Oldenburg Model United Nations Conference 2011

- Changes and Challenges in a Globalised World -

Guide to

The Economic and Social Council

Preventing the Outbreak of Currency Wars

Personal introductions

Distinguished delegates,

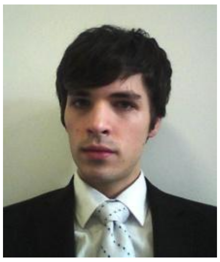
My name is Phillip Kuck and I am 19 years old. I am living in Bremen and I currently study at Beluga College in Bremen. By the age of 16 I went to study abroad for one year and experienced a great time in the United States of America. I spent my high school year in a small village called Creighton (Nebraska) and got to know what it means to live in the middle of nowhere. The American high school spirit fascinated me and I was curious to try new sports like American Football and Baseball.

Concerning my Model United Nations experience I attended two conferences last year, the Oldenburg Model United Nations in June and the Model United Nations of Munich in November. Since this is my first conference as a chairman I am looking forward to a new challenge and to experience a Model United Nations conference out of a different perspective.

Feel free to approach me if you have any questions or concerns and I am looking forward to see all of you in June!

Phillip Kuck

Honourable delegates,



I am very proud to have the opportunity to serve as the president of this years' ECOSOC at the OLMUN 2011. I am very sure that this will be an amazing and unforgettable experience for all of us and I will do everything possible to help you enjoying this fantastic event.

A bit about myself: my name is Jan-Hendrik Röske, I graduated 2009 from the Graf-Anton-Günther Schule in Oldenburg, did my civil service in the nine subsequent months at the Pius Hospital Oldenburg (an amazing time) and started my studies in 2010 at the Cass Business School (London), where I am currently a student of the "BSc Banking and International Finance" degree. As you might have already guessed, I have a deep passion for finance.

Another passion of mine is of course international politics and I have thus participated in the last two OLMUNs. Unfortunately I was so far unable to participate in any other MUNs. 2009, the year I started to get involved, I have been a journalist at our wonderful newspaper and in the last year I have been one of chairs of the UN HABITAT GC.

I am very much looking forward to welcome you all to our committee and to see a passionate and constructive debate,

Jan-Hendrik Röske

Our Committee

The Economic and Social Council

The Economic and Social Council was established by the United Nations in 1945. The Council consists of 54 member states that serve for a three-year term. The aim of ECOSOC is to help the United Nations in establishing stronger economic development in countries and situations and stronger social cooperation between states and situations.

The ECOSOC tries to provide solutions to economically related social problems, which prevent societies and countries from developing and having a higher development. Other aspects that are debated in ECOSOC are in relation to health problems found across the world, and overcoming the economic challenge of providing health benefits, nutrition, education and other such aspects to less developed societies. In ECOSOC, issues concerning granting all members of society rights and freedoms regardless of their race, gender, age, status, religion and culture.

What is the problem?

In the recent time we are at the brink of a currency war and in the 1930s we have seen what a currency war can lead to. Starting with Great Britain abandoning the Gold Standard and the subsequent devaluation of its currency, the currency war started and ended in a trade war that cut world trade by half. Countries tried to devalue their currencies to make their goods cheaper for foreigner thus leading to growth in exports and a way out of the crisis. But, since every country in the 1930's tried this, they effectively sterilized each other's actions and just disrupted international trade by increasing the likelihood of unpredictable significant changes in the exchange rates. Unpredictability of future exchange rates, implementation of capital controls and tariffs worsened the crisis and damaged international trade deeply for years.

In the last crisis in 2008/2009 we have seen coordinated international actions to fight crisis which was celebrated as a successful prevention of the repetition of the Great Depression. But now, that the worse of the crisis seems to be over, a currency war might break out. As part of their actions against the financial crisis the United States' central bank called "Federal Reserve" (FED) decided to purchase financial assets worth $1,700,000,000,000.00. This put pressure on the Dollar against many other currencies so that they appreciated against the Dollar thus making US American products cheaper in comparison with domestic products. But at that time this first round of Quantitative Easing was seen as necessary for the financial stability of the USA and thus for the rest of the world. Nevertheless this was the end of the Dollar appreciation, in which the Dollar appreciated from summer 2008 until early 2009 sharply against nearly all other currencies, and the bottom of most commodity prices (oil, metals and soft commodities like wheat, corn and coffee).

