Southern China International MUN

Official Background Guide

Economic and Social Council: On measures to mitigate poverty in LEDCs through establishing microfinancing institution.

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1.Description of Issue

1.1 History of Issue

In a modernizing and economically based era, the line separating Less Economically Developed Countries (LEDCs) and More Developed Countries (MEDCs) is becoming more distinct. The phrase "the poor get poorer while the rich get richer" is the vivid reality of the 21st century. Consequently, the global issue of **poverty** has persisted as an everlasting, multi-faceted challenge, with economic hardships impacting billions of lives.

As defined by the United Nations, "Poverty is a denial of choices and opportunities, a violation of human dignity. It means lack of basic capacity to participate effectively in society." In this context, the stem of poverty in LEDCs has been found to be the lack of basic traditional banking systems like access to saving, investments, and loans. This lack of basic resources has left millions of people in a spiraling poverty trap. Over the years, the international community has recognized the urgent need for innovative solutions to alleviate poverty at its root. One significant development has been the emergence of Microfinancing Institutions (MFIs). Microcredit or microfinancing is the provision of financial services, including microloans, micro savings, microinsurance and financial education to low-income entrepreneurs in underserved communities facing poverty. The key idea of microfinancing being the specific targeting of communities in which traditional banking services are not available and limiting economic growth.

Microfinancing can be traced all the way back to the late 20th century when Muhammad Yunus, the founder of Grameen Bank, revolutionized the idea of microfinancing. Yunus's concept of empowering the impoverished by providing traditional banking services and fostering entrepreneurship at the grass hoop level laid its foundation for the upcoming global movement. Later as the concept gained traction, numerous international organizations, Nongovernmental Organizations (NGOs), and governments started acknowledging the instrumental potential that MFIs could have an influential role in mitigating poverty as a whole. As MFIs enabled small-scale businesses to expand, generate income, increase job employment, and individually improve impoverished people's standard of living. The early 21st century witnessed a huge surge in initiatives in establishing MFIs globally.

Microfinancing is primarily deployed through NGOs who receive donor funds to operate. In many cases, diverse fiscal and monetary interventions are very common in the microfinancing industry. Some governments play a big role in MFIs through setting policies for the microfinancing industry and providing lump sum grants to NGOs. Monetary assistance includes financial support from credit unions, cooperatives, and commercial banks.[1]

The model of non-market-based microfinancing operated by NGOs has shown success in both financial and social aspects. Case studies demonstrating extremely high repayment rates from Small and medium-sized Enterprises (SMEs) supported through MFIs. Which theoretically makes MFIs beneficial for both the borrowers and investors. An overview examination done by the Consultative Group to Aid the Poorest (CGAP) has concluded that microfinance has proven to be an effective poverty mitigating model.

Over the years, microcredit or microfinancing has shown to significantly increase living standards for citizens in poverty. Enabling borrowers to attain higher household incomes, have a stable income for basic living necessities, etc. In the big picture, the implementation of microfinancing institutions has shown to improve broader social benefits like improving health; including a nutritional diet, preventive health practices, and higher immunization rates. MFIs have also improved greater gender equality targeting women.

1.2 Recent Developments

Microfinancing as a concept has evolved significantly in the past twenty-five years. There has been a great increase in the number and size of MFIs in many parts of this world. Many countries in the world started to establish or enhance the foundation of MFIs in order to serve a larger number of clients. Meaning that there has been a significant increase in the financial inclusion of people in poverty. By 2001, there were more than 1,000 individual microfinance programs around the world that had reached an upwards of 20 million borrowers alone (Granitsas and Sheehan, 2001).

