



General Assembly Second Committee Topic Background Guide
Topic 3: Responding to the International Financial Crisis¹

23 October 2011

The contemporary international financial system was established in 1944 at the United Nations Monetary and Financial Conference in Bretton Woods, New Hampshire. The Bretton Woods conference was not sponsored by the United Nations organization, however, because that organization did not yet exist. Instead, the conference was named after the World War II alliance of the US, UK, France, Russia, and China, which opposed the Axis powers of Germany, Italy, and Japan. This alliance was officially called the United Nations. In the midst of the war, the allies drafted plans for an international organization to maintain international peace and security. They gave the new organization their name, gave themselves veto power on the Security Council, and gave the Security Council a critical role in amending the Charter and admitting new members.

In addition to creating the United Nations, the allies created three international economic organizations. Because they were conceived in Bretton Woods, they are often called the Bretton Woods institutions. These institutions were the International Bank for Reconstruction and Development (IBRD, often called the World Bank), the International Monetary Fund (IMF), and the General Agreement on Tariffs and Trade (GATT, which was replaced in 1995 by the World Trade Organization). The World Bank and IMF are the cornerstones of today's international financial system. Yet neither was able to prevent the international financial crisis that spread from the US to the rest of the world in 2008 and that continues to affect people and states worldwide.

Since 2008, there have been many calls for reform of the international financial system. There has also been much debate about what kinds of reform would be effective and whether such reforms are politically and economically possible. Meanwhile, the crisis has spread from one country to the next, devastating even Iceland, which in 2007 was at the very top of the United Nations Development Programme's (UNDP) list of developed states.² Today, it threatens to break apart the European Union.

History

Among those in attendance at the 1944 Bretton Woods conference was the British economist and policy maker, John Maynard Keynes. In 1918, Keynes had attended a similar post-war meeting, the Paris Peace Conference, where the World War I allies imposed economic reparations on Germany to punish it for the damage it had caused to France and the UK. In his book, *The Economic Consequences of the Peace*, written immediately after the conference, Keynes argued that the reparations were so high that they would devastate Germany and weaken economies throughout Europe.³

By 1944, Keynes' prediction had come true. During the 1920s, the Germany economy contracted as the government paid its reparations to the UK and France. When the German currency collapsed and Germany defaulted on its reparations payments, the UK and France were unable to pay their war debts to the US. This, in turn, created economic problems in the US, including the 1929 crash of the US stock market. Thus the effort to punish Germany had backfired, creating the Great Depression, the worldwide economic crisis that lasted for more

¹ This document was written by Karen Ruth Adams, faculty advisor. Copyright 2011 by Karen Ruth Adams.

² United Nations Development Programme, "2007/2008 Human Development Index rankings," <http://hdr.undp.org/en/statistics/>

³ Robert B. Reich, "John Maynard Keynes," *The TIME 100: Scientists and Thinkers*, *TIME*, March 29, 1999, pp. 1-2, <http://www.time.com/time/time100/scientist/profile/keynes.html>

Montana Model UN High School Conference

than a decade.⁴ German reparations also played an important role in causing World War II. Adolf Hitler's election in 1933 was largely in response to the hopes of German citizens that he would free them from the reparations and restore German power.⁵

At the end of World War II, the allies were determined to take a different path. As economist Robert B. Reich explains, the first lesson they took from the first decades of the 20th century was that international economic cooperation is vital for international peace and prosperity:

Instead of repeating the mistake made almost three decades before, the U.S. and Britain bore in mind Keynes' earlier admonition. The surest pathway to a lasting peace, they then understood, was to help the vanquished rebuild. Public investing on a grand scale would create trading partners that could turn around and buy the victors' exports, and also build solid middle-class democracies in Germany, Italy and Japan.⁶

Thus the purpose of the World Bank was to make loans to member states to help them rebuild from the war so they would not feel a need to impose reparations on the losers. The first World Bank loans were to France, the Netherlands, Luxembourg, and Denmark. Since then, the World Bank has made billions of dollars in loans to countries rebuilding after wars and natural disasters. In addition, the World Bank makes loans to help developing countries build infrastructure and reduce poverty.⁷

The second lesson the allies took from the interwar years was that, once an economic crisis gets going, isolationist foreign policies can make it worse. As explained by the US State Department:

The policies adopted by governments to combat the Great Depression – high tariff barriers, competitive currency devaluations, discriminatory trading blocs – had contributed to creating an unstable international environment without improving the economic situation. This experience led international leaders to conclude that economic cooperation was the only way to achieve both peace and prosperity, at home and abroad.⁸

The purpose of the GATT was to help member states reduce tariffs (taxes on imports) so that producers would have worldwide markets for their goods. The WTO, the GATT's successor, helps countries reduce other trade barriers, as well, including quotas, regulations, and subsidies. In summer 2008, WTO's most recent round of trade negotiations, the Doha Round, broke down over the issue of agricultural protection. Developing countries, especially India and China, disagreed with developed countries, especially the US, about whether developing countries should be able to impose tariffs on agricultural imports to protect producers from import surges and price declines.⁹ Also at issue were developed country agricultural subsidies. Subsidies are payments to domestic businesses to enable them to

⁴ Robert Lekachman, "The Universe of Money," *New York Times*, January 3, 1982 [review of Anthony Sampson, *The Money Lenders: Bankers and a World in Turmoil*], <http://query.nytimes.com/gst/fullpage.html?res=9A0CE0DA1338F930A35752C0A964948260>. US Department of State, "The Dawes Plan, the Young Plan, German Reparations, and Inter-allied War Debts" and "The Great Depression and U.S. Foreign Policy," <http://www.state.gov/r/pa/ho/time/id/>

⁵ BBC, "Historic Figures: Adolf Hitler (1889 - 1945)," http://www.bbc.co.uk/history/historic_figures/hitler_adolf.shtml

⁶ Reich, "John Maynard Keynes," p. 2.

