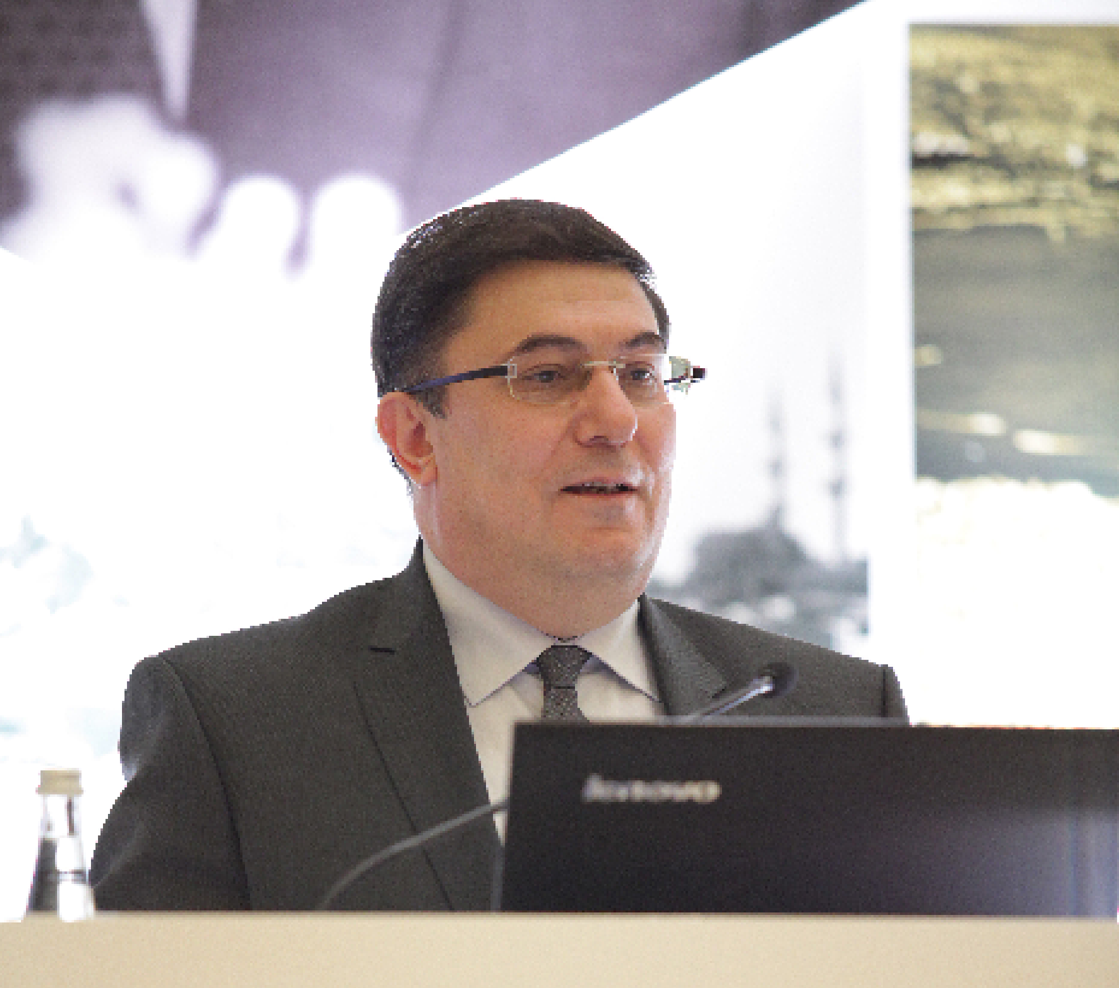

REDESIGNING THE GLOBAL FINANCIAL SYSTEM

by

İbrahim H. ÇANAKCI

Undersecretary of Treasury

Co-Chair, G-20 International Financial Architecture Working Group

A speech delivered at

ADFIMI DEVELOPMENT FORUM

Istanbul

November 7, 2013

ADFIMI Contact Details:
Address:ADFIMI Saka Mehmet Sokak, No:13, Kat:2, Sultanhamam,
Eminonu, 34116, Istanbul,Turkey
Tel:+90 (212) 526 51 26   +90 (212) 526 51 27   Fax:+90 (212) 526 51 28
E-mail :adfimi@adfimi.org Alternate E-Mail:info@adfimi.org
www.adfimi.org