From early 2009 on many countries have seen their countries' currency as well as the price of most commodities rising. Appreciating currencies as well as commodity prices lead to inflation. The appreciation of a currency means that imports are getting cheaper (i.e. buying goods from other countries), but the downside is that the country's own goods become more expensive for foreigners thereby having a negative effect on the economy.

Another effect is that investments in this country become more attractive for foreigners because on top of the return on the investment foreign investors gain from the appreciation in this currency. This can lead to a bubble in this country's financial markets with the following burst of the bubble hurting the economy severely as seen in 1997 in the Asian Crisis. Because once investors change their view on a currency this might lead to a rapid depreciation, especially when the currency has been overvalued before.

The fear that the USA and its central bank, the FED, would conduct a policy that would lead to the devaluation of the Dollar and increasing commodity prices came up in the summer of 2010 resulting in a further appreciation of most currencies against the Dollar and rising commodity prices. The reason for that was the upcoming of rumours about the FED starting a second round of Quantitative Easing. Financial markets started to price in "QE2" in summer 2010 thus bringing several countries into trouble. Seeing huge speculative capital inflows, surging commodity prices and their currencies going up against the Dollar, many countries thought that something must be done. In September the situation seemed to escalate: Japan intervened in the markets to devalue its currency and Guido Mantega, Brazilian finance minister, exclaimed that "We're in the midst of an international currency war". In November 2010, the Fed decided to start the second round of Quantitative Easing totalling to $600,000,000,000.00 leading to even further interventions by other governments in response.

So far the following countries have either directly (i.e. by buying foreign currencies, mainly the Dollar) or indirectly (by restricting the purchasing of their domestic currency or by limiting foreign investments) intervened to devalue or at least not to let their currency appreciate and prevent asset bubbles:

Israel	Brazil	Chile	Peru
Taiwan	South Korea	Turkey	South Africa
Indonesia	Philippines	Columbia	Thailand
Mexico	Japan	Switzerland	Indonesia

Please note: Missing in this list are countries that constantly intervened the in the markets like China and Saudi Arabia and we do not claim to have a full list of countries having intervened in the markets to devalue their currency and this was the stage of affairs some months ago.

The tale of a complicated love-hate relationship

Apart from the USA's QE there is another key issue related to our topic: China and its currency the Yuan or Renmimbi. The Chinese Central Bank pegged the Renmimbi to the Dollar for most of its time since it introduced it in 1949. By this, the exchange rate was completely fixed to the US-Dollar. In the 1980s, when opening up its economy to the rest of the world, China devalued the Renmimbi to gain a competitive edge over other countries and to boost its exports. In 2005 China abandoned the pegging to the Dollar and instead allowed the Yuan to fluctuate within a certain range against a basket of other currencies.

The constant interventions in the foreign exchange market to keep its currency overvalued resulted in China having huge foreign exchange reserves $2.85 trillion in December 2010.

These reserves were reinvested mainly in US Treasuries (i.e. US bonds/government debt) thus artificially lowering US interest rates reinforcing also the housing boom in the USA and therefore being partly blamed for the financial crisis.

Another problem is that when the Chinese Yuan is fixed in terms of Dollars, a depreciation of the Dollar against other currencies automatically leads to a depreciation of the Yuan against these other currencies.

The artificially low value of the Yuan makes Chinese goods cheaper thereby increasing China's exports. The biggest consumers of Chinese goods are the USA. Although the rest of the world can enjoy cheap Chinese goods it means that China uses an unfair method to support its own economy on the cost of other countries.