⁷ World Bank, "World Bank History," <http://go.worldbank.org/2GIYUD9KB0>. World Bank, "Pages from World Bank History: The Bank's First Development Loans," May 30, 2003, <http://go.worldbank.org/3AYV8BU300>

⁸ U.S. Department of State, "The Bretton Woods Conference, 1944," <http://www.state.gov/r/pa/ho/time/wwii/98681.htm>

⁹ Stephen Castle and Mark Lander, "After 7 Years, Talks Collapse on World Trade," *New York Times*, July 30, 2008, available at <http://www.nytimes.com/2008/07/30/business/worldbusiness/30trade.html>

Montana Model UN High School Conference

compete against imports. In the European Union (EU) for example, domestic wheat farmers are paid \$200 per ton of wheat; however, outside the EU wheat can be purchased at \$150 per ton; thus EU farmers are being subsidized by \$50 per ton.¹⁰ Similar subsidies exist in the US, Canada, and Australia.

The purpose of the IMF is to help member states out of short-term currency crises (also called balance of payments crises) so that one country's economic problems will not spread worldwide. To understand the IMF, it is vital to understand balance of payments crises. Every three months, each state tallies up its financial transactions with the rest of the world. This tally is the state's balance of payments (BOP). The two major components of a state's BOP are its current account or trade balance (exports minus imports) and its capital account balance (foreign money coming into the country minus national money flowing abroad, through investments, loans, and foreign aid). Before the IMF was created, when countries had negative balances of payments, they had just four options, each of which caused other countries to suffer. These options were:

1. to impose trade barriers (to limit imports or increase exports), which hurts other countries' ability to prosper through trade
2. to impose currency exchange controls (to keep money from leaving the country), which reduces the options of international investors and reduces confidence in international investments
3. to devalue the currency by printing money (to pay off loans or make the country's exports more competitive), which reduces the ability of other countries to export their products and spreads inflation
4. to deflate the economy by raising interest rates (to make it harder for citizens and businesses to take out loans that allow them to live beyond their means), which puts the national economy in recession and hurts countries that normally export to that country.

The IMF was created to give states another option. Each IMF member state pays dues (called a quota) to the organization in proportion to the size of its economy. In exchange, when it has a negative BOP, it can ask the IMF for a short-term loan to assist with adjustment. If the IMF Executive Board votes to offer it a loan, the country is less likely to manipulate the value of its currency or impose trade barriers to deal with the situation. In fact, IMF loans generally come with conditions prohibiting these actions. Together, the loans and the conditions are intended to get states back on track without major disruption to the international economy.¹¹ Before 2008, the IMF had been involved in balance of payments crises in developing countries such as Mexico (1982, 1994), Argentina (1995), and Thailand, Korea, Malaysia, Indonesia, the Philippines, Russia, and Brazil (1997). Many aspects of the IMF's packages have been criticized, especially the tendency to impose conditions limiting government regulation.¹² For example, most countries that accept IMF loans must agree to cut the size of their government by closing offices, laying off workers, and ending subsidies for food, health care, education, and transportation.

At a national level, governments also began to engage in deficit financing to soften the effects of economic downturns. This reflected agreement with John Maynard Keynes' observation that although, in the long run, the Great Depression would end, "in the long run, we are all dead."¹³ As US Federal Reserve Board Chairman Ben S. Bernanke explains,

¹⁰ John Lingard, "Agricultural Subsidies and Environmental Change," *Wiley.co.uk*, available at <http://www.wiley.co.uk/egec/pdf/GB403-W.PDF>

¹¹ International Monetary Fund, "IMF Lending: A Factsheet," October 2008, <http://www.imf.org/external/np/exr/facts/howlend.htm>

¹² Steven Radelet and Jeffrey D. Sachs, "The East Asian Financial Crisis: Diagnosis, Remedies, Prospects," Harvard Institute for International Development, April 20, 1998, <http://www.cid.harvard.edu/archive/hiid/papers/bpeasia.pdf>

¹³ Reich, "John Maynard Keynes," p. 3.