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İbrahim Halil ÇANAKCI

Mr. İbrahim H. Çanakcı was born in 1962 in Elazığ. After he graduated from Elazığ High School, he completed his studies in Economics at the Faculty of Political Sciences in Ankara University.
He started his professional life in 1986 as an associate expert at the State Planning Organization ("SPO"). In 1992 he received the expert title. In this period, he has worked in analysis of macroeconomic developments, forecasting, and the establishment of macro balances of annual and 5-year development plans.
Throughout the 1989-1991 period, he studied at the Michigan State University, US and earned the masters degree in Economics.
Upon his return to the SPO, he worked as the Head of Conjuncture Department between May 1994 - December 2000.
He pursued his career in the Banking Regulation and Supervision Agency ("BRSA") after December 2000. Following his tenure as the Department Head of Economic Evaluations for about two years, he became the Vice Chairman to the Banking Regulation and Supervision Board on December 11, 2002.
On May 5, 2003 he was appointed as the Undersecretary of Treasury.
He has several studies on macroeconomic analysis, forecasting and conjuncture evaluation and is fluent in English.
Mr. Çanakcı is married with two children.

Distinguished Guests, Ladies and Gentlemen,

I would like to start by thanking to ADFIMI for organizing this forum and giving me the opportunity to share my views on the global financial system with such a distinguished audience.

As I was asked especially to comment on "redesigning the global finance", I will first briefly elaborate on the necessity of reshaping the current global financial architecture, and then try to share G-20 actions on this front, and give an emerging market perspective on the discussions on this matter.

Esteemed Guests,

Though there is no generally agreed definition, the term "global financial architecture" broadly refers to the framework and set of measures that can help prevent crises and manage them better in the context of an increasingly integrated international financial environment. Literature on international financial architecture generally focuses on three broad areas namely the economic model by which international financial relations are conducted, the network of institutional arrangements, and the distribution of decision making power in the system.

The foundations of the current global financial system were set up in the aftermath of the Second World War. Yet, since then, the basic model of international economic relations has evolved substantially. Global events since the collapse of the Bretton Woods System made painfully clear that the financial crises have become the new phenomena. Indeed, they occur quite often, and the international financial system is unable to safeguard the world economy from frequent financial crises with devastating real effects. Following the outbreak of each crisis, discussions on design of domestic, regional and international financial architecture were heated.

The world experienced a new and unprecedented crisis in 2008, which shattered both perceivably the most robust economies and the fragile ones. The recent crisis also led to a wide-ranging debate on the structure and functioning of the international monetary and financial system. A broad agreement has emerged that there is a clear necessity of redesigning the global financial system to meet the realities of today's global finance. That said, reform of the international financial system is a complex issue and has many contentious aspects. Those aspects clearly hinder making progress as quickly as desired.

At this point, the G-20, as the premier forum for international cooperation on economic and financial matters, came to the fore as it was able to unify the much-needed efforts. Even though the recent financial crisis was born in developed countries, resolving it required the cooperation and collaboration of both developed and developing countries. That made G-20 superior to the G-7 as the new platform of global policy coordination.

The G-20 undertook significant actions initially through its International Monetary System Working Group and subsequently through its International Financial Architecture Working Group, in which I assumed the co-chair position together with my Australian colleague.

The G-20 worked to adopt the necessary framework to address global financial needs, to improve the analytical and policy capacity of international financial institutions, as well as to improve representation and governance in the central organizations.

