PWS MUN

UNGA - ECOFIN

Background Guide

Agenda:

Measures to Further Sustainable Financial Systems in Central and South America

PWS MUN

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Dear Delegates,

Welcome to the Economic and Finances Council of Affairs Committee of Pathways E-MUN 2020!

The ECOFIN committee concerns itself with the questions of economic and financial matters on a global level. We are more than delighted to hold the position of the Executive Board for this committee and guide you throughout this journey.

The risk of climate change to economic development and the climate-related susceptibility of Latin America Central and South America has led many of those countries to proactively prioritize climate-resilient growth through environmentally sustainable financial and economic policies. Since the United Nation Climate Change conference, there has been a lot of willingness to allocate climate finance to governments and private sectors. It has become crucial to look at how these Latin American countries' financial sector perceives itself in the new landscape, the challenges it poses, various barriers to deal and measures to further it.

As a part of the Economic and Financial Affairs Council, delegates are expected to have a sound knowledge about the climate-related vulnerability faced by Latin America, have a comprehensive idea of the different financial systems and the economic growth of the Latin American countries. This study guide was prepared as a primary introduction to the topic, to help you become familiar with the committee's purpose. However, you will need to explore the questions and understand the challenges, so feel free to do a lot of research and reading from different sources. We shall follow a stringent policy against plagiarism, and we anticipate more solutions than arguments. We, as the Executive Board of the committee, hope to see you advocate your proposals, challenge yourself and collaboratively come up with solutions you've never thought of before.

Should you require any help or have any questions do not hesitate to contact us, we would be more than happy to help. We hope you are as excited as we are for the conference.

All the best!

The Executive Board
UNGA - 2, ECOFIN
Pathways PWSMUN 2020

Introduction and Overview

ECOFIN or the Economic and Financial Affairs Council, second of the six committees of the United Nations General Assembly, was formed with the rest of the General Assembly in 1945. It deals with global finance and economic matters; some of the many issues the committee addresses are economic growth, international trade, macroeconomic policy and securing financing for sustainable development. It has worked towards helping developing countries with financial assistance during the time of a crisis to encourage growth and prosperity. Through various foreign aid programs, it has been striving to lower poverty and decrease economic stress on countries facing huge debts or countries that need financial restructuring.

The financial system is an integral part of a country's economic development. It is a set of institutions such as banks, stock exchanges etc. that permits the exchange of funds as investments and savings. In doing so, the financial system creates links between savers and investors and also enables the enlargement of financial markets and helps in financial deepening and broadening.

They help in the growth of the capital market, infrastructure development, employment, development of trade, and various other areas. Though financial systems function on different levels, we will discuss only regional/global financial systems, which include central banks, government treasuries and international banks (government and private sector).

Sustainability is a relatively new concept in the financial sector. The United Nations introduced Sustainable Development Goals (SDGs) and the Paris Climate Agreement to take measures against the increasing pressure on the environment. It is crucial to include the sustainability criteria in the financial sector to address these climate change challenges. A shift in the landscape of the financial system is needed to make investments and expenditures beneficial to the investor and the society.

Sustainable finance aims primarily at integrating environmental, social and governance (ESG) criteria into financial services. In simple words, sustainable finance is green finance, which refers to allocating capital and financial investment to firms, services and projects that accelerate environment friendly and climate-resilient economies - a responsibility to which technological advancements and digital finance are crucial.

Characteristics of the Latin American Financial Systems

The region of Latin America has multiple nations and varying levels of economic complexity. Their economy is mostly export-based for individual countries in the geographical areas of primarily central and south America. Up until their independence in the early nineteenth century, they thrived with the regional economy, and later, much of Latin America integrated into the global economy as an exporter of commodities, mostly natural resources. Financial markets expanded swiftly at the beginning of the early 1970s in the world's largest and most developed economies.

Most emerging markets of Latin America were with tight capital control over the financial sectors. The domestic capital markets were mostly bank-based, and the security markets were not of much importance. Also, the government looked over most of the operations of the financial institutions and the allocation of credit. Most of the funds were utilized by international banks to finance public sector borrowing in the developing markets. Understanding how each financial system functions concerning its partner will give insight at how the states individually and collectively try and adapt to the various changes in the global economy.

Up until 2015, there were a total of 2430 regulated institutions which included 574 banks, 278 non-banking institutions and 1578 cooperatives or credit unions. Different institutions constituted the majority of the financial system in other countries. Bank participation was very predominant in almost all the nations, mostly 85% except for Jamaica and Costa Rica with 75%.

The cooperative sector also played a significant role in accounting to up to 10% of the total financial system, especially in Mexico and Costa Rica. Non-bank mortgage institutions were also important, with a 23% share of the total and deposits in the financial system in Jamaica. Many others also showed about 5 to 12% of participation of the non-bank mortgage institution. However, Brazil had the highest number of regulated cooperative institutions. Though there was a significant change in financial inclusion, it did not assure market penetration in some countries.

Their financial systems are mostly bank-based. Inspite of that their banking systems remains relatively small compared with their GDP. Deposit-to-GDP ratios are less than 50% compared to 90% in East Asian emerging markets. Their credit growth was predominantly quick in the early 1990s in most countries, but later collapsed after the banking crises in the mid-1990s and has then stayed subdued.