Keeping a counter-attack open

To be able to punish countries that use unfair methods to boost their export, the USA has passed the "Currency Reform for Fair Trade Act 2010", supplementing the "Omnibus Trade and Competitiveness Act of 1988", that will implements tariffs against countries that undervalue their currencies. Nevertheless a government report said that the Chinese government would have not conducted an unfair policy so that it is not to be punished under these acts (see the report from the US Treasury in the Appendix).

China's dilemma

China tries to slowly appreciate the Yuan, not just to avoid trouble with the USA, but also to bolster domestic consumption. So, we can expect the undervaluation of the Yuan to diminish or at least to decrease. But a fear is that a faster appreciation of the Yuan leads to a speculative bubble in the Chinese financial markets and with the following burst to an economic crisis.

2 perspectives

The problem with the Yuan and the Dollar can be seen in two ways: the USA causes it or China does.

The current account deficit (the difference between what a country exports and what it imports, it is a deficit when a country buys more goods from abroad (imports) then it sells to abroad (exports)) of the USA, it can be argued, is the result of China manipulating its currency or a result of the USA spending more than it earns.

Focusing on what matters

What most countries forget is that it is not just the exchange rate to the Dollar that matters but to all their trade partners. If a country mainly exports to the Eurozone and not the USA then this country's main concern must be the exchange rate to the Euro and not to the Dollar. If their exchange rate to the Dollar goes up (one Dollar buys less of their currency) then it loses its competitiveness in the US market, but when nothing happens to their exchange rate to the Euro then most of their exports won't be affected.

Capital flows

To be fair it must be said that capital/money flows are also motivated by the difference in interest rates (USA, UK, Japan and Euro zone between 0% and 1% while the interest rates in countries like Brazil and China are 11% and 6%) because an investor could borrow money cheaply in one country and invest it a different country ("carry trade"). Another reason for the money flows into countries like Brazil is the good economic outlook.

In general a distinction must be made between two types of capital flows. One type is welcomed by all countries while the other is not. Foreign Direct Investments (FDIs) are welcomed because this is something like a company from a different country builds a factory in another country. The other type of flows is "hot money" which is speculative capital on the search for the highest return which has the characteristic of possibly reversing quickly and therefore causing instability in an economy.

Another reason for the large flows of capital into emerging markets (countries that have a low income per head but a high growth rate and are thus emerging from being poor) is that the alternative to the USA, the Euro zone has its own problems with the sovereign debt crisis and therefore investors prefer countries like the emerging markets over other countries because when they have to take the risk they want at least a good economic outlook.

To summarize it all, the main concern is that countries, through the manipulation of their own currency, try to gain a competitive edge.

What should not be done?

The greatest fear is that if a currency war breaks out this would lead to a trade war and thus crash world trade as happened in the 1930s. Trade barriers would harm international trade and thereby the world economy. In case that a "war" breaks out this would have significant economic and social implications such as higher unemployment rates and higher state budget deficits due to stimulus measures from governments to counteract this downturn. Another problem would be that this would increase the likelihood of just another round of Quantitative Easing getting the world economy into spiral of ever more destructive measures, a policy called beggar thy neighbour in the times of the Great Depression.

Trade barrier could come in the form of tariffs, which are a tax on imports (in our case) or exports or non-tariff trade barriers. These could come in the form of licenses needed for foreigners to sell goods in a country, a quota which sets a limit to the amount of goods sold by foreigners in a country or foreign exchange controls where it can be forbidden for locals to buy foreign currencies or for foreigners to buy local currencies thus disturbing trade.

What can be done? What are possible solutions?

This is the hardest part of our topic and it is on behalf of the delegate's to come to a solution.

In history we have only two examples of periods of stable currencies. The most stable one was the Gold Standard until the 1930s. This was a time where world trade flourished and the world was as globalized as today. This sadly ended with the Great Depression and Great Britain abandoning its Gold Standard. The great advantage of it was that when (nearly) every currency was exchangeable into gold then the exchange rate for every currency was easy to find out and totally predictable. Furthermore current account deficits or surpluses meant that gold flowed from countries having a deficit to countries having a surplus.

