Southern China International MUN

Official Background Guide

ECOFIN Committee: On measures to mitigate the asymmetrical growth from expansionary monetary and fiscal policies for recovery from COVID related disruptions

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1. Description of the Issue

1.1 History of the Issue

Monetary policy as we know it today is a relatively novel development. For centuries prior, governments mainly relied on controlling the supply of coins or paper money to maintain the coinage, now better known as money supply. A comprehensive understanding of the causal links among different monetary mechanisms was nonexistent; hence, forms of monetary policy such as increasing the coinage or money supply were uncoordinated with other forms of monetary policy, such as interest rates. As a result of a lack of cohesive plans pursued by governments, monetary failures were unheard of [1].

Over three centuries later, a new form of banking emerged in Britain. In **1694**, the Royal Charter promptly founded the Bank of England after the Glorious Revolution. By **1717,** England adopted a de facto gold standard, where the country's currency would be fixed vis-à-vis the value of gold and constantly kept in check by the government's guarantee to exchange gold with the base currency, the pound. Soon enough, the idea of monetary policy independent of governmental action was established. This monetary policy aimed to maintain the value of the coinage and print paper per the country's exchange rate goals to the gold standard and reduce volatility among inter-currency transactions. The specifics of this monetary policy included national banks, such as the Bank of England, setting the interest rate that they charged for borrowing, be it consumer or other banks in a liquidity crunch. As many industrialized economies adopted the gold standard to foster trade, monetary policy became more widespread since **1971**. President Nixon ended the Bretton Woods system by decoupling the dollar from gold in 1971 and rendering the dollar virtually a fiat currency[1].

The idea of fiscal policy originates from governments using tax revenue on most public projects. The previously held notion on the appropriate use of a fiscal policy was to pursue a balanced budget, where a government's expenditure is equal to its tax revenue, as appropriate. It was only until the **1930s** when the Great Depression gave birth to the idea that fiscal policy could be used in cycles during economic contraction and expansion[2].

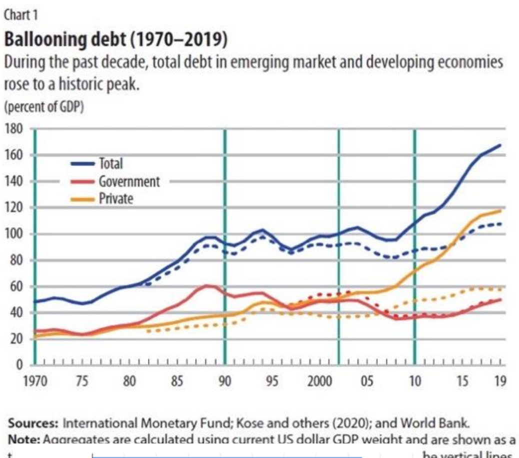
In historic recessions like the **2008 Global Financial Crisis**, a mix of both fiscal and monetary policies was used to bolster the labor markets and other financial markets from wreaking havoc on the global economy and the global financial system. One such initiative was the TARP [12], where the U.S. treasury helped mitigate the number of foreclosures in the

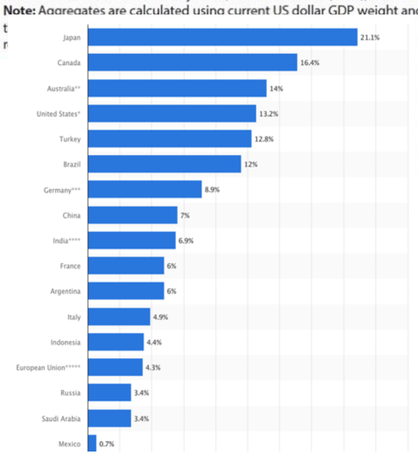
United States. Since the Global Financial Crisis was relatively contained within developing nations, its spillover effects on LEDCs were not as stark as the current asymmetrical growth attributable to the COVID-19 pandemic. As a result, such asymmetrical growth attributable to monetary and fiscal policy is a relatively new phenomenon, necessitating calls for a solid, globalized framework to tackle COVID-related disruptions while alleviating income inequality among nations and the stark polarities in socio-economic outcomes.