Along these lines, the G-20 has identified four areas as the key for a sound global financial architecture. Those are namely coherent macroeconomic policies at the global level, a strong IMF with effective surveillance and adequate financial resources, better governance and legitimacy of the international financial institutions, and a well-regulated financial system.

Let me start with the coherent macroeconomic policies at the global level.

The recent crisis has made evident the need to enhance the coherence of macroeconomic policies. Uncoordinated fiscal, monetary and foreign exchange policies created a highly volatile and instable financial system, of which the spillover effects particularly for developing countries could be disastrous. We saw that decisions taken by countries based solely on their own national interest may end up hurting everybody. Thus, the importance of policy coordination for the stability of global financial system became more visible and urgent.

Building on this idea, the G-20 came up with the “Framework for Strong, Sustainable and Balanced Growth”. As part of this framework, all G-20 countries have been announcing their plans in fiscal and monetary policy and structural reforms.

Under the framework, country policies are scrutinized by the whole G-20 and the public. This mechanism, achieved an important success in avoiding tail risks, initiating a recovery in the global economy and laying the foundations for strong, sustainable and balanced growth. However, much needs to be done, as global economy is still facing many downside risks and continues to underperform.

Distinguished Guests,

Given its mandate, the IMF plays an important role in international financial architecture. Through its surveillance and coordinating functions as well as its lending role, the Fund is mandated to monitor and ensure the stability of the system, represent the interests of all its members and provide support to avoid abrupt adjustments in the case of crises. That's why the G-20 has also placed much emphasis to the Fund related issues.

In this context, since the onset of global crisis, the Fund's lending capacity was bolstered through new quota subscriptions and large temporary borrowing arrangements from member countries. Thus, the IMF was provided with a considerable amount of resources to ensure its effectiveness in crisis prevention and resolution. The G-20, together with a broad IMF membership, has made a big contribution to these endeavors by agreeing to double the IMF quotas and pledging an additional USD 460 billion into the IMF firewall. I think emerging economies did their part by contributing significantly to these unprecedented efforts.

It should also be highlighted that the emerging markets started to accept that the problems with the international financial architecture are systemic and as such, everyone should contribute to the solution.

Distinguished Participants,

An effective IMF surveillance is very important for the international financial system. The Fund definitely needs a strong, transparent, and impartial monitoring and oversight system in order to maintain crisis prevention and resolution capabilities.

The G-20 was successful in pushing the IMF to review its surveillance system. Fund has undertaken major initiatives to modernize the monitoring and oversight methodologies to respond to a more globalized and interconnected world. A new Decision on Bilateral and Multilateral Surveillance was approved. This measure was accompanied by the decision to prepare a pilot assessment report on the external sector to strengthen multilateral analysis and improve the transparency of surveillance.

However, the job is not done yet. Further work on strengthening particularly the assessment of spillover effects and developing global liquidity indicators is needed. In this context, the Fund should focus more on the transmission channels so that the members could take more responsibility to evaluate spillover effects of their policies. I believe emerging market economies should closely watch the implementation of the new surveillance framework to ensure that it is done effectively and evenhandedly. I also believe that emerging market economies have a stake in ensuring that related IMF recommendations to especially major advanced economies are reflected into their policies.

Dear Guests,

Currently, the key challenge in the international monetary system is the redistribution of power in international financial institutions, particularly the quota shares in the IMF. The

relevance, effectiveness and legitimacy of the IMF depend on quotas being adequately reflecting the relative weight of countries in the global economy which have changed substantially over the last decade. Yet, it is obvious that current governance and quota structure of the IMF does not reflect these new global realities.
The current representation gap within the Fund weakens emerging market countries' ownership towards the IMF and the Fund's effectiveness in playing its role in promoting global financial stability.

As a response to the urgent need of enhancing the efficiency and legitimacy of the IMF governance structure, some steps were taken both before and in the aftermath of the recent global crisis. With the impact of 2006 selective quota increase and 2008 Voice and Governance Reform, a certain level of quota transfer was made in favor of the major emerging market economies. In this area probably the most significant step so far was the adoption of the 2010 Reform package.