Bank restructuring that happened during the 1990s also led to increasing attention. More than 60% of bank assets concentrated in the ten largest institutions, and held about 70% of deposits and provided 75% of the credit. However, the central institutions mostly remain in government hands.

Few other characteristics of the Latin American financial system would include the bank profitability, dollarization and some weakness in the areas of savings, macroeconomic instability and capital flow.

Financial System: Crisis and Reforms

Over the past few decades, the banking system instabilities have contributed to several crises that have urged a lot of restructuring and reforms in the financial sector. A first wave of crisis-hit Latin America in the 1994 and first hit Bolivia, then Brazil, Mexico and Venezuela and a few other countries as well. It hit Argentina and Paraguay in 1995 and Ecuador in 1996.

In a way, these reforms and restructuring helped strengthen banking systems and avoid the crisis on a large scale like that of Asia. Microeconomic impacts like poor bank management, frail regulation and bank supervision were also responsible for bank problems in a few countries.

They also came up with numerous reforms to overcome the crisis. A lot of private banks were merged as a process of restructuring and reforming, and some state-owned banks were privatized. Central banks had the power and authority to supervise and deal with problems. Bank supervisions were strengthened and made more independent. There was a reinforcement of prudential regulations by raising initial capital requirements for new banks to keep a check on the number of new private banks. Control over offshore operations was tightened. They also introduced insurance schemes to protect small depositors.

The institutional structure was strengthened by improving accounting standards, establishing disclosure requirements, imposing strict rotation rules on external auditors, reforming the legal and regulatory framework for bankruptcy, and also establishing a market for the securitization of credit and facilitating the recovery of nonperforming loans.

Sustainable banking is a fast-growing area, and many global institutions have researched and assessed specific proposals linked to sustainability in the financial sector, aiming to accelerate the development of acceptable practices. Sustainable banking refers to an area of the financial market that directs at promoting a positive environmental impact from its operations, including climate change.

Recent developments in the field of sustainable finance aim at integrating environmental, social or governance (ESG) criteria into financial services. Decisions about investments and capital expenditures should consider those criteria while being helpful to both the investor and society at large.

Latin America's vulnerability to climate change and recognizing the impact climate change could have on the economic development, has led to most of the countries in the region to try and prioritize climate-resilient ways to come up with environmentally sustainable economic development principles. Latin American countries have taken this up after their commitment made in the 2015 United Nations Climate Change Conference or the Paris Conference of Parties 21.

In mid-2017, the International Finance Corporation (IFC) and the Latin American Federation of Banks (FELABAN), alongside Eco. Business Fund (EBF), established an association with the common aim of preparing a report on the state of green finance in Latin America. The report was on a survey of one hundred and one (101) financial institutions participated from eighteen (18) countries in Latin America and analyzed the practices associated with environmental sustainability in the banking sector.

The banking sector plays a significant role in structuring and financing the sustainable environment, "it is impossible to establish a green and inclusive economy without mobilizing sufficient capital for financing the long-term needs of a resource-efficient future" (Federal Office for the Environment, 2015). Sustainable financing is a global movement that is quickly developing with rising demand from stakeholders ranging from employees and customers to investors.

It would bring a lot of reforms to the existing structure and will change the investment and expenses dynamics of the investors and borrowers. It will in turn move towards building a sustainable future, that as mentioned above, will no longer be individual or region-centric but more global and enable countries to work towards a sustainable goal by bringing in various reforms. It has become critical to comprehend how the financial sector perceives itself in this new panorama, the actions it is taking to meet its objectives, and the potential gaps to meet climate change mitigation goals.

Policy Responses and Challenges

This figure encapsulates the findings of a survey conducted in Latin America by comparing the adoption rate of banks carrying out the dimensions of green banking analyzed with the strategic level of each measure.

As shown in the graph, progress in the direction of sustainability begins in many cases from the acceptance of eco-efficiency practices (74% of the banks surveyed), to reaching strategic green commitments (46%).

However, there are specific challenges or barriers when it comes to executing these financial policies. The main challenges for adopting and mainstreaming green finance are perceived inadequate support from top management, low client demand, lack of technical knowledge and capacity, and unknown costs of implementing green finance as a new business line. Sustainable finance systems in Latin American markets are opening up business opportunities for banks.

By committing to sustainable banking, banks are taking accountability for global needs by supporting climate change mitigation, while also seizing a business opening that can contribute to profitability through superior performance and growth.

It doesn’t just stop there; increasing financial inclusion is a high-priority challenge for many countries. FinTech claims that almost 70% of the Latin American population is considered unbanked. Financial inclusion is less because of the lack of financial education. People must be introduced to new tools now available to them and understand how they can help to make sound financial decisions. Access to tools and the knowledge consumers need to develop responsible money habits is encouraging and assisting people in taking ownership and accountability of their finances, and in turn, driving development in the region as a whole.

Questions a Resolution Must Answer (QARMA)

- Given that financial inclusion plays a significant role in the development of sustainable financial growth. Suggest a few ways to increase financial inclusion.

- What are suggestive measures the international community can come up with in order to empower the economies in Central and South American nations?

- What are the various measures you would suggest to further the sustainability in finance systems in the different sectors (banking, stock market, etc.)?

- How can ECOFIN tackle the challenges and barriers while developing newer economic and financial policies in Central and South America?

- What are the policy changes/recommendations that should be included by ECOFIN in order to improve sustainable financial systems?

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