Figure 1: Evolution of Microfinance

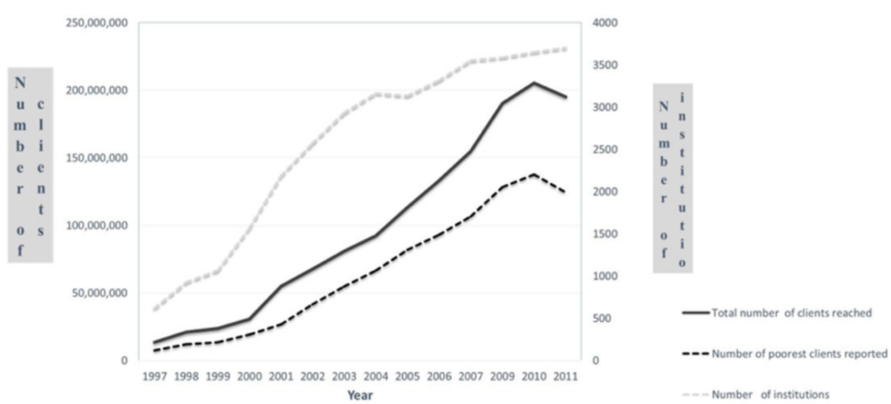
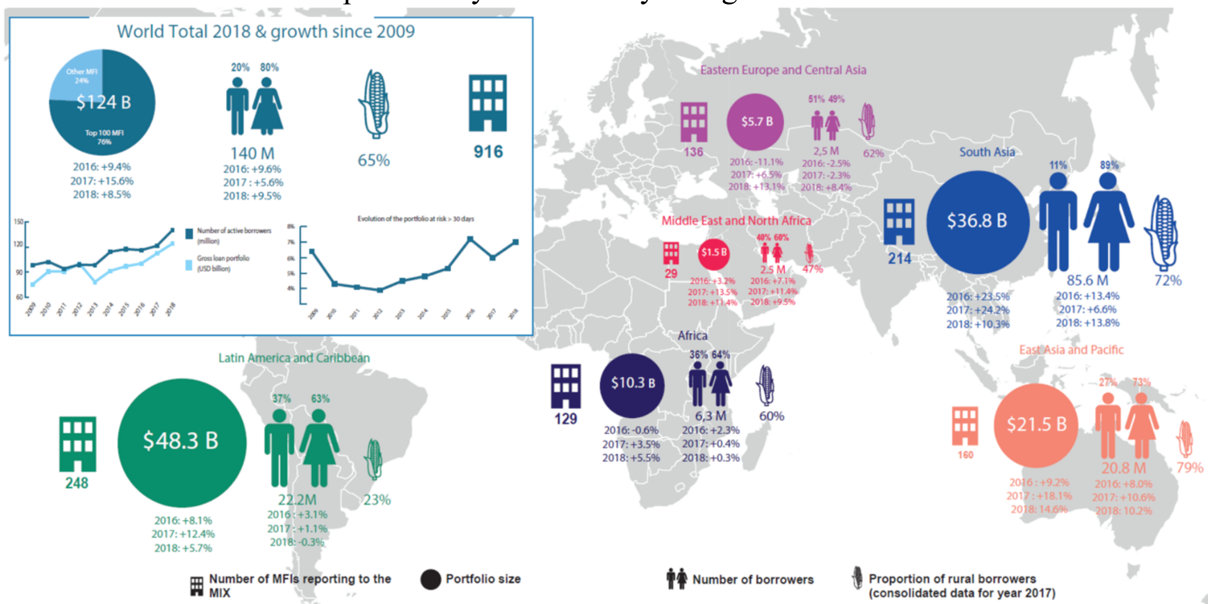


Figure 1 shows the evolution of Microfinance since 1997 when microfinancing started to develop into an innovative solution for alleviating poverty. Both the number of MFIs and numbers of clients have exponentially increased by a stagnant amount.



This chart shows the statistics of key features in the global microfinancing market of the 21st century. The growth rate of MFIs in the past 5 years has been 11.5% and the rate of borrowers has significantly increased by 12% in the past 10 years. This chart shows how the microfinance has evolved into an act of empowering the independence of women and supporting gender equality, as majority of the selected borrowers are women. Over the past decade, MFIs have improved efficiency-wise.