Montana Model UN High School Conference

...the experience of the Depression helped forge a consensus that the government bears the important responsibility of trying to stabilize the economy and the financial system, as well as of assisting people affected by economic downturns. Dozens of our most important government agencies and programs, ranging from social security (to assist the elderly and disabled) to federal deposit insurance (to eliminate banking panics) to the Securities and Exchange Commission (to regulate financial activities) were created in the 1930s, each a legacy of the Depression.¹⁴

According to economist Robert Reich, the IMF has forgotten these important lessons of the 1930s. Writing in 1999, Reich argued that

Were Keynes alive today he would surely admire the vigor of the U.S. economy, but he would also notice that some 40% of the global economy is in recession and much of the rest is slowing down: Japan, flat on its back; Southeast Asia, far poorer than it was just two years ago; Brazil, teetering; Germany, burdened by double-digit unemployment and an economic slowdown; and declining prices worldwide for oil and raw materials. In light of all this, Keynes would be mystified that the International Monetary Fund is requiring troubled Third World nations to raise taxes and slash spending, that "euro" membership demands budget austerity, and that a U.S. President wants to hold on to budget surpluses.¹⁵

Since 1999, of course, the situation has changed dramatically. In particular, as explained below, the US economy crashed as the result of a housing bubble, which has reduced economic growth and prosperity worldwide.

Another goal of the IMF was to stabilize currency exchange rates to create confidence in international trade. Exchange rates are the international price of money. They express the value of one currency compared to the value of another. For example, the Euro/US dollar exchange rate on November 7, 2008 was \$1.27. Thus, to pay for a 100 Euro hotel room in Paris, you would need \$127. In July 2008, the Euro/US dollar exchange rate was over \$1.60. Thus, simply because of currency fluctuations, your trip would have cost 25% more before the 2008 market downturn than after.¹⁶

Exchange rate stability is vital for international trade. Only when producers and consumers are confident about the stability of exchange rates will they be willing to trade. Historically, great powers have tried to stabilize exchange rates by establishing gold standards (UK) or gold exchange standards (US), in which the great power pledges to print money in strict proportion to the amount of gold it has, and other states peg their currencies to the great power's at a certain, set rate. Because the British gold standard made it difficult for the world economy to grow and for individual states to adjust to changes in their economies,¹⁷ the post-World War II US gold exchange standard was devised with more flexibility. This system was governed by the IMF Executive Board, which from 1945-1971 established the rates at which member states' currencies could be exchanged for the US dollar. In 1971, US President Richard Nixon took the US off the gold exchange standard when European countries complained that the US had printed far more dollars than it had gold to finance the Vietnam War and therefore demanded gold instead of dollars.¹⁸

¹⁴ Ben S. Bernanke, "Money, Gold, and the Great Depression," Remarks at the H. Parker Willis Lecture in Economic Policy, Washington and Lee University, Lexington, Virginia, March 2, 2004, <http://www.federalreserve.gov/boarddocs/speeches/2004/200403022/default.htm>

¹⁵ Reich, "John Maynard Keynes," p. 3.

¹⁶ "Currencies," *New York Times*, November 7, 2008, <http://markets.nytimes.com/research/markets/currencies/currencies.asp>

¹⁷ Bernanke, "Money, Gold, and the Great Depression."

¹⁸ Thomas L. Friedman, "The World; A Nixon Legacy Devalued By a Cold War Standard," *New York Times*, May 1, 1994, <http://query.nytimes.com/gst/fullpage.html?res=9F06E6D91230F932A35756C0A962958260>. U.S. Department of State, "The Bretton Woods Conference, 1944."

Montana Model UN High School Conference

Since 1971, the IMF's role in stabilizing exchange rates has been replaced by the Group of 7 industrialized countries (G-7), which cooperate to buy and sell currencies when exchange rates fail to stay within certain ranges. The members of the Group of 7 are the US, UK, France, Germany, Italy, Japan, and Canada. These states are also members of the Group of 8, which includes Russia. But because of their wealth and extensive international transactions, it is the G-7 countries that cooperate to stabilize exchange rates. In September 2011, finance ministers of the G-7 countries affirmed their commitment to "market determined exchange rates" and their belief that the Euro should be bolstered to "maintain the stability of the global financial system."¹⁹

Current Events

Today, the World Bank, WTO, and IMF continue to carry out the missions defined for them at the Bretton Woods conference. Yet the membership of these organizations and the economic environment in which they operate have changed dramatically since 1945. In considering how the UN and its sister organizations -- the World Bank, WTO, and IMF -- should respond to the current international financial crisis, it is important to understand these changes.

The first major change since 1945 has been a dramatic increase in membership in the Bretton Woods organizations. From the start, the UN included most independent states worldwide. By contrast, until the 1990s, the members of the Bretton Woods institutions were largely the Western bloc allies of the United States. Although the Soviet Union participated in the Bretton Woods conference, in 1945 Joseph Stalin decided Russia would not join the organizations, both because the US had ignored a Russian request for a reconstruction loan and because Stalin was reluctant to make the financial disclosures required to establish what the Russian quota would be.²⁰ Russia did not join the IMF and World Bank until 1992.²¹ As of 2011, it is still in the process of joining the WTO.²² China, by contrast, was one of the original 45 members of the World Bank, IMF, and GATT. But, after the Chinese Revolution of 1949, when the Chinese Nationalist government fled to Taiwan and a Communist government controlled the mainland, the Chinese seats at the IMF and World Bank were held by the Nationalist (Taiwanese) government. This remained the case until 1980, when the membership was transferred to the People's Republic of China.²³ Ever since, the IMF has treated Taiwan as a province of China. China joined the WTO in 2001.²⁴ In 1945, the IMF had 29 members. Today, it has 185. Growth in World Bank and IMF membership has been similar.

