial and conditional debt forgiveness is a *fait accompli*. Expanding it to full and unconditional debt forgiveness—as some groups now advocate—would simply transfer more resources from poor countries that have used aid effectively to those that have wasted it in the past. The challenge for civil society, the World Bank, IMF, and other agencies is to ensure that conditional debt forgiveness really does lead to government reforms that enhance the prospects of poor countries.

How can we promote economic reform in the poorest nations without repeating past failures? The lesson of structural adjustment programs is that reforms imposed from the outside don't change behavior. Indeed, they only succeed in creating an easy scapegoat: Insincere governments can simply blame their woes on the World Bank and IMF's "harsh" adjustment programs while not doing anything to fundamentally change economic incentives and ignite economic growth.

It would be better for the international financial institutions to simply offer advice to governments that ask for it and wait for individual countries to come forward with homegrown reform programs, financing only the most promising ones and disengaging from the rest. This approach has worked in promoting economic reform in countries such as China, India, and Uganda. Rushing through debt forgiveness and imposing complex reforms from the outside is as doomed to failure as earlier rounds of debt relief and adjustment loans.

The prevention of future large-scale debt crises requires the private sector to become the sole source of loans and direct investment to developing countries, and the g-7 countries, World Bank, and IMF need to serve notice to private investors that, from now on, there will be no more bailouts of governments in financial distress. Since markets are more demanding of economic performance than governments, better quality loans will be made, which, in turn, will create more jobs and improve standards of living in developing countries.

This topic demands delegates to consider macroeconomic balances in the world and question the efficiency the policy measures applied by the International Monetary Fund (IMF), mostly during loaning funds to countries in economic crisis. Not demanding collateral or conditionality but imposing fiscal austerity are particular examples to these policy measures. Till today countries are struggling from the financial crises after he 2008 fallout and in this committee it is our job to help the global market.

"The world is near the bottom of a global recession that is causing widespread business contraction, increases in unemployment, and shrinking government revenues. Although recent data indicate the large industrialized economies may have reached bottom and are beginning to recover, for the most part, unemployment is still rising. Numerous small banks and households still face huge problems in restoring their balance sheets, and unemployment has combined with sub-prime loans to keep home foreclosures at a high rate. Nearly all industrialized countries and many emerging and developing nations have announced economic stimulus and/or financial sector rescue packages, such as the American Recovery and Reinvestment Act of 2009.Several countries have resorted to borrowing from the International Monetary Fund as a last resort. The crisis has exposed fundamental weaknesses in financial systems worldwide, demonstrated how interconnected and interdependent economies are today, and has posed vexing policy dilemmas.

The process for coping with the crisis by countries across the globe has been manifest in four basic phases. The first has been intervention to contain the contagion and restore confidence in the system. This has required extraordinary measures both in scope, cost, and extent of government reach. The second has been coping with the secondary effects of the crisis, particularly the global recession and flight of capital from countries in emerging markets and elsewhere that have been affected by the crisis. The third phase of this process is to make changes in the financial system to reduce risk and prevent future crises. In order to give these proposals political backing, world leaders have called for international meetings to address changes in policy, regulations, oversight, and enforcement. The job of IMF is to construct policies that will help make this process easier and faster as the world needs it."
On September 24-25, 2009, heads of the G-20 nations met in Pittsburgh to address the global financial crisis. The fourth phase of the process is dealing with political, social, and security effects of the financial turmoil. One such effect is the strengthened role of China in financial markets. The role for Congress in this financial crisis is multifaceted. While the recent focus has been on combating the recession, the ultimate issue perhaps is how to ensure the smooth and efficient functioning of financial markets to promote the general well-being of the country while protecting taxpayer interests and facilitating business operations without creating a moral hazard.

In addition to preventing future crises through legislative, oversight, and domestic regulatory functions, On June 17, 2009, the Department of the Treasury presented the Obama Administration proposal for financial regulatory reform. The proposal focuses on five areas and includes establishing the Federal Reserve as a systemic risk regulator, creating a Council of Regulators, regulating all financial derivatives, creating a Consumer Financial Protection

Agency, improving coordination and oversight of international financial markets, and other provisions. Treasury also has submitted to Congress proposed legislation to implement the reforms. The reform agenda now has moved to Congress. Legislation in Congress addresses many of the issues in the Treasury plan but also may focus on other financial issues. Congress also plays a role in measures to reform and recapitalize the International Monetary Fund, the World Bank, and regional development banks.