While clearly underlining that the emerging markets and developing countries are underrepresented compared to their relative positions in the world economy; the 2010 Reform envisages a doubling of IMF quotas, shift of voting shares to dynamic emerging market and developing countries and a reduction in advanced European Executive Board representation by two chairs. However, this crucial Reform has yet to be approved by capitals. The halt in the ratification delays the progress on other reforms steps.
Despite some progress as a result of these steps, the long run objective has not been achieved on this front, as it would only be achieved by raising the Fund´s quotas. Higher quotas will in turn rebalance the current governance structure of the Fund by giving more representation to emerging market countries. Higher quotas will also help maintaining the quota-based structure of the Institution.

Dear Guests,

Since the costs of the global financial crisis have been extremely high, a broader and more solid response to financial sector issues has been necessary. G-20 has been taking the lead in the financial sector regulatory reforms to make the financial system safer and more resilient. In order to reach this ultimate goal, G-20 is trying to ensure that all financial markets, products and participants are regulated and subject to oversight in an internationally consistent way. With the aim of achieving a financial system which may better serve the real economy, G-20 has developed an ambitious financial regulation agenda.

The key issues in the agenda are ending too-big-to-fail, regulating over-the-counter (OTC) derivatives markets, reducing mechanistic reliance on CRA ratings, and issues concerning shadow banking. The Financial Stability Board (FSB) is assigned to coordinate the works in these areas.

In order to end the too-big-to-fail phenomenon, there is a comprehensive reform agenda under the G-20 umbrella to increase loss absorbency capacity, strengthen resolution mechanisms and intensify the supervisory oversight of systemically important financial institutions.

The G-20 committed to implement strong measures to improve transparency and regulatory oversight of OTC derivatives in an internationally consistent and non-discriminatory way. In this regard, OTC reform agenda aims at trading of contracts on exchanges or electronic trading platforms, central clearing of OTC transactions, reporting of all transactions to trade repositories and higher capital requirements for non-centrally cleared contracts. These reforms will ensure transparency and a stricter control on exposures of financial firms in OTC derivatives markets.

Reducing mechanistic reliance on the ratings of credit rating agencies is another important issue in the G-20 agenda. In the aftermath of financial crisis, the credibility of Credit Rating Agencies (CRA) fairly came under question. We have also apprehended that CRA rating downgrades have a potential to trigger a herding behavior, create cliff effects and result in systemic disruptions by amplifying procyclicality. Therefore, G-20 has aspired to improve the quality of ratings and reduce the risk of conflicts of interest and the mechanistic reliance on CRA ratings.

In this context, international organizations and countries are expected to reduce references to CRA ratings in their legislations and improve internal risk management capabilities.

Thanks to efforts of the FSB and the IOSCO, CRAs are now strongly regulated under higher transparency requirements.

Global crisis has also proven that bank-like entities which are leveraged and making maturity transformation can be vulnerable to “runs”, generate contagion risk and amplify systemic risk. This so called “shadow banking” activities have become another important agenda item for G-20.

Distinguished Guests,

The efforts which I have just mentioned mainly address the problems of financial markets in developed countries. This is no surprise as the global financial crisis was born and bred in developed countries majorly due to the fault lines in their financial systems. Since the size and depth of the financial markets in emerging countries are smaller, the systemic risks they pose are also less significant. In fact, it is difficult to find the relevance of some of the reform efforts which I have just touched upon for emerging countries.

Nonetheless, these reform efforts pave the way for the stability of global financial system and may indirectly help the financial markets of emerging countries to become safer and a more resilient. Therefore, to transform the global financial reform agenda into a more win-win type of a game, we attach great importance to active participation of emerging economies to the designing process. In this regard, we believe that bolstering the representation of the emerging economies in the Financial Stability Board (FSB) is essential.
In this respect, we welcome the revision of representation in the Steering Committee and the Standing Committees of FSB. We expect these works to be completed by the end of 2014. Thus, FSB with its higher capacity, better resource utilization and enhanced governance will support the effectiveness of financial regulation agenda.