1.2 Recent Developments

The markedly evident effects of COVID-19 were devastating: every nation on earth, regardless of region, has faced an economic downturn due to COVID-19, while some countries are on the verge of bankruptcy.[4] Yet, the United Nations and world leaders' efforts to address these issues have been relatively futile. Each country's inherent idiosyncrasies, as per a free market or a firm, centralized body of financial control, hinder a global organization's ability to make a collective decision on behalf of a worldwide monetary system. Thus, many economic policies enacted have been uncoordinated and essentially contradictory.

The impact of COVID-19 in peoples' lives is undeniable, yet the extent of its implications differs wildly, from unemployment to the loss of a loved one. Among nations, this analogy holds: MEDCs had ample resources and infrastructure to combat the virus quickly and readily, while LEDCs were limited in the responses, inevitably exacerbating their economic contractions. Moreover, regardless of region, every nation on earth is projected to face or have faced an economic downturn or a recession- some even at the risk of defaulting on their loans. Countries unable to mint their currency- i.e., Italy, Greece, and Liberia- are inhibited in their responses impeded by the hindrances to provide ample stimulus. Furthermore, COVID-19 is projected "to slash global economic output by $8.5 trillion over next two years"[4].





Source: https://www.statista.com/statistics/1107572/covid-19-value-g20-stimulus-packages-share-gdp/

To make matters worse, COVID-19 is to cause 34 million people to fall into extreme poverty- 56% from African nations. By 2030, another 130 million people are projected to join those in extreme poverty, further undermining the attempts to alleviate those in extreme poverty and eradicate world hunger.[4] In terms of the working laborer, the income inequality will exacerbate due to the instability of these jobs. Thus, the low-skilled, low-income jobs will inevitably suffer from more severe inequity. In terms of nations, this analogy holds once more: with LEDCs being so burdened by this economic fallout, and they will begin to lag even further behind in development to their more developed counterparts.

As for why LEDCs have a stagnant recovery, a majority are burdened with public debt and other chronic fiscal deficits, undermining their ability to implement successful fiscal policy to provide more liquidity in the financial markets and other sectors. Thus, these fiscal policies have minimal effects: the average value of the fiscal packages of LEDCs was less than 1% of the GDP. In contrast, Germany had a moderately sized fiscal stimulus plan worth 8.9 % of the GDP. However, the size of the GDPs of MEDCs and LEDCs differ by billions of dollars. Therefore, even if some LEDCs were to implement fiscal packages of similar value as their MEDCs counterparts, the stimulus would be inadequate due to the relatively trivial amount. Many nations dependent on exports, tourism, commodities, and other volatile revenue areas are being pressured with an increasing pile of debt- raising the question of debt sustainability. In short, their debt burden is undermining and deterring them from implementing appropriate fiscal packages.[4]

In all, a clear-cut solution to tackle the complications that entail a worldwide shutdown does not exist. For the most part, the United Nations and leaders' efforts to address these issues have been futile due to the inherent idiosyncratic attributes evident in nations: some pursue a free market, whereas others adopt a centralized government. For example, the U.N. cannot enforce coordinated stimulus packages as each nation's primary role is its own, thus reducing cooperation in key areas. Ergo, the status quo highlights the pivotal role regional cooperation can play in alleviating the burden, as the current efforts from LEDCs, for the most part, have been met with futile results. The bottom line is that every country differs. Thus, every country needs different methods and policies to recover their economy, so there isn't an easy, impromptu panacea or dues ex Machina for a hasty economic recovery.

Key Terms

Expansionary/ Contractionary Policy – "Expansionary monetary policy works by expanding the money supply faster than usual or lowering short-term interest rates. It is enacted by central banks and comes about through open market operations, reserve requirements, and setting interest rates."[9]

CARES Act (Coronavirus Aid, Relief, and Economic Security Act) - A $2.2 trillion economic stimulus bill passed by the 116th U.S. congress and signed by President Donald Trump on March 27th, 2020.