The role for Congress in this financial crisis is multifaceted. The overall issue seems to be how to ensure the smooth and efficient working of financial markets to promote the general well being of the country while protecting taxpayer interests and facilitating business operations without creating a moral hazard. With the 2008 global financial crisis followed soon by a new sovereign debt crisis in Europe, central banks need to adapt to a less stable global financial environment. The inflation targeting paradigm that shaped the institutional design of central banks over the last two decades remains relevant but perhaps not sufficient for this more challenging environment. A number of central banks at the epicenter of the 2008 crisis adopted some radical innovations in the conduct of monetary policy that contain lessons for the redesign of monetary policy frameworks going forward. While central banks in Asia and Latin America emerging markets generally escaped the worst of the global financial crisis, they can benefit from the lessons learned by these other central banks in developing their frameworks to cope with future crises.

This financial crisis which began in industrialized countries quickly spread to emerging market and developing economies. Investors have pulled capital from countries, even those with small levels of perceived risk, and caused values of stocks and domestic currencies to plunge. Also, slumping exports and commodity prices have added to the woes, pushing economies world wide either into recession or into a period of slow economic growth. The global crisis now seems to be played out on two levels.

The first is among the industrialized nations of the world where most of the losses from subprime mortgage debt, excessive leveraging of investments, and inadequate capital backing credit default swaps have occurred. The second level of the crisis is among emerging market and other economies that may be "innocent bystanders" to the crisis but who also may have less resilient economic systems that can often be whipsawed by actions in global markets. Most industrialized countries (except for Iceland) seem to able to finance their own rescue packages by borrowing domestically and in international capital markets, but emerging market and developing economies may have insufficient sources of capital and may have to turn to help from the International Monetary Fund (IMF) or from capital surplus nations, such as Japan, and the European Union.

For the United States, the financial turmoil touches on the fundamental national interest of protecting the economic security of Americans. It also is affecting the United States in achieving national foreign policy goals, such as maintaining political stability and cooperative *relations with other nations and supporting a financial infrastructure that allows for the smooth functioning of the international economy. Reverberations from the financial crisis, moreover, are not only being felt on Wall Street and Main Street but are being manifest in world flows of exports and imports, rates of growth and unemployment, government revenues and expenditures, and in political risk in some countries. The simultaneous slowdown in economic activity around the globe indicates that emerging market and developing economies have not decoupled from industrialized countries and governments cannot depend on exports to pull them out of these recessionary conditions.*

The global financial crisis has brought home an important point: the United States is still a major center of the financial world. Regional financial crises (such as the Asian financial crisis, Japan's banking crisis, or the Latin American debt crisis) can occur without seriously affecting the rest of the global financial system. However, when the U.S. financial system "stumbles," it may bring major parts of the rest of the world down with it. The reason is that the United States is the main guarantor of the international financial system, the provider of dollars widely used as currency reserves and as an international medium of exchange, and a contributor too much of the financial capital that sloshes around the world seeking higher yields. The rest of the world may not appreciate it, but a financial crisis in the United States often takes on a global hue.

The process as it has played out in countries across the globe has been manifest in four overlapping phases. The first phase has been intervention to contain the contagion and strengthen financial sectors in countries. On a macroeconomic level, this has included policy actions such as lowering interest rates, expanding the money supply, quantitative (monetary) easing, and actions to restart and restore confidence in credit markets. On a microeconomic level, this has entailed actions to resolve underlying causes of the crisis including financial rescue packages for ailing firms, guaranteeing deposits at banks, injections of capital, disposing of toxic assets, and restructuring debt. This has involved decisive (and, in cases, unprecedented) measures both in scope, cost, and extent of government reach. Actions taken include the rescue of financial institutions considered to be "too big to fail" and government takeovers of certain financial institutions, and government facilitation of mergers and acquisitions.

In the United States, traditional monetary policy almost has reached its limit as the Federal Reserve has lowered its discount rate to 0.5 percent and has a target rate for the federal funds rate of 0.0 to 0.25 percent. The Federal Reserve and Treasury, therefore, have turned toward quantitative monetary easing (buying government securities and injecting more money into the economy) and dealing directly with the toxic assets being held by banks.

What has been learned from previous financial crises is that without a resolution of underlying problems with toxic assets and restoring health to the balance sheet of banks and other financial institutions, financial crises continue to drag on. This was particularly the case *with Japan. Even Sweden, often viewed as a successful model of how to cope with a financial crisis, had to take decisive action to deal with the non-performing assets of its banking system.*

The second phase of this process is less uncommon except in the depth of the economic troubles confronting countries around the world. Countries are coping with the macroeconomic impact of the crisis on their economies, firms, investors, and households. Many of these countries, particularly those with emerging and developing markets, have been pulled down by the ever-widening flight of capital from their economies and by falling exports and commodity prices. In these cases, governments have turned to traditional monetary and fiscal policies to deal with recessionary economic conditions, declining tax revenues, and rising unemployment.