The second major change since 1945 has been a significant increase in international trade and finance compared to levels seen during the interwar years. During the Cold War, successive US administrations worked to increase economic interdependence within the Western bloc, tying US allies together in the Bretton Woods organizations. In the 1980s, after President Nixon's 1971 recognition of the mainland Chinese government, China joined the UN and became part of the Western economic bloc. Since the end of the Cold War, Russia and its many former satellite states have also become integrated into the international economic system. As a result of these

¹⁹ Ben Rooney, "G7 pledges 'strong, coordinated' effort on economy," CNN Money, 16 September 2011, available at http://money.cnn.com/2011/09/10/news/economy/g7_meeting/index.htm

²⁰ Arnold A. Offner, *Another Such Victory: President Truman and the Cold War, 1945-1953* (Stanford, CA: Stanford University Press, 2002), 130-132, <http://books.google.com/books?id=P5tbHSsBS-AC>

²¹ Steven Greenhouse, "Lending Agencies Admit Ex-Soviets as Full Members," *New York Times*, April 28, 1992, <http://query.nytimes.com/gst/fullpage.html?res=9E0CE2DC1438F93BA15757C0A964958260>

²² World Trade Organization, "Accessions: Russian Federation," http://www.wto.org/english/thewto_e/acc_e/a1_russie_e.htm

²³ International Monetary Fund, "At a Glance – China and the IMF," September 2004, <http://www.imf.org/external/country/chn/rr/glance.htm>. World Trade Organization. "WTO successfully concludes negotiations on China's entry," Press/243, 17 September 2001, http://www.wto.org/english/news_e/pres01_e/pr243_e.htm

²⁴ World Trade Organization, "China and the WTO: Member Information," http://www.wto.org/english/thewto_e/countries_e/china_e.htm

Montana Model UN High School Conference

changes, the value of international trade (measured in constant 2000 US dollars) was more than 200 times greater in 2007 than it was in 1950.²⁵

Today, no country pursues an “autarkic” strategy of completing avoiding international trade and financial ties. Instead, most states are engaged in at least some international trade and finance. In 2007, Germany was the world’s largest exporter, followed by China and the US. In slightly different order, these countries were also the world’s largest importers, with the US at the top, followed by Germany and China.²⁶ Yet these countries were not equally vulnerable to international economic crises, as can be seen by comparing each country’s exports and imports to its overall economic production (gross domestic product). As shown in Table 1, in 2007, Germany’s reliance on international trade was much greater than the US’s and China’s:

Table 1
Export, Imports, and GDP of Germany, China, and the US (2007)²⁷

	Total Exports 2007	GDP 2007	Exports as % of GDP	Total Imports 2007	Imports as % of GDP	Trade Balance (Exp-Imp)
Germany	\$1.354 trillion	\$2.807	48%	1.075	38%	279
China	7.099	1.220	17	0.905	13	6.194
US	1.148	13.780	8	1.968	14	(82)

Germany sells 48% of what it produces to other countries and spends 38% of its annual national income on imported goods and services. China and the US, by contrast, rely much less on foreign markets to buy their goods and supply their consumption needs. Thus, if all other aspects of their economies were the same, Germany would be more affected by international economic crises than the US and China.

Yet these countries differ in three ways that further affect their overall vulnerability to international economic crises. First, Germany and especially China have large, positive current account (trade) balances, while the US has a negative trade balance. In addition, the US has a large government debt, which totaled \$10.6 trillion at the beginning of the crisis, 27 percent of which was held by foreigners, especially governments and investors in Japan, China, and the UK.²⁸ In the three years since the economic crisis began, US debt has grown to \$14.9 trillion.²⁹ Thus, in the long run, the US is more vulnerable to changes in the international financial system and loss of investor confidence than Germany and especially China, whose large trade surplus gives it huge profits to invest at home or abroad. However, in the short term, the crisis has increased worldwide demand for US government

²⁵ World Trade Organization, “World merchandise exports, production and gross domestic product, 1950-2007,” *International Trade Statistics 2008*, Appendix Table A1a, http://www.wto.org/english/res_e/statis_e/its2008_e/appendix_e/a01a.xls

²⁶ World Trade Organization, “Leading exporters and importers in world merchandise trade, 2007,” *International Trade Statistics 2008*, Table 1.8, http://www.wto.org/english/res_e/statis_e/its2008_e/section1_e/i08.xls

²⁷ All figures are in trillions of US dollars. Source: US Central Intelligence Agency, *World Factbook* country pages for Germany, China, and the US, <https://www.cia.gov/library/publications/the-world-factbook/>

²⁸ US Department of the Treasury, “Debt to the Penny and Who Holds It,” <http://www.treasurydirect.gov/NP/BPDLogin?application=np> (accessed November 10, 2008). US Department of the Treasury/Federal Reserve Board, “Major Foreign Holders of Treasury Securities,” October 16, 2008, <http://www.ustreas.gov/tic/mfh.txt>

²⁹ US Department of the Treasury, “Debt to the Penny and Who Holds It,” <http://www.treasurydirect.gov/NP/BPDLogin?application=np> (accessed 23 October 2011).