Mortgage - A mortgage is a loan taken by people from the bank or company to purchase properties like houses.

Subsidy - A direct or indirect payment to the individuals or firms, usually in cash, from the government or targeted tax cut to help the people during an economic recession.

Quotas_- It is a limited quantity of a particular product that can be produced, imported, or exported.

GDP (Gross Domestic Product) - Total value of goods and services produced in a certain country.

Tariff - Tariff is a tax on imports or exports between the countries. It is a form of regulation that taxes foreign products to encourage or guard domestic products.

Domino Theory- This theory posits that the countries' economic systems are profoundly interconnected. Therefore, an economic issue in one country will spread rapidly and affect other countries and other firms, hence the name.

2. Emphasis of the Discourse

2.1 Right-Wing Approach

The right-wing is a political terminology pertaining to politicians or states with conservative and nationalistic tendencies, valuing tradition and freedom over unity. It tends to include countries or politicians with capitalist tendencies. They embrace the view that social orders and hierarchies are natural and desirable; thus, they tend to be content with the status quo. They believe that the state's role is to impose minimum regulations for economic activities. After all, they believe in individual will and market principles. During the pandemic, notable right-wing nations openly advocated for left-leaning economic policies. However, some countries provided minimal support to the people, often citing fear of inflation and debt unsustainability for justifying their rationale. Most countries that impose right-wing regulations implement policies that encourage individuals to provide economic stimulus rather than restrict economic activities. While some say this is an approach to respect individual freedom and minimize government intervention in the market, critics say that the government's grazing attitude is quite paradoxical with the raging virus within nations' borders.

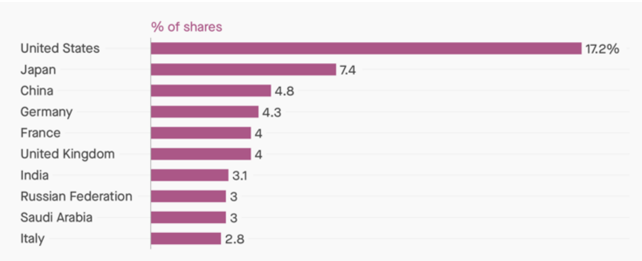
2.2 Left-Wing Approach

A left-wing approach is synonymous with a politician or state with progressive ideals and tendencies. In some cases, they are radical, reformative, prioritize equality over freedom, and insist on change. Left-wing policies were designed to prioritize the wellbeing of society and to maintain a more systematic order. Many countries, including China and Mongolia, have taken control of flights. It is said to have effectively prevented the spread of the virus. The noteworthy point is that the mortality rate from the virus in countries that used left-wing politics was lower than those of right-wing governments. Critics claim that such intervention encroaches and undermines personal liberty; a prevalent claim among the opposition to centralized control is that intervention in the market has reduced the number of free decisions people can make, causing chaos to international markets.

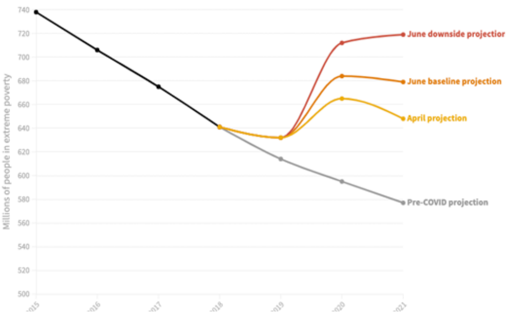
2.3 Stance of Intergovernmental Organizations

Intergovernmental Organizations (IGOs) include the U.N., Organization for Economic Cooperation and Development (OECD), International Monetary Fund (IMF), The World Bank, and the International Labor Organization. Each of these organizations aims to hold an impartial stance; however, they often fall prey to being held liable for national issues, but, in some cases, it is justified.