The other system that gave the world certainty over exchange rates was the Bretton Woods from 1945 to the early 1970's. In this system the Dollar was fixed in terms of gold and other currencies were fixed in terms of Dollars. To maintain these fixed rates the countries were obliged to intervene in the markets. By-products of Bretton Woods were the International Monetary Fund (IMF) and the World Bank Group. Bretton Woods is a good example of an international agreement that established a currency system that gave stability for quite a long time.

Thinkable approaches to this problem could involve the under Bretton Woods established IMF because it was originally intended that the IMF would observe and regulate the international monetary system. Another institution is the World Trade Organization (WTO) that currently mainly deals with trade barriers such as Tariffs. Also possible would be cooperation between the two or a completely new institution.

What must be taken into account is that fixed exchange rates would probably not work with the current account deficits and surpluses we currently observe in the world.

Why world trade matters

World trade lives from an idea that has been discovered about 200 years ago, the idea of comparative advantage. Two countries can gain from trade even when one country is better in producing all products. Assuming we would just have 2 countries each producing 2 goods, wine and cloth. Let the 2 countries be Britain and Portugal. Britain can produce cloth at $100 and wine at $110 while Portugal can produce cloth at $90 and wine at 80$ per unit. Even though Portugal is more efficient in producing both cloth and wine Portugal can still gain from trade. If both countries concentrate on producing what they themselves produce the best (e.g. Britain cloth and Portugal wine) relative to the other good, then both countries can be better off in the end if they trade one good for another (or in money terms). Britain can get wine by trading it for cloth, so exports cloth and imports wine. Thereby it would pay with cloth which cost $100 and receives wine which would cost $110 to produce by itself. Portugal can obtain cloth at a cost of $80 by trade rather than for $90 by production.

The Foreign Exchange Market

The Foreign Exchange Market (also known as "Forex", FX or currency market) is the market where currencies are traded against each other and thus the market that our topic is about. Quoted are currencies as mentioned above against each other, that is to say EUR/USD is the Euro in terms of US Dollar. An exchange rate of 1,30 therefore means that for 1€ one gets $1,30. It is in many ways a unique market. There is not such as thing as a real "exchange", so no central market place. Currencies are traded "over-the-counter" (OTC). This means that the trading is decentralised and done directly between the two parties that trade and not through an exchange like the NYSE or the "Deutsche Börse".

The majority of the trade is done with a bank as the counterparty. Other participants are Hedge Funds, companies, Central Banks, investment firms and retail investors. This market is - since it is decentralized and thus independent from an exchange - open 24 hours except for the weekends. It is also the most liquid one which is to say that it has the highest trading volumes. According to the Bank for International Settlement the volume was around $4 trillion per day of which around 37% are done via London followed by New York (18%) and Tokyo (6.2%). Since trading always involves two currencies the aggregated percentages of the currencies share in the FX market must add up to 200%. The most traded currency is the US Dollar with a market share of around 85% followed by the Euro with 39% and then Yen (19%) and the Pound Sterling (13%).

Research

We require all delegates to send a short (maximum half a page) policy statement to us until the May 29th. This policy statement should outline what you think your countries position to our topic is.

Furthermore all delegates have to hold an opening speech at the beginning of the committee lasting no longer than one minute. The purpose of this speech, apart from the delegates presenting their countries view on the topic and thus facilitating the lobbying process, is that all delegates will speak in front of the committee at least once which they can prepare in advance. We hope that this will help to include everybody in the discussion.

As the public discussion about economic and social topics is mainly driven by ideologies and lobbyists, it is of the utmost importance during the whole research to analyse the source you are using and you should make sure whether your text is credible and correct or not. It is important to start your research as soon as possible so that you do not run out of time. However, you will still need to get updates on your country's position just before the conference as there frequently take place summits and discussions on that topic, so that countries publish statements or reports or even change positions.

It is very important that you **know as much as possible about the country you will be representing**: its history, current policy, religion, socio-economic structures, etc. and especially its opinion on our topic to be able to make informed and realistic decisions in the debate.

We would also advice you to look at current proposals and develop your own draft resolution using these proposals as a basis, but going a step further by developing new approaches yourself. If you do all this thoroughly you can look forward to an interesting debate!