Montana Model UN High School Conference

bonds because no other country has the large and stable financial system of the US. Japan has been in a recession for over two decades and, with the earthquake, tsunami, and nuclear crisis is not a place that international investors want to put a lot of money for safekeeping. Similarly, China's economy is large and growing but is not stable or transparent enough to inspire investor confidence. For many years, the European Union was perceived as a strong investment alternative to the US, but once European countries caught the US financial "flu," the Euro started falling, and now its future is in doubt.³⁰

Second, China is a developing country. According to the CIA, in 2007 GDP per capita (per person, purchasing power parity) was just \$5,400 in China, compared to \$34,100 in Germany and \$45,800 in the US. Because poverty is still a widespread problem in China, even a small economic downturn can have very large effects on the Chinese people. By contrast, German and American citizens, with their much higher incomes, should be less likely to fall back into extreme poverty. Three years after the crisis began, we can see that these predictions have borne out. China's unemployment rate has skyrocketed, and its poorest citizens have suffered. However, due to continued domestic and international demand for Chinese products, in 2010, Chinese per capita GDP had grown to \$7,600.³¹

Third, the US is not just a state that exports and imports a great deal. From 1945 to 1989, it was one of the two most powerful states in the world. During this time, the US set up and ran the Bretton Woods international economic system to advance its interests and balance the power of the Soviet Union. Since 1989, the US has been the single most powerful state in the world. In 2007, the US accounted for just 5 percent of world population and 6 percent of the world's land area, yet it accounted for 45 percent of worldwide military spending and 21 percent of gross world product. The next largest military spenders were the UK, China, France, and Japan, each of which accounted for just 4 to 5 percent of world military spending.³²

Because of its power, the US has long had a dominant role in setting and enforcing the rules of the international economic system. For example, at the World Bank and IMF, member states' votes are weighted based on the quotas (dues) they pay. In 2008, the US paid 17.09 percent of the IMF's quota and held 16.77 percent of the votes. By contrast, Germany's quota was 5.99 percent (5.88 percent of votes), and China's quota was 3.72 percent (3.66 percent of votes).³³ In recent years, China has lobbied to have the quota system revised so each member state, regardless of size, has more votes. As explained by the *China Daily*,

China's gross domestic product (GDP) was more than six times that of Belgium in 2006, while Belgium had a 2.16 percent quota and China's quota was only 2.98 percent. IMF took an initial, yet major, step toward overhauling its quota share structure last September by increasing the quotas for four developing economies: China, South Korea, Mexico and Turkey. China's quota was then raised from 2.98 percent to 3.72 percent. "Last year's quota increase (for China) is more a symbolic move than a substantial one, as the developed economies, especially the United States and Europe, are still the dominant powers in the Fund," said Tan Yaling, a senior researcher with the global financial market department of the Bank of China.³⁴

³⁰ "Times Topics: European Union," *New York Times*, available at http://topics.nytimes.com/top/reference/timestopics/organizations/e/european_union/index.html?scp=1-spot&sq=european%20union&st=cse

³¹ US Central Intelligence Agency, *World Factbook* pages for China.

³² Population, land area, and economic figures were calculated from US Central Intelligence Agency, *World Factbook* pages for US and World. Military data is from Stockholm International Peace Research Institute, "The 15 Major Spender Countries in 2007," http://www.sipri.org/contents/milap/milex/mex_major_spenders.pdf

³³ International Monetary Fund, "IMF Members' Quotas and Voting Power, and IMF Board of Governors," September 26, 2008, <http://www.imf.org/external/np/sec/memdir/members.htm#u>

³⁴ "Country seeks greater say in IMF," *China Daily*, November 20, 2007, <http://english.peopledaily.com.cn/90001/90776/90884/6305837.html>

Montana Model UN High School Conference

Thanks to this system of weighted voting, in an economic crisis the US is more likely than China (or other developing countries) to receive IMF assistance. Moreover, the IMF is less likely to criticize the US and more likely to criticize China (and other developing countries).³⁵ Nevertheless, because the US and other G-7 members needed China to help bail the international financial boat, in 2010, they agreed to increase China's quota and voting rights, as well as those of other leading developed countries, such as India and Brazil. To accomplish this, the quotas and voting rights of some European states were reduced. Today, the weighted voting system remains in place, and the US continues to have more influence on IMF decisions than any other member state.³⁶

Another benefit of US power is widespread international confidence in the dollar. Most countries with trade deficits have trouble attracting foreign investment to keep their balance of payments positive. But because the US is among the top three importers and exporters, and because it is China's largest trading partner and Germany's second-largest trading partner,³⁷ the bulk of international trade occurs in dollars. In addition, because no other state in the world has such developed and diversified financial markets and such a generally stable currency, the US has historically been a very safe place for individuals, firms, and states from all over the world to invest their money. This is why, despite the US's large debt, the US economy did not contract very deeply or for very long. Today, many Americans remain unemployed, but the US has not experienced a balance of payments crisis, which some thought was likely in 2008. This is because, at the moment, the US still dominates the world economy. As a result, there are few secure alternatives for international investors.