Although the number will only continue to increase, the current number still only represents a small percentage of the poor on a global scale. To put into perspective, Bangladesh, which is one the most developed microfinance providers in the industry, has only yet to reach 18.4% of the national poor population. While in the opposite spectrum, microfinance services in Brazil, have yet to reach 0.4% of the poor nationally. (World Bank, 2003). The issue that arises is now how to establish the MFIs on a larger scale in a more sustainable method. Scaling up Microfinancing worldwide would increase the impact, depth, and quality of microfinances overall effect on poverty. This would also mean the expansion of the set of microfinancial services provided.

A common consistency regarding the impact of microfinancing has shown to be extremely effective for the moderately poor, rather than the extreme poor. This has to do with selection bias, which results from "self-selection bias" from the MFIs. This means that clients who are more likely to be able to repay loans have a higher chance of being selected for microfinancing services. This has resulted in a targeted selection towards moderately poor citizens due to higher repayment rates rather than people in extreme poverty who have a lower chance of repayment. This is partly due to the lack of credit scoring models, making each loan a risk.

As previously mentioned, microfinancing is primarily initiated through NGOs. Typically, these NGOs have habitually developed into being extremely dependent on government funding and doners, which is limiting the microfinancing industry to develop. With the exception of a small number of NGOs that have completely transformed themselves into financial institutions (non-bank financial institutions (NBFIs) focused on microfinancing, capable of running independently without any government intervention. There have also been some cases of commercial banks or monetary organizations entering the microfinance industry.

The reasons why organizations and financial institutions have shied away from entering the microfinance industry, despite being extremely beneficial for LEDCs, are many reasons. This is because of the high costs of microlending compared to commercial lending. Adding on to the higher cost, microfinancing is typically classified as a risk by regulators because of how there is no guarantee. Although the same applies to commercial banking and loans, there are additional political and social problems that come along with charging high interest rates to microfinance operations.

In combat of the following issues, there have been cost and benefits regulations set by the IMF. Which consists of two forms of regulation, prudential regulation, which seeks to reinforce the financial soundness of SMEs, and non-prudential regulation that serves as consumer protection. The only way microfinancing can become more sustainable and become a worldwide procedure is if it is mutually beneficial for both the LEDC and supporting MEDC. In order to scale-up within the global microfinancing industry, a sustainable and independent system will be necessary. Pioneering microfinance models like the Bangladesh Rural Advancements Committee (BRAC) is one of the most well-known and developed in the world.

Key Terms

Microfinance: Providing the poor population with small loans (microcredit) to help them engage in productive activities and build business foundations

Microfinance Institutions (MFI): "An organization that offers financial services to low-income populations." (Pakistan Journal of Social Sciences)

Less Economically Developed Countries (LEDC): Nations that exhibit lower or less developed levels of overall economic development indicated by income per capita, industrialization and infrastructure.

More Economically Developed Countries (MEDC): Nations that exabit higher levels of economic development indicated by income per capita, industrialization, and infrastructure.

Small and Medium-sized Enterprises (SME): Small or medium-sized enterprises that are larger than micro-enterprises but operate at a smaller scale compared to large-scale enterprises that are often supported through MFIs.

Non-Governmental Organizations (NGOs): Non-profit organizations that are separate from government entities and work to provide financial services like microfinancing.

Consultative Group to Aid the Poorest (CGAP): Independent, global partnership of thirty organizations that work towards advancing financial inclusion globally.

Non-Bank Financial Institutions (NBFIs): Financial entities that provide numerous financial services but do not hold a banking license and do not act the same as traditional banks.