Furthermore we recommend knowing the following facts about your country:

1. Did your currency appreciate or depreciate over the last few months, years? Especially against, US Dollar, Euro and Yuan?
2. To which extent does your country's economy rely on exports/imports?
3. What has the government and/or central bank done to influence the exchange rate?
4. Does your country employ any tariffs or other trade barriers?
5. Did your country experience anything (e.g. financial crisis etc) in its recent past that affects its opinion?

Contact

If you have any questions concerning our council's topic, your country's policies, how to conduct your research, procedural matters, how to write the resolution or any other issues, please feel free to contact us at ecosoc@olmun.org. We also would correct your resolutions or policy statements according to style and content and send it to other delegates. Furthermore it has proven to be useful for a smooth debate to get in touch with your fellow delegates prior to the conference using the OLMUN-Forum at www.olmun.org. In this forum you can exchange your ideas, resolutions, tactics, policy statements or more useful research sources you have discovered. Both emailing and forum are a good opportunity to make pre-lobbing and get to know more about the other countries in anticipation. You can also find useful information in the OLMUN Handbook.

We are very much looking forward to having a passionate and constructive debate with all of you at the 11th OLMUN!

Yours sincerely,

Philip Kuck
President

Jan-Hendrik Röske
President

Sources

These are some links we have used to conduct the research for this committee guide. These may also be very useful to you:

- Questions and answers about currency war from the newspaper "The Telegraph"
  http://www.telegraph.co.uk/finance/currency/8067431/Currency-Wars-QandA.html

- A collection of countries that intervened until 27th January
  http://www.reuters.com/article/2011/01/27/currencies-controls-idUSSGE69503F20110127

- Articles on and comments about Mantega's speech, the first time currency war was mentioned
  http://uk.reuters.com/article/2010/09/28/uk-brazil-currency-idUKLNE68R00720100928?feedType=RSS&feedName=stocksAndSharesNews&rpc=452
  http://www.ibtimes.com/articles/66385/20100928/brazil-currency-imports-trade.htm
  http://www.bloomberg.com/news/2010-10-08/soros-says-currency-war-concerns-not-far-off-mark-as-g-7-officials-meet.html
  http://uk.reuters.com/article/2011/01/28/brazil-economy-mantega-idUSN2810146020110128

- Article on speech from South African finance minster
  http://www.mg.co.za/article/2010-10-19-gordhan-warns-of-trade-war

- Proposal how to solve the problem
  http://www.ceps.eu/system/files/book/2010/09/DG%20Levelling%20the%20capital%20playing%20field%20rev.

- UN report mentioning the topic
  http://www.un.org/en/development/desa/policy/wesp/wesp_current/2011wesp_pr_global_en.pdf

- US finance ministerr attacking China, other countries also mentioned
  http://www.bloomberg.com/news/2010-10-13/geithner-signals-china-forcing-other-emerging-market-nations-to-intervene.html

- Wikipedia article on the above mentioned acts
  http://en.wikipedia.org/wiki/Omnibus_Foreign_Trade_and_Competitiveness_Act
  http://en.wikipedia.org/wiki/Currency_Reform_for_Fair_Trade_Act_2010

- Article on Columbian interventions
  http://www.reuters.com/article/2010/09/15/colombia-currency-idUSN1514548320100915

- Report from US treasury giving an overlook over some countries currency policies
  http://www.treasury.gov/resource-center/international/exchange-rate-policies/Documents/Foreign%20Exchange%20Report%20February%204%202011.pdf

- Japanese intervention
  http://www.reuters.com/article/2010/09/15/us-markets-global-idUSTRE67G0CV20100915

- Interview with President of the Institute for the Study of Long-Term Economic Trends discussing QE and currency war
  http://www.democracynow.org/2010/11/5/new_600b_fed_stimulus_fuels_fears

- Website of "The Economist" , having interesting features worth a look
  www.economist.com