To summarize, although Germany, China, and the US was all in the top three importers and exporters in 2007, each had different levels and types of exposure to the international economic crisis. Moreover, although these countries were unique in having very high trade volumes, their vulnerabilities were similar to those of many other states. Some countries are, like Germany, very vulnerable to disruption in international demand for their products. Other countries are, like China, less vulnerable on this front in aggregate terms; but because of their lower GDPs per capita, small changes in international demand could have large effects on their living standards. Finally, some countries are, like the US, vulnerable to changes in investor confidence.

High levels of international economic interdependence mean that both good economic times and economic downturns spread quickly and widely through the system. Moreover, the US' dominant position in the world economy means that (as policy makers and analysts frequently note) "when the US sneezes, the world catches a cold." This has been very much the case in the current financial crisis, which began with risky mortgages made in the US and bundled into investments purchased by banks, hedge funds, insurance companies, and many other investors in the US and abroad. When it became evident that millions of these mortgages would not be repaid, banks had to shore up their loss reserves, so they stopped making new loans to individuals, firms, and governments. In turn, individuals, firms, and governments cut back their consumption of goods and services, which reduced corporate profits, stock prices, and employment. In this way, the crisis spread from Wall Street to Main Street and from the US to other countries. In the ten weeks from September 7 to October 28, 2008, the crisis resulted in the failure and government takeover of a number of US and international banks. Stock markets worldwide fell by more than half from their peaks. Exchange rates fluctuated widely, with the Euro/US rate, in particular, falling 25% from its July 2008 peak as funds flowed into US investments, especially Treasury bonds, which are seen as a safe haven.³⁸

³⁵ International Monetary Fund, "Financial Reforms Critical to Transforming Chinese Economy," *IMF Survey* online, July 20, 2011, available at <http://www.imf.org/external/pubs/ft/survey/so/2011/car072011a.htm>

³⁶ Steven R. Weisman, "U.S. Seeks Bigger China Role in I.M.F.," *New York Times*, August 30, 2006, <http://www.nytimes.com/2006/08/30/washington/30trade.html?scp=1&sq=china%20imf%20quota&st=cse> Changes were agreed in 2008 and 2010. The former were small, and the latter have not yet gone into effect. International Monetary Fund, "IMF Executive Board Approves Major Overhaul of Quotas and Governance," Press Release 10/418, 5 November 2010, available at <http://www.imf.org/external/np/sec/pr/2010/pr10418.htm>

³⁷ US Central Intelligence Agency, *World Factbook* country pages for Germany and China, <https://www.cia.gov/library/publications/the-world-factbook/>

³⁸ "Ten Weeks of Financial Turmoil," *New York Times*, updated April 2011, http://www.nytimes.com/interactive/2008/09/27/business/economy/20080927_WEEKS_TIMELINE.html. Steven

Montana Model UN High School Conference

Although the crisis started in the US and led to significant decreases in US real estate and stock values and an increase in unemployment, the US situation is not as bad as it would be if investors lacked confidence in the dollar. By contrast, Iceland, Hungary, Ukraine, and Turkey – which have received considerable foreign investment in recent years – saw foreign funds flee their markets, which made it necessary to obtain balance of payments assistance from the IMF.³⁹ Trade sensitive countries such as Germany and China also felt the effects of the dramatic worldwide downturn in consumption.⁴⁰

Previous Committee Work on this Topic

By early November 2008, the financial crisis had spread from the US to affect most countries in the world. Thus many UN committees and agencies begun to analyze the causes and effects of the crisis and discuss ways to reduce its detrimental effects on employment, incomes, and poverty worldwide. In addition, the crisis was under discussion in a number of non-UN forums, such as the IMF, World Bank, and WTO, which are affiliated with the UN but are run separately. Other organizations that have since held meetings to discuss the crisis include the G-7, the European Union, and the Group of 20, which consists of G-7 members plus 13 of the most advanced developing countries (often called emerging economies), including China, Brazil, Russia, and India.

In early November 2011, leaders of the G-20 will meet in Cannes, France to develop a strategy for responding to the crisis. At present, the crisis has five main aspects. First, because US unemployment remains high, US consumers are not purchasing imports at the rate they once did. This means that the many countries from which the US imports are suffering as well. Second, because European banks held so many US mortgage-backed securities, they continue to be weak from the losses of 2008. Third, when international investors saw how overvalued housing was in the US, they began to dump housing and other real estate in other countries, such as Spain, Ireland, Greece, and Portugal. Fourth, because many large French and German banks hold the debt of these other European countries, if the Euro is going to survive, they are all going to have to figure out how to compromise so that the lender countries are not overly strict and the debtor countries are not encouraged to pursue the same policies again. Finally, and -- from the point of view of worldwide living standards -- most importantly, while the US and European Union focus on their problems, people in developing countries are suffering mightily from decreased demand for their exports and slowdowns in international loans and aid.⁴¹ As a result, the upcoming G-20 meeting is likely to be marked by widespread and perhaps violent protests.⁴²

Since the crisis began in 2008, many countries have experienced economic protests. Some (such as the protests in Egypt) culminated in a change of government. Others (such as those in London) involved days of riots that were ultimately repressed by police forces. Still others (such as the Occupy Wall Street movement that began in the US and has spread to other countries) are in their early stages. The G-20 therefore provides an international

Pearlstein, "With Bubbles Popping Worldwide, No Wonder the Economy's Gone Flat," *Washington Post*, October 7, 2008, <http://www.washingtonpost.com/wp-dyn/content/article/2008/10/06/AR2008100603184.html>.

