# Durmuş Yılmaz: Role and responsibilities of emerging economies in the global monetary system

Speech by Mr Durmuş Yilmaz, Governor of the Central Bank of the Republic of Turkey, at the conference on "Where Is Global Finance Heading?", Istanbul, 2 October 2009.

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Dear Guests,

I would like to welcome you all to Istanbul. It is a great pleasure for us to host this conference and such a distinguished group of central bankers, academics and experts. I hope this meeting, together with the upcoming events, will be helpful in shedding light on the future of the global financial system.

It has been almost two years since the surfacing of global financial crisis of epic proportions and we are still dealing with its repercussions. One can easily identify a variety of reasons for its occurrence: Global macroeconomic imbalances certainly played a key role. Deficiencies in financial regulations and lack of coordination among monetary authorities and regulatory institutions played even a bigger role. Policy makers were quite complacent during the build up in asset bubbles. Accommodative monetary policies enabled access to cheap money.

High leveraged transactions magnified the amount of liquidity created through financial system. Search for high yields led to excessive risk taking and use of complex instruments. Compensation scheme in the financial sector encouraged short-term bias. Above all, believed that with the use of complex financial instruments, one can wipe out the risk from balance sheets. However, risks only changed form and address in the financial system, just like the energy continuously transforms in the physical universe.

Almost all economists agree that we are heading to a slow, gradual and painful recovery. And as a central banker who has spent almost 30 years in this profession, I can tell you that it is a miracle itself to have so many economists agree on one issue with so much vigor and conviction.

The future of the global financial system will be shaped by the lessons we derive from our current experience. The ongoing crisis revealed that preventive measures put in place at the local level by national authorities may not be effective to address global problems.

It also underlined the importance of international cooperation and coordination in designing and implementing economic policies. It is clearly understood that the only way to prevent future crises at the global scale is multilateral cooperation. However to establish and sustain multilateral cooperation is not an easy task. As (John Maynard) Keynes once said, “The biggest problem is not to let people accept new ideas, but to let them forget the old ones.“ It is very likely that economic agents will try to hold onto their old habits when the effects of the crisis subdue.

Appeals on regulators will pile up for a more lenient implementation of rules, regulations, and policies. Politicians will face pressure from their constituents to give priority to local concerns at the expense of global coordination. Dominant academic paradigm may restrict those who radically incorporate lessons of these days into their studies. And of course, central banks, as always, will be criticized for spoiling the party at its hottest moment by taking away the punch bowl. We should be aware that keeping the old habits will only give us a new and may be more severe crisis in the near future.

Thanks to the global efforts, lessons derived from the crisis have already started to initiate dramatic changes in the global financial governance. There have been encouraging developments in recent months to design a new global financial system to prevent future crises. In the recent meeting of G-20 finance ministers and central bank governors, member countries confirmed their commitments to the principles of strengthening transparency and accountability, enhancing sound regulation, promoting integrity in financial markets, and reinforcing international cooperation. I believe the establishment of Financial Stability Board with increased participation of emerging countries is a critical step in achieving these objectives.

In recent years, as a byproduct of market-oriented structural reforms and prudent macroeconomic policies, the share of emerging countries in world output and their role in global financial markets has significantly increased. Now, we are faced with a more diversified group of countries with different objectives and interests. Since the rise of emerging economies has dispersed economic power, decision-making process and international cooperation has become more complicated. For legitimacy and effectiveness of measures and also for better global governance, emerging economies should involve in decision-making process and be part of the solution.

However, emerging countries should also be aware of the fact that more power in decision-making process comes with more responsibilities. Both developed countries and emerging market countries share the blame in global economic imbalances that worsened the magnitude of current crisis. In theory, the adjustment of imbalances should have taken place through either exchange rates or interest rates or both. Mainly developed countries prevented that adjustment on the interest rates, whereas emerging market countries joined their counterparts by preventing adjustment on the exchange rates.

Today, many people debate the need for a new global reserve currency, creation of an international clearing system, enhancing the role of central banks, and establishment of a supranational body to safeguard global economic and financial system. These discussions are necessary and maybe overdue.

A global reserve currency might be needed to alleviate the tension between appropriate monetary policy of the reserve currency country and that of the global economy. Creating an international clearing agency between trade partner countries may be useful to reduce the need for accumulating foreign exchange reserves.

A supra-national body may be the only solution for the externality problem in the Bretton Woods system and its successor, so called, the Bretton Woods II. Main responsibilities of central banks may be enhanced to the stability of asset prices as well as prices of goods and services.

Of course, as a central banker, I am fully aware that identifying asset bubbles is not an easy task and it may also be challenging to convince the public and politicians about the necessity of raising policy rates at a time when economy is booming but the prices of goods and services are stable. However, the recent crisis has demonstrated that central banks may ignore imbalances in financial markets at their own peril.

Today, we have a unique opportunity to discuss the future of the global financial system and the role and responsibilities of the emerging economies. I believe that the timing and the framework of this conference will provide ample opportunity for sharing new ideas and highlight some critical lessons to reshape a better global financial system for a more resilient and stable global economy.

Once again I extend my warm welcome to all participants. I also want to thank the distinguished participants for their valuable contributions. I hope you enjoy both the conference and your stay in Istanbul.