2.Emphasis on the Discourse

2.1 Stance of Intergovernmental Organizations

The United Nations (UN) is an essential intergovernmental organization consisting of member countries who advocate microfinancing as a poverty-mitigating strategy. The UN holds a positive perspective towards microfinancing as a "weapon against poverty and hunger" (United Nations) Fully acknowledging that fully reducing poverty is impossible with the poor population not having access to financial services like savings, loans, and insurance, the UN strongly believes that the implementation of MFIs is "the only hope for financial inclusion to the world's poor." (United Nations) Despite this, the idea of microfinancing has caused lot of controversy on the extent to the efficiency of which microfinancing can alleviate poverty. After 10 years of precise evaluation, after the Third International Conference on Financing for Development, The UN has strongly expressed in the resolution of microfinance that microfinancing is a productive method of poverty alleviation. Firmly stating that microfinance is the subject of significant demand worldwide. The UN also acknowledges how microfinance brings major advancements on women empowerment as a big majority of clients are women with micro-enterprises. General Assembly Resolution 52/194 is a great example of the effect of support from major intergovernmental organizations. The resolution endorsed huge steps towards the development of MFIs across thw world, reaching out to 100 million of the world's poorest families. IGOs around the world are incredibly in favor of the outcomes that microfinancing brings and is gaining increasing recognition globally.

Numerous different intergovernmental organizations have shown awareness of the importance and impact that microfinancing holds. The United Nations Development Program (UNDP) emphasizes how microfinancing is an efficient tool to achieve Sustainable Development Goals (SDGs), specifically the goal of poverty eradication. The UNDP has promoted an inclusive and sustainable developmental plan for microfinancing in the UNDP Essential Microfinance evaluation. Additionally, the International Monetary Fund (IMF) has shown appreciation of microfinance as a tool to enhance entrepreneurship, employment, and gender equality in LEDCs. The World Health Organization (WHO) has also advocated for microfinance as it is beneficial in improving living standards in LEDCs which is directly correlated to health outcomes.

2.2 Stance of Developed Countries

Developed countries or more specifically, MEDCs affirm their commitment to addressing global poverty in LEDCs through initiatives that invoke sustainable development. In the 21^{st} century and though the popularization of microfinance as a tool for poverty alleviation, MEDCs have started to acknowledge the role of microfinance and its effects on LEDCs' poverty mitigation, economic sustainability, and the self-sufficiency of LEDCs. Many developed countries allocate financial resources to assist microfinance institutions in LEDCs. As microfinance or in the other words, the funding of microbusinesses in LEDCs is often seen as a risk, developed countries require responsible and ethical practices within microfinance institutions to ensure the well-being of borrowers and investors. Consequently, developed countries have required robust monitering and evaluation of microfinance clients as traditional banking systems are not present. On the switch side, it is key for MFIs to monitor for fair interest rates, transparency, and to ensure that the rights of clients are protected. Notable developed countries that have shown major influence in the microfinancing industry include the United States, the United Kingdom, Canada, Germany, and the Netherlands. The following countries all have major organizations that are a big part of the investment and capapcity-building part of the industry. The United States has organizations like the Accion and Grameen Foundation and countries like the Netherlands has orgnaizations like the Oikocredit, a Dutch Cooperative that provides funding to global MFIs globally.

2.3 Stance of Developing Countries

Developed countries or more specifically in this case, LEDCs recognize microfinancing as an extremely beneficial tool to mitigate poverty at its roots. MFIs serve as catalysts for financial inclusion of the poor, community empowerment, job employment, and the cultivation of local entrepreneurship. Developing countries prioritize bringing national financial inclusion and have actively engaged in building a conducive infrastructure for microfinance. In efforts of this goal, developing countries have formulated specialized policies and initiatives to establish sustainable MFIs within their country. Specifically focusing on reaching out to marinized rural communities, women, and small-scale entrepreneurs, developing countries see microfinance as a novel tool in alleviating poverty. Developing countries have engaged in the collaborative approach "South-South Cooperation" which is an organization that fosters the experiences and collective efforts to enhance microfinancing. Notable developing countries that have shown prominence in the microfinancing industry includes but is not limited to Bangaldesh, India, Peru, Kenya, Nigeria, etc. These LEDCs are often considered to be the birthplace of the foundational microfinancing models. The following countries have remarkable support for people in poverty when it comes to bringing financial inclusion. As developing countries are unable to do this completely independently, LEDCs capitalize the importance of national and international collaboration with MEDCs in support of microfinance initiatives.