³⁹ Mark Landler and Brian Knowlton, "Iceland Poised to Get \$6 Billion Rescue Package," *New York Times*, October 20, 2008, <http://www.nytimes.com/2008/10/21/business/worldbusiness/21iceland.html?fta=y>. Landon Thomas, Jr., "Turkey Tries to Resist Aid From I.M.F.," *New York Times*, November 7, 2008, <http://www.nytimes.com/2008/11/08/business/worldbusiness/08turkey.html>

⁴⁰ "Europe and the financial crisis: The end of the beginning? Berlin, Madrid, Paris and Rome," *Economist*, October 16, 2008, http://www.economist.com/displayStory.cfm?story_id=12436221. David Barboza, "Once Sizzling, China's Economy Shows Rapid Signs of Fizzling," *New York Times*, November 6, 2008, <http://www.nytimes.com/2008/11/07/business/worldbusiness/07yuan.html>.

⁴¹ Jonathan Glennie, "The G-20 summit must look beyond the west and think of the rest," Poverty Matters blog, *Guardian* newspaper (UK), 19 October 2011, available at <http://www.guardian.co.uk/global-development/poverty-matters/2011/oct/19/g20-summit-not-just-west>

⁴² Kim Willsher, "G-20 protesters plan major demonstration in Cannes," *Guardian* newspaper (UK), 17 October 2011, available at <http://www.guardian.co.uk/world/2011/oct/17/g20-protesters-major-demonstration-cannes>

Montana Model UN High School Conference

focal point for these many individual protests to come together in demanding change for people who have been harmed by the economic crisis.

At this point, the three fundamental questions facing UN member states are, first, what caused the crisis and, therefore, what is the best way to avoid a similar crisis in the future? Second, which international organizations should coordinate the response? Third, what have been the effects of the crisis, and how and by whom can they be mitigated?

With regard to the first question, most observers agree that lack of US regulation of non-bank issuers and traders of mortgages was where the problem began. As a result, there have been many calls for increased regulation of US and international mortgage and financial markets to avoid similar problems in the future. Analysts and policy makers have disagreed, however, about who should carry out this regulation. French President Nicholas Sarkozy, for example, argued that the Bretton Woods institutions should be reformed to regulate international banking and investment. By contrast, US President George W. Bush and his successor Barack Obama have argued that countries simply need to coordinate their own domestic responses.⁴³

In addition to disagreeing about the solution, policy makers and analysts disagree about who should carry it out. Sarkozy, for example, emphasized the role of the G-7, while Bush and Obama have pushed for a greater role for the G-20. These are far from the only options on the table, however. US economist Fred Bergsten has called for what he calls the G-2 of the US and China.⁴⁴ According to French economist Nicolas Simiand, the best option is a G-4 representing “the four main currencies in the world” – the US dollar, the Euro, the Japanese yen, and the Chinese yuan.⁴⁵ In 2008, UN General Assembly President Miguel d’Escoto Brockman called for consideration by the G-193 (the General Assembly).⁴⁶

Finally, there are questions about the effects of the crisis to date and its likely effects if, as expected, it continues for some time. In particular, analysts are debating to what extent the crisis will hurt the poorest countries in the world. According to economist Jeffrey Sachs, middle-income countries such as Brazil and India will feel the effects of the crisis more than the poorest countries, which are less involved in international trade and finance.⁴⁷ But UN Secretary General Ban Ki-moon has expressed concern about the effects of the crisis in reducing aid to developing countries. “While recently we have heard much in this country about how problems on Wall Street are affecting innocent people on Main Street, we need to think more about those people around the world with no streets. Wall Street, Main Street, no street – the solutions devised must be for all.”⁴⁸

⁴³ Mark Landler, “U.S. Does Not Support a Global Crisis Regulator,” *New York Times*, November 5, 2008, <http://www.nytimes.com/2008/11/06/business/06global.html>

⁴⁴ C. Fred Bergsten, “A Partnership of Equals: How Washington Should Respond to China's Economic Challenge,” *Foreign Affairs*, July/August 2008, <http://www.foreignaffairs.org/20080701faessay87404/c-fred-bergsten/a-partnership-of-equals.html?mode=print>

⁴⁵ Nicholas Simiand, “Exchange rates: a cold case for the G-7 finance?” Economic summits blog, 3 February 2010, available at <http://www.economicsummits.info/2010/02/exchange-rates-cold-case-g7-finance-meeting/>

⁴⁶ UN General Assembly, “Press Conference on General Assembly Panel on Global Financial Crisis,” October 30, 2008, http://un.org/News/briefings/docs/2008/081030_Financial_Crisis.doc.htm

⁴⁷ “Seven Questions: Jeffrey Sachs,” *Foreign Policy*, October 2008 http://www.foreignpolicy.com/story/cms.php?story_id=4517

⁴⁸ “Ban holds talks with economists on impact of financial crisis on poverty goals,” UN News Centre, October 23, 2008, <http://www.un.org/apps/news/story.asp?NewsID=28685&Cr=ki-moon&Cr1=mdg>

Montana Model UN High School Conference

Conclusion

The international financial crisis has been underway for three years and because of globalization has affected countries worldwide. Whether the crisis develops into a 21st century version of the Great Depression and whether it calms or fuels international conflict remains to be seen. From the lessons of the 1930s, we know that the answers depend on what policy makers do next.

