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Economic and Social Council (ECOSOC)

Topic 2: Divergences in global monetary policy and the extreme volatility of currencies in relation to the EURO and the US Dollar

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I. Definition of Key Terms

Monetary policy: range of decisions made by the monetary authority of a country, usually the Central Bank, in order to regulate the money supply and fix the interest rate of the currency.

Money Supply: quantity of money injected by the monetary authority into an economic system for a specific period of time.

Monetary Union: agreement among a group of countries deciding to adopt the same currency.

Inflation: progressive decrease in monetary purchasing power, which usually leads to an increase in prices.

Deflation: progressive decrease in prices and, consequently, in productivity, which usually marks a period of economic crisis.

Volatility of currency: an unpredictable phenomenon involving a rapid increase or decrease in the value of a specific currency in comparison to another one over a short period of time.

Interest: the charge for borrowing money, usually expressed as an annual percentage rate.

II. Introduction

Control over the money supply and the interest rate of the currency is a fundamental implement for a country in order to reach various aims, such as maintaining the rate of inflation stable or stimulating its economy; for this reason, different monetary policies should be aligned to guarantee equal economic growth worldwide. In fact, the current differences in monetary policies have lead to a situation of misbalance between First World Countries and Developing Countries, since the latter struggle to compete economically with the former.
Furthermore, the extreme volatility of some currencies in comparison with the EURO and the US Dollar, which represent two of the most influential economic systems, is closely linked to wealth disparity. This phenomenon, in fact, usually marks an alternation between periods of inflation and deflation in a certain country, which often struggles to trade with other States and invest money in its economy since such rapid changes in currency value make investments too risky.

III. Background Information

As regards differences in global monetary policies, one of the most relevant efforts to converge them was the foundation of the Economic and Monetary Union of the European Union with the Treaty of Maastricht in 1992, which eventually led to the adoption of a single currency (EURO) in 19 countries. Nevertheless, some States whose currency had strong purchasing power, such as the United Kingdom, decided not to adopt the EURO. Monetary unions have also been stipulated among some countries in West Africa (Cameroon, Chad, Central African Republic, Congo, Equatorial Guinea and Gabon) and among Caribbean Countries in order to converge their monetary policies and consequently facilitate trade.
Regarding the volatility of currency, it is linked with an alternation between periods of inflation and deflation, neither of which is auspicious for a country's economy. In fact, deflation usually leads to a decrease in prices and productivity and therefore to unemployment, as customers are inclined to economize. Inflation, after a certain period of high profit, becomes an issue when income is no longer adequate to cope with expense.

IV. Major Countries Involved

Many different factors generate an economically unsound situation, which often escalates into a monetary crisis. This forces a reorganisation of trading rates. Systems of solid exchange rates (such as the Bretton-Woods-System or the European currency system) show that such crises appear over and over again if the economic development of states diverges.

The Economic and Monetary Union (EMU) is a group of states with its own currency and therefore without interstate trading rates. Nineteen countries of the EU have introduced a common currency (Euro): Belgium, Germany, Estonia, Finland, France, Greece, Ireland, Italy, Luxembourg, Latvia, Lithuania, Malta, Netherlands, Australia, Portugal, Slovakia, Slovenia, Spain and the republic of Cyprus.

The monetary policy in the member states of the EMU is controlled by the European Central Bank (ECB). The stability of the common currency depends on the convergent economic development and the coordinated economic policy adapted by the Euro-countries. Convergence criteria were established in order to guarantee that only countries which carry comparable structural conditions would join the EMU. Furthermore, the member states of the EMU were obliged to finance political discipline through the Stability and Growth Pact (SGP). Nevertheless, Great Britain and Sweden have refused to become members of the EMU. In Montenegro and Kosovo the Euro is the legal currency, even though they do not belong to the Eurosystem.

V. UN Involvement

For the WTO the regulation of international currency and finance relations is an important task. This regulatory task is also carried out by the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD).
With this agreement, the 44 founder states of the IMF seek to create the monetary conditions for the expansion of global trade. Another important function of the IMF consists in helping member countries to overcome balance-of-payment problems. To monitor these aims and obligations the IMF analyses national economic development and monetary policies, verifies fiscal and trading rate measures and examines the world economic situation at six month intervals. By acknowledging the obligations contained in the contract, the 189 signatories of the IMF acquired the right to utilize the financial resources of the fund. The IBRD promoted the reconstruction of war-damaged countries and the financing of international development projects.
On account of the rising demand for international liquidity, additional monetary reserves were created in the form of Special Drawing Rights (SDR).
Furthermore, the World Bank and its subsidiary institutions (for example: IBRD, IDA; IFC) form the so-called World Bank Group. The World Bank Group promotes economic development through financial aid, consultation and technical assistance. The priority of the World Bank is to support the poorest developing countries which have difficulty taking up loans on the international capital markets.
The IDA awards interest-free loans, with a repayment term from 30 to 40 years, to LEDCs. The IBRD gives loans with market-customary interest to middle income states. The IFC supports the financing of projects in the private sector for developing countries and makes available loans, technical support and consultation to governments and enterprises. The UN member states which are not members of the World Bank are: Andorra, Cuba, Liechtenstein, Monaco, North Korea, Vatican City and State of Palestine.

VI. Useful Links

http://www.worldbank.org
http://www.imf.org/external/index.htm
https://www.cfr.org/global/global-monetary-policy-tracker/p37726