The third phase of the process—to decide what changes may be needed in the financial system—is also underway. In order to coordinate reforms in national regulatory systems and give such proposals political backing, world leaders began a series of international meetings to address changes in policy, regulations, oversight, and enforcement. Some are characterizing these meetings as Bretton Woods II. The G-20 leaders' Summit on Financial Markets and the World Economy that met on November 15, 2008, in Washington, DC, was the first of a series of summits to address these issues. The second was the G-20 Leaders Summit on April 2, 2009, in London, and the third was held in November 2009 [1].

The fourth phase of the process is dealing with political, social, and security effects of the financial turmoil. These are secondary effects that relate to the role of the United States on the world stage, its leadership position relative to other countries, and the political and social impact within countries affected by the crisis. For example, on February 12, 2009, the U.S. Director of National Intelligence, Dennis Blair, told Congress that instability in countries around the world caused by the global economic crisis and its geopolitical implications, rather than terrorism, is the primary near-term security threat to the United States.

The financial crisis works on political leadership and regimes within countries through two major mechanisms. The first is the discontent from citizens who are losing jobs, seeing businesses go bankrupt, losing wealth both in financial and real assets, and facing declining prices for their products. In democracies, this discontent often results in public opposition to the existing establishment or ruling regime. In some cases it can foment extremist movements, particularly in poorer countries where large numbers of unemployed young people may become susceptible to religious radicalism that demonizes Western industrialized society and encourages terrorist activity.

The precipitous drop in the price of oil holds important implications for countries, such as Russia, Mexico, Venezuela, Yemen, and other petroleum exporters, who were counting on oil revenues to continue to pour into their coffers to fund activities considered to be essential to *their interests. While moderating oil prices may be a positive development for the U.S. consumer and for the U.S. balance of trade, it also may affect the political stability of certain petroleum exporting countries. The concomitant drop in prices of commodities such as rubber, copper ore, iron ore, beef, rice, coffee, and tea also carries dire consequences for exporter countries in Africa, Latin America, and Asia. In Pakistan, a particular security problem exacerbated by the financial crisis could be developing. The IMF has approved a $7.6 billion loan package for Pakistan, but the country faces serious economic problems at a time when it is dealing with challenges from suspected al Qaeda and Taliban sympathizers, when citizen objections are rising to U.S. missile strikes on suspected terrorist targets in Pakistan, and the country faces a budget shortfall that may curtail the ability of the government to continue its counterterror operations.*

The second way that the crisis works on ruling regimes is through the actions of existing governments both to stay in power and to deal with the adverse effects of the crisis. Any crisis generates centrifugal forces that tend to strengthen central government power. Most nations view the current financial crisis as having been created by the financial elite in New York and London in cooperation with their increasingly laissez faire governments. By blaming the industrialized West, particularly the United States, for their economic woes, governments can stoke the fires of nationalism and seek support for themselves. As nationalist sentiments rise and economic conditions worsen, citizens look to governments as a rescuer of last resort. Political authorities can take actions, ostensibly to counter the effects of the crisis, but often with the result that it consolidates their power and preserves their own positions. Authoritarian regimes, in particular, can take even more dictatorial actions to deal with financial and economic challenges.

The IMF has suggested various principles that could guide the scope and design of measures aimed at restoring confidence in the international financial system. They include:

- *employ measures that are comprehensive, timely, clearly communicated, and operationally transparent;*
- *aim for a consistent and coherent set of policies to stabilize the global financial system across countries in order to maximize impact while avoiding adverse effects on other countries;*
- *ensure rapid response on the basis of early detection of strains;*
- *assure that emergency government interventions are temporary and taxpayer interests are protected; and*
- *pursue the medium-term objective of a more sound, competitive, and efficient financial system.*

The committee should keep this in mind and work forward to find more ways of solving the current instability and bring greater economic strength globally.

Helpful Links:

http://www.imf.org/external/pubs/ft/gfsr/
http://www.imf.org/external/pubs/ft/survey/so/2013/new011713a.htm
http://www.twnside.org.sg/title2/ge/ge25.pdf
http://www.cemla.org/actividades/2011/2011-10-seacen/cemla-seacen-07p.pdf

[1] Information on the London G-20 Summit is available at http://www.londonsummit.gov.uk/en/