As you research your country's position on this issue, consider the following questions:

- What is your country's involvement in international trade and finance? To what extent and in what ways is it vulnerable to a downturn in trade and/or withdrawal of finance?
- How has your country been affected by the crisis thus far?
- How has your country responded to the crisis?
- Has your country received help from the IMF, World Bank, UN, or other UN member states to adjust to the crisis? If not, does it need such help, or can it give help to others?
- Which international organizations, if any, should lead the response to the crisis?
- How should the causes of the crisis be addressed? Should the response be primarily national or international? Should the Bretton Woods institutions be reformed or left as they are?
- How should the effects of the crisis be addressed? Should the focus be on reducing effects in developed, emerging, or developing countries?
- What can and should the GA-2 do to respond to the crisis and prevent the emergence of similar crises in the future?

Recommended Reading

International Monetary Fund. *World Economic Outlook* 2011. Available at <http://www.imf.org/external/pubs/ft/weo/2011/01/index.htm> and *World Economic Outlook* 2011 database. Available at <http://www.imf.org/external/pubs/ft/weo/2011/01/weodata/index.aspx>

The first link provides access to the IMF's most recent report on the world economy, which is useful in understanding the overall problem and policy options. The second link goes to the data used in the report. There you can find out how your country has fared during the crisis. Pay particular attention to the change in gross domestic product (GDP) from 2008 to present. When GDP falls, a country is considered to be in a recession or depression. Also notice GDP per capita, which gives a rough sense of how citizens are faring. In this data, you should also be able to find information on changes in imports and exports. Another option for that data is the World Trade Organization, http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm

Landler, Mark. "U.S. Does Not Support a Global Crisis Regulator." *New York Times*. November 5, 2008. <http://www.nytimes.com/2008/11/06/business/06global.html>

This article explains the US position going into the November 15 G-20 summit. In particular, it explains why the Bush administration did not think the crisis created a need to reform or replace the IMF. Since this has largely been the position of the Obama administration, as well, this article remains relevant.

Pearlstein, Steven. "With Bubbles Popping Worldwide, No Wonder the Economy's Gone Flat." *Washington Post*. October 7, 2008. <http://www.washingtonpost.com/wp-dyn/content/article/2008/10/06/AR2008100603184.html>

This column by a Pulitzer-prize winning economist is the single best summary of the causes and likely effects of the financial crisis. You can read other analysis by Pearlstein from links on this site.

Montana Model UN High School Conference

“Ten Weeks of Financial Turmoil.” *New York Times*. Updated 21 April 2011.

http://www.nytimes.com/interactive/2008/09/27/business/economy/20080927_WEEKS_TIMELINE.html

This interactive *New York Times* site provides insight into how the crisis began in the United States.

UN General Assembly. “Press Conference on General Assembly Panel on Global Financial Crisis.” October 30, 2008. http://un.org/News/briefings/docs/2008/081030_Financial_Crisis.doc.htm

This document summarizes a 2008 press conference held by the GA President and a number of top international economic experts. It provides a good summary of some of the questions the GA wrestled with in deciding how to respond to the crisis. As of 2011, most of these questions remain on the table. To find out your country’s position on these issues, go to the website of your country’s UN mission (there are links at <http://www.un.org/en/members/>) and read its September 2011 speech at the General Assembly Plenary. Many world leaders, include Brazil’s president, used their speech to highlight the dire effects the crisis has had – and could have – on their economies.

United Nations. *Millennium Development Goals Report 2011*. United Nations. Available at <http://www.un.org/millenniumgoals/reports.shtml>

This report details the challenge of meeting the MDGs in the wake of the financial crisis. It discusses particular countries and regions and offers suggestions for improvement.

United Nations Development Programme (UNDP). “Millennium Development Goals: Tracking Country Progress.” Available at <http://www.undp.org/mdg/countries.shtml>

On this site, you can read country reports on the Millennium Development Goals. If your country is a developing country, this will help you learn how your country has been affected by the crisis. Similar reports for developed countries can be found on the OECD website, http://www.oecd.org/countrieslist/0,3025,en_33873108_33844430_1_1_1_1,00.html

UN News Centre. “News by topic: Economic Development: Trade, Investment, Technology.” <http://www.un.org/apps/news/subject.asp?SubjectID=2>

This site provides links to recent UN debates and activities related to economics. You can also use the search engine to search for stories on the financial crisis.

Wolf, Martin. “Why agreeing a new Bretton Woods is vital.” *Financial Times*. November 4, 2008. http://www.ft.com/cms/s/0/7cc47dfe-aa95-11dd-897c-000077b07658.html?nclick_check=1

This 2008 opinion piece provides a good summary of the arguments for reforming the IMF and other Bretton Woods institutions, neither of which has been accomplished. Martin Wolf writes regularly on economic matters; his columns on the European crisis are excellent.