The IMF is an IGO that oversees the stability of the global monetary system, with its major members and key funders being individual states. Thus, the IMF efficiently responded to the economic contraction caused by COVID-19. On IMF.com, they have stated that they have “provided emergency financing, grants for debt relief, call for bilateral debt relief, enhancing liquidity, adjusting existing lending arrangements, policy advice, and capacity development.”[10] The IMF has a tremendous ability to provide loans; however, they often provide loans in not-so-ample amounts for bureaucratic hurdles and the polemic consensus of the member nations on the specifics of loan agreements. The IMF has also provided ample debt forgiveness: "Today, I am pleased to say that our Executive Board approved immediate debt service relief to 25 of the IMF's member countries under the IMF's revamped Catastrophe Containment and Relief Trust (CCRT) as part of the Fund's response to help address the impact of the COVID-19 pandemic." (IMF Executive) These small loans or debt forgiveness have aided LEDCs in their recovery, but IMF Managing Director, Kristalina Georgieva, has stated, "The global economy is beginning to climb back from the depths of the crisis, but this calamity is far from over," setting a cautious tone for future recovery.



Source: https://theatlas.com/charts/B1_EmJ4Hf



Source: https://blogs.worldbank.org/opendata/updated-estimates-impact-covid-19-global-poverty

Unlike the IMF, The World Bank is an IGO that aims to reduce poverty in LEDCs. With that said, during the pandemic, many LEDC economies were stalled in terms of recovery due to a lack of stimulus. This, consequently, has exacerbated poverty rates globally, as evident in the figure above. In response, The World Bank “is making available up to $160 billion in financing tailored to the health, economic and social shocks countries are facing, including $50 billion of IDA resources on grant and highly concessional terms." (World Bank) However, to put that into context, the World Bank's potential stimulus of $160 billion is inadequate for fully stimulating LEDC economies. On average, most MEDCs individually have packages easily worth over $160 billion, which is to be shared among LEDC nations from the World Bank. Of course, this is not free money; however, the World Bank only charges above 0.5% above its cost to borrow, highlighting the deal.

2.4 Stance of developed countries

Most developed states have provided great responses, including monetary and fiscal mechanisms. Some economies are on track to full recovery as of now. These nations, however, have incurred some debt, which, in the long run, some speculate as being unsustainable. [10] Countries like Japan, Italy, and Greece had unimaginable debt levels just a few decades ago. Therefore, some of these nations take a more conservative approach to overall government spending, anxious about running high deficits. The United States has provided ample stimulus by key actions: the U.S. $2.3 Trillion Coronavirus Aid Relief and Economy Security Act (CARES act), U.S. $483 Paycheck Protection Program (PPP), and Health Care Enhancement Act, and other copious aid. [10] Also, easy-money policies, better known as expansionary monetary policy, have also provided an additional level of reinforcement to the stimulus packages pursued by governments.

2.5 Stance of developing countries

Prominent developing nations such as China and India have pursued mid-sized stimulus packages, evident in many developing countries. China, for example, has implemented an RMB 4.8 Trillion fiscal stimulus package geared towards low-income earners. The People's Bank of China has also injected liquidity into its financial system via expansionary monetary policies such as open market operations and other methods. India, similarly, has implemented direct fiscal stimulus geared towards low-wage workers. The Reserve Bank of India has also slashed the repo and reverse repo rates by 115 and 155 basis points, signaling a decisive move to inject liquidity into the financial system.[10]

<u>Possible Solutions</u>

2.6 In Favor of Developed Countries

Developed nations have the privilege to provide stimulus packages of value to their citizens. Currently, most developed countries do not have a problem stimulating their economies. Take the United States: by virtue of the plethora of policies they pursued, they have hit record- low-interest rates, boosting home sales [5], and smashing previous records in terms of equity prices. For most, incomes have not fallen, a resounding example of America's unprecedented economic success during the pandemic. Therefore, the solutions that favor developed countries are policies that leave them out of the equation: they do not want to partake in helping a nation service its debts as it means lower returns to the creditors (which tend to be MEDCs). Further, this often results in bailouts, which results in the creditors not recovering their initial investment. Furthermore, some MEDCs have yet to fully recover their economies, lowering the priority of LEDCs at this point. Thus, most efforts for recovery in LEDCs have come from domestically or from support from IGOs. Increasing the cooperation among regions, such as the North American region with the rest of the world, is beneficial. However, such generous aid for foreign nations depends on America's foreign policy and will likely sway per party cycle.