Esteemed Guests, Ladies and Gentlemen,

In addition to these rather challenging items, G-20, also spents significant time and effort on some other technical issues as well. Among those, I should count the development of global liquidity indicators, assessment of capital flows, SDR allocations, the restructuring of the SDR basket, strengthening global financial safety nets, better coordination between IMF and Regional Financing Arrangements, and local currency bond markets.

These are surely important items that will significantly contribute to the transformation of the international financial system to a more stable structure. However, I think that these issues cannot be addressed, as long as the representation challenge in the international financial architecture endures.

Ladies and Gentlemen,

It is evident that current international financial system has not been functioning smoothly in many aspects and recurrent financial crises mainly stem from the system's obvious deficiencies. Global financial crisis of 2008-2009 has led a renewed interest in reforming the international financial system. This renewed focus on the transformation has acquired a global political interest, particularly under the leadership of the G-20. Though much has been done and much effort has been exerted to strengthen and reform the foundations of the global financial architecture, systemic deficiencies continue to persist.

Therefore the fundamental need to redesign the architecture of today's global financial system is still there. We need to exert our best efforts to align our understandings about the core elements of a sound system and unite our efforts to that end. International cooperation and particularly, the political will of the G-20 plays a crucial role in the realization of this goal.

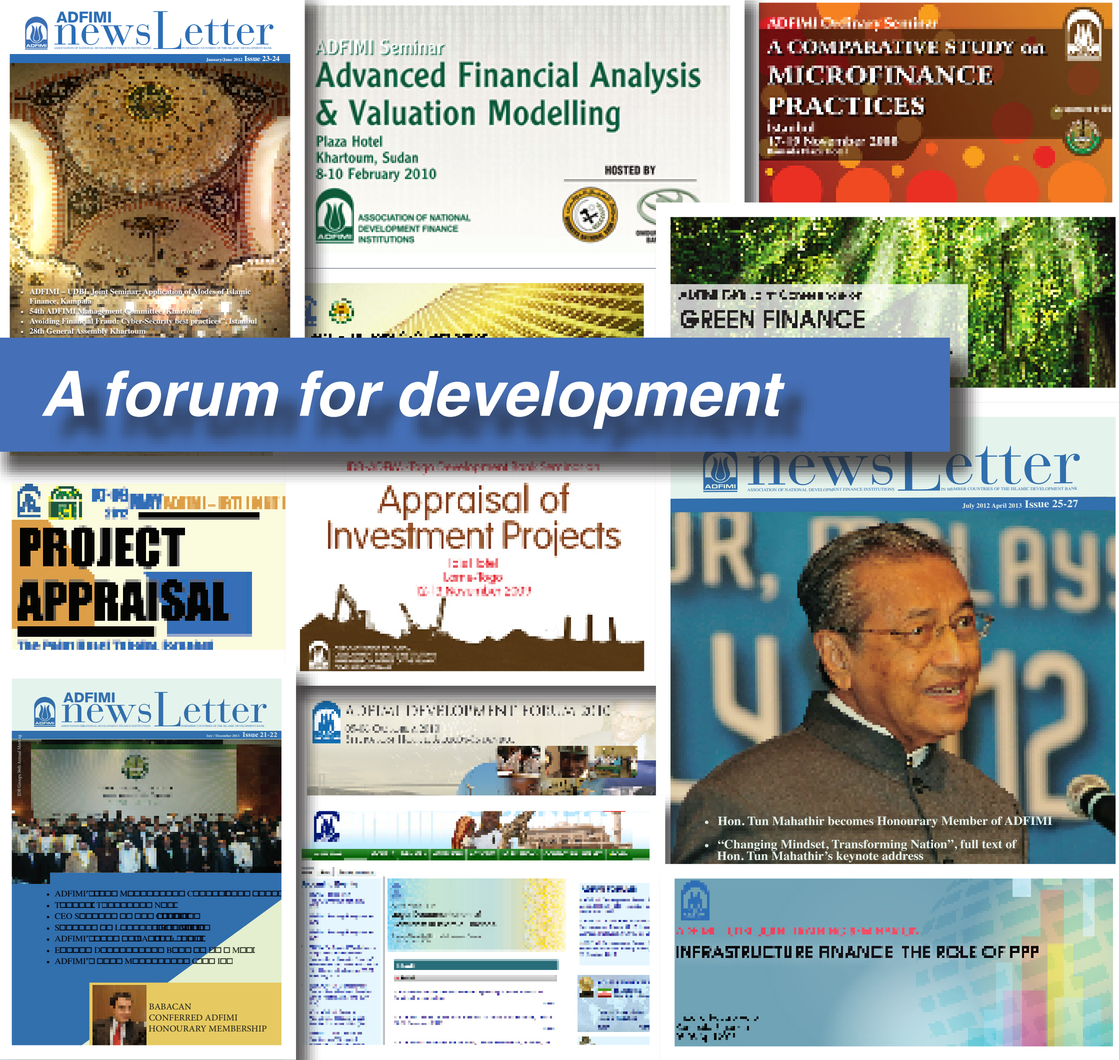
As you know, Turkey will hold the rotating presidency of the G-20 in 2015. Though we have approximately one year ahead of us until the beginning of the Turkish G-20 Presidency, we have initiated the preparatory process and have started consultations. Since much remains to be done in this area, Turkey will certainly continue to focus on these issues with a view to addressing bottlenecks towards the effectiveness of the international financial system.
I thank you all for your kind attention.