- Website of International Monetary Fund
  www.imf.org

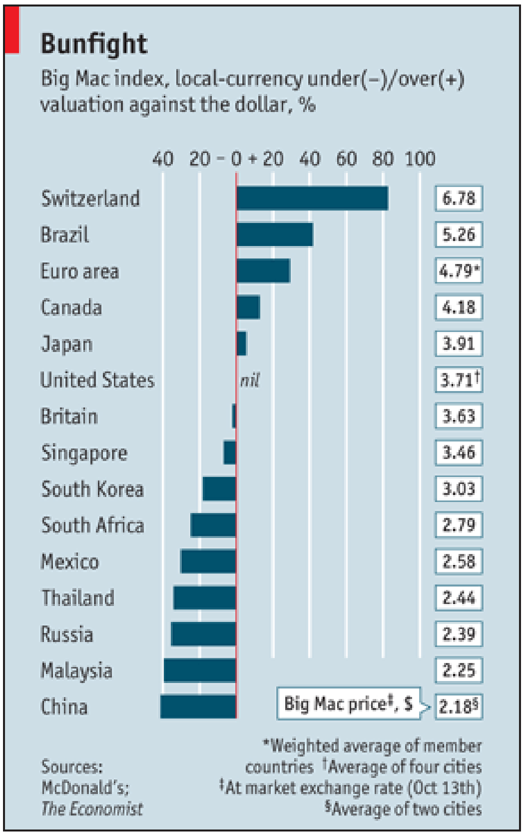
- WTO's website
  http://www.wto.org/

- Trade barriers
  http://en.wikipedia.org/wiki/Trade_barrier
  http://en.wikipedia.org/wiki/Non-tariff_barriers_to_trade
  http://www.wto.org/english/thewto_e/glossary_e/glossary_e.htm

Glossary

- Exchange rate: the exchange rate is the ratio of two different currencies, that is to say how much is currency 1 worth in currency 2, an example if the exchange rate Euro-US Dollar is 1,30 then 1€ is worth $1,30, so it here expresses how much Dollars one can buy with 1€
- Quantitative Easing: QE, an alternative form of monetary policy, where a central bank purchases financial assets with newly created money to boost the economy by freeing up capital
- Gold Standard: in the Gold Standard a currency is fixed in relation to gold, so if the € would be fixed to gold then Euros could be in a predetermined and fixed (so stable, non-changing) exchanged into gold at a specified rate (example, € is fixed to gold at 750€, so if one presents 750€ to the central bank then one would get one ounce (33,1g) of gold)
- Central bank: institution that issues a countries' currency and sets its monetary policy (either the supply of money, how much money there is in the economy, or the interest rates, the short-term rates at which banks can borrow money from it), it is mostly independent from the government
- Appreciation: a currency appreciates when it is worth more in another currencies

- Devaluation of a currency: a currency is devalued when it can buy less goods (inflation) and/or less other currencies (depreciation in the foreign exchange market)
- Tariffs: a tariff is a tax on either an import or export, depending on what the government wants to discourage, e.g. when it is on an import then the tariff is on a good that has been produced outside the country but is sold in this country, so e.g. a Ford bought in Germany, on the actual selling price the government puts on top an extra tax thus making it more expansive
- Asset Bubble: an asset bubble occurs when the price of an asset class (such as houses, stocks, bonds or commodities etc) is highly over-valued and investors have unrealistic and unsustainable expectations about it that leads to prices significantly overshooting its true, intrinsic value
- Carry trade: a carry trade is a trade where an investors borrows money where interest rates are low and invests the money in another country where interest rates are higher
- Beggar thy neighbour: a policy where a country tries to get benefits at the expense of others countries
- Big Mac Index, a measure of the over-/undervaluation of a currency



This image shows you the "Big Mac Index", published by" The Economics". It compares the prices of a Big Mac (a international "good" and well comparable to between different countries) in different countries and then compares the foreign exchange rate to the foreign exchange rate derived from comparing Big Mac prices.

As we can see here, according to this measure, the Swiss Franc was overvalued by 80% as of 13th October 2010 and the Chinese Yuan 40% undervalued against the US dollar.