2.7 In Favor of Developing Countries

Most developed economies are debt-based, where money is loaned into existence. When the COVID-19 recession occurred, there was insufficient income to service debt, leaving businesses debt-riddled and the economy deteriorating. An inherent flaw with a debt-based economy is that the economy would contract if new loans were not issued. Many believe that the logical solution is for the central banks to lower interest rates by using tools such as quantitative easing and other tools to inflate the money supply, firing the economy up. This notion, however, is fallacious, especially for LEDCs. The LEDCs do not have the privilege to manage their money supply with such autonomy. Usually, the LEDCs do not have credibility let alone trust from their citizens." Increasing their money supply will entail trouble as these currencies are volatile and lack in demand to back them; thus, causing many to avoid these currencies, often citing fear of inflation.

As for fiscal measures, debt from LEDCs is used for strategic reasons, including debt-trap diplomacy and a plethora of other economic ploys. Thus, it becomes challenging to fund such extensive packages with low demand and a predominant creditor.

Therefore, the most logical solution would be to 1) increase the stability of the national currency and 2) curb inflation or other inconsistencies in currencies. By doing so, debt could become more valuable, which could fund more programs; an increase in the money supply may not cause confounding effects such as capital flight. Another reasonable solution would be to 3) decrease foreign dependency in LEDCs for funding infrastructure projects, which many LEDCs succumb to. However, an increase in funding will have detrimental effects on its right; therefore, though it may not be realistic, a continental trade organization could help spur regional demand, allowing domestic industries to develop and recover.

However, in all honesty, a simple consideration of the facts will show that such regional trade organizations frequently prove inefficacious, as globalization is convenient access to capital and economic growth. Thus, such efforts at fostering regional trade may backfire, as many in similar regions tend to suffer from similar dilemmas. Regional cooperation need not limit to a physical locale; rather, it can be across borders and between regions. These troubled regions can then set up mutual industries, benefiting international trade.

3. Keep in Mind the Following

While researching your position, focus on the nation's status quo, foreign dependency, economic partners, sovereign debt, foreign capital holdings, trade volume, trade balance, political allies/ enemies, and commercial stance. Below are some questions to consider:

1. To what extent should foreign organizations provide relief to LEDC economies?
2. Are the public debt levels of this nation unsustainable? If so, who are the largest creditors, and are they beneficial for economic growth? *(Keep in mind that short-term foreign capital injections may come with a tradeoff in the long run, thus being a façade in the short term.)*
3. How much are the foreign exchange holdings of this particular nation? Are they at sufficient levels to underpin currency stability?
4. Do the political allies align with dependent nations? If so, what is jeopardized in exchange for that relationship.
5. What is the public response to a specific program- be it fiscal stimulus or infrastructure projects? *(Keep in mind that, in many LEDCs, the legitimacy of leaders may be exerted through ostentatious infrastructure projects, which many citizens may be oblivious to the means!)*
6. Are there current attempts of this nation to partake in regional trade alliances or lessen foreign dependency?

4. Evaluation

"The challenges loom large. Much more than 1 million people have died from the COVID-19 pandemic. More than 100 million people are being pushed into extreme poverty. Hunger has doubled. Famines loom, inequalities are growing. Disruption to education is risking to create a "lost generation", especially for children trapped on the wrong side of the digital divide. And even the gender equality gap is widening, and women's labour force participation – a key driver for inclusive growth – has been set back decades. Now, as we face an urgent need for climate action and building a sustainable and circular economy, we need to do differently and let's recognize that developing countries, in particular, are on the precipice of financial ruin… We also must mobilize the financing to build forward and put economies on a sustainable path."[12] Hence, the road to putting the economies on a sustainable path is quite unclear at this point; it's exactly why you need to represent your nations accurately and adduce creative yet pragmatic resolutions. On a final note, your solutions, and your voice, will be amplified when you are ready to apply your knowledge to the real world.

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