Global crisis of 2008 was considered to be the biggest financial economic and financial crisis since the 1930s.Although history suggests that financial crisis occur with monotonous regularity, since 1994, the frequency of financial crises seems to have increased considerably. As the crises developed so did the measures to respond to the crisis.

ADFIMI with a mission to provide networking and solidarity among the development finance institutions in the member countries of Islamic Development Bank was established with its headquarters in Istanbul, in 1986. It organizes training programmes, workshops, conferences and forums to fulfill its mission. It has over 50 members in 18 countries. In its regular annual development forum, ADFIMI has decided to review the experience gained in 'managing risks' during the latest global financial crisis.

All severe crises had necessitated focusing on two areas: the first, the coordination of the macroeconomic policies to come out of the crisis and, the second, the reform or redesign of international financial architecture. Hence the forum discussed "Limiting systemic risks through macro prudential policies" as well as issues pertaining to "redesigning the global financial system" by several experts on the subjects in two sessions.

ADFIMI also tries to recognize contributions made by the nationals of IDB member countries in development and development finance by conferring ADFIMI's honorary membership on such personalities. In 2012, Honourable Tun Mahathir, the fourth Prime Minister of Malaysia was conferred the same for his outstanding achievements in Malaysia's development. In 2013 HE Ali Babacan, Deputy Prime Minister of Turkey, was conferred the honorary membership for his masterly conduct of the Turkish economy during the global financial crisis. He inaugurated the Forum with a speech on 'Tackling of Global Financial Crisis'.



About ADFIMI

Established in 1986, ADFIMI, Association of National Development Finance Institutions in Member Countries of Islamic Development Bank is an international non-profit association serving 50 members in 18 countries with headquarters in İstanbul. The main field of activity of ADFIMI is capacity building of its member institutions some of which come from the least developed countries. In this context, ADFIMI organizes seminars / workshops / conferences for its members in various cities in its region (like İstanbul, Antalya, Karachi, Kuala Lumpur, Amman, Hammamet, Cairo, Beirut, Sarajevo, Prishtina, Damascus, Khartoum, Girne, İslamabad, Kuwait City, Kampala, Tunis, Dubai, Lefkosa, Maldives). In its 26 years of existence, ADFIMI has trained over 2500 executives and directors from development finance institutions.

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