3.Possible Solutions

3.1 In favor of Developed Countries

In favor of developed countries, the establishment of MFIs in a sustainable, mutually beneficial manner is extremely important in the poverty-mitigation process. With available financial resources and money, there are many ways developed countries can provide sustainable and mutually beneficial MFIs to developing countries due to how microfinancing was designed.

There are numerous ways to go at this, one of which is through business training or assistance to borrowers, which can significantly increase the repayment rates and call for a more productive poverty alleviating element. In the long-term, with a foundation of proper business education, the probability of success in alleviating poverty and repayment will significantly increase.

Another method in favor of developed countries has been through imposing loan ceilings to subsidized MFIs. In the case where clients need above-ceiling loans, it can result in co-financing. Co-financing is attractive to MFIs because of how it allows a free ride on the banks screening process. This has caused some controversy on the side of developing countries.

3.2 In favor of Developing Countries

As developing countries are the most poverty-stricken places that need microfinance, the methodology of microfinancing itself is extremely beneficial in favor of developing countries.

In order for microfinancing to be utilized to its maximum, the regulation and supervision of the MFIs should be top notch. This will maximize the mobilization of funds, ensure appropriate credibility, protect depositors, and enhance efficiency in the allocation of capital loaned. This will also increase the probability and confidence of regulators or investors as credibility builds up.

Building credit is also extremely important in favoring developing countries as higher loans are able to be made and the subsidization of entrepreneurship can be present. This approach does not only adress immediate financial needs but acts as the groundwork for long-term economic resilience. In the goal of building credit and and credibility in the relationship between the client and investors and the overall microfianamnce system, implementing a financial education curriculum has shown be extremely effective. Allowing for people in poverty to be literate financially not only increases the credibility between the clients and investors but can lead to a higher success rate and correleating return on investment (ROI) for investors.

4.Keep in mind the following

When researching your country's stance on this topic, make sure to investigate the current situation of microfinancing in the scope of your country at a national level. Then, expand the scale to how your country is affecting the economy and whether it is contributing or against entrepreneurship in the world. Lastly, consider how LEDCs could improve living standards with microenterprises in their current economic status. Some questions to guide you through your research are the following:

1. *What is your country's current economic status in need of microfinancing and how does it relate to national poverty levels and financial inclusion?*
2. *What is the level of financial inclusion for the population, and does the lack or surplus of financial inclusion have any relation to specific demographics or regions?*
3. *Does your country have any ongoing poverty alleviating programs, policies, or actions implemented to mitigate poverty at a national or international level?*
4. *How can your country support microfinancing institutions in support of less economically developed countries?*
5. *Does your country retain any relations with LEDCs in need of microfinancing institutions?*
6. *Does your country's government emphasize the importance of alleviating poverty in LEDCs through the establishment of MFIs? What is your country's stance on microfinancing and the supporting of SMEs or micro-entrepreneurship?*

5. Evaluation

Mitigating poverty in LEDCs through the establishment of microfinancing institutions is an unravelling and emerging anomaly that requires a comprehensive and nuanced approach. The global community must grapple with the intricate challenges, including regulatory hurdles, financial inclusivity, and cultural intricacies specific to LEDCs. It is crucial for delegates to examine the adaptability of existing microfinancing models, fully acknowledging and respecting socioeconomic landscapes of diverse LEDCs. Additionally, delegates must evaluate the long-term success and impact of alleviating poverty through microfinancing institutions; or in other words the sustainability development of microfinancing. Therefore, it is important for delegates to navigate these complexities with creativity and strategic foresight. Good luck.

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