Regaining Control: The Global Adjustment Question from Bretton Woods to a Multipolar World

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I would like to start by thanking the Reinventing Bretton Woods Committee, the Oesterreichische Nationalbank, and the Austrian Federal Ministry of Finance for organizing this highly relevant and timely conference.

Following the comprehensive remarks by Jean Boivin and Jerome Booth, I would like to provide an emerging market perspective on the global adjustment question.

In my remarks today, I will start with a very brief overview of the rising weight of the emerging market economies in the global economy and then I will spend more time on the linkages between international financial architecture reform and global adjustment issue.

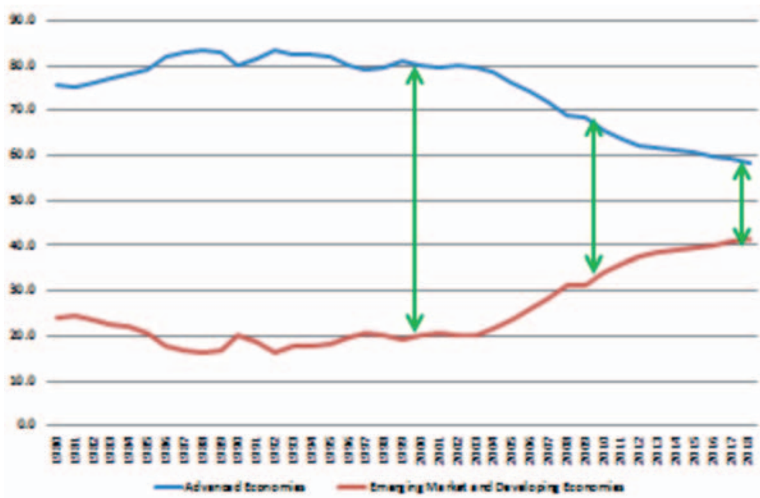
I don't have a full power-point presentation on my remarks today. But I have only two slides to share with you to show the rapid shift in the role of EMEs in the global economy.

As the first slide on the screen shows, according to IMF projections emerging economies are expected to produce approximately 42% of the global GDP in 2018. This is slightly more than double compared to the beginning of 2000s (chart 1).

Chart 2 is even more striking. It shows how rapid has been the shift in the **economic center of gravity** between 2000 and 2010. This decisive shift to the **East and South** is expected to continue during the next 15 years as well. Again what is sharp about this transformation is that this shift has been tremendously swift. The change in the last decade or two is comparable to that of 50 to 100 years of the past (chart 2).

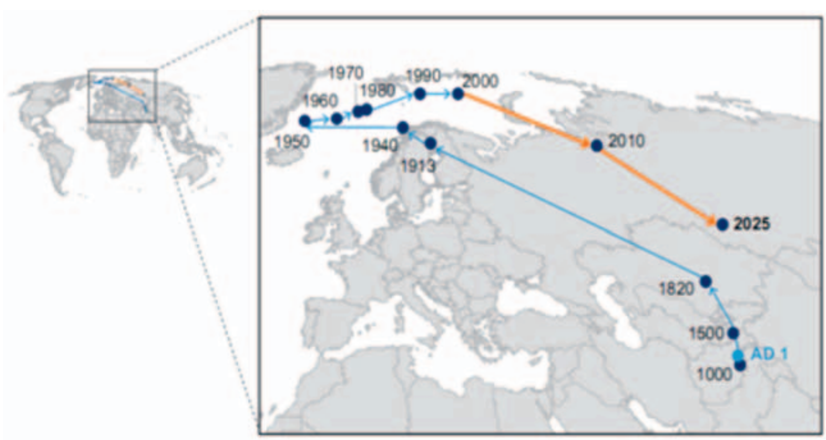
Chart 1: Share in Global

%



Source: IMF, WEO (October, 2013).

Chart 2: World's Economic Center of Gravity



Source: Urban World Cities and the Rise of the Consuming Class, McKinsey Global Institute (June 2012).

As a result of this tremendous change, the **emerging market countries** have become more important for the global economic stability. This became obviously clear during the 2008–2009 crisis. Although the financial crisis was born in developed countries, resolving it required the cooperation and collaboration of both developed and developing countries.

At this point, **the G-20** came to the fore with its ability to ensure the much-needed cooperation between advanced and emerging market economies.

Thanks to the G-20's concerted and decisive actions, further deepening of the global economic crisis was averted, a recovery process was initiated and some reduction in global imbalances was accomplished.

Despite these achievements, we must admit that global adjustment process is still far behind from its desired level and quality. Of course, there are many reasons and challenges that hinder a rapid and smooth global adjustment process. Jean has very well covered some of these reasons and challenges. As I said at the beginning, I would like to elaborate particularly on the **importance of global policy coordination, adequate global financial safety nets,** and the I**MF reform** for a more effective global adjustment process.

Regarding global policy coordination, I must say, despite important steps taken in recent years at both the G-20 platform and the international financial institutions, we still need a more concrete and accountable mechanism to enhance global policy cooperation. This issue has become even more critical in the context of the **"Fed's tapering"** process. Although we have seen some clear messages in the recent period from the Fed, there is still a need for further strengthening the efforts there. To this end, better sharing of information between policy makers and increased transparency and consistency of communication is certainly needed. Such improvements will obviously reduce the cost of global adjustment and create a win-win outcome for the whole world.

Now, let me say a few words on the role of global financial safety nets. We see **a lack of effective global financial safety nets** as an important factor that besets the global adjustment process. As a result of this inadequacy, some economies prefer to build-up excessive reserves, intervene in foreign exchange markets – sometimes in a non-market friendly manner, and use capital flow management measures to protect themselves from external shocks. Such policies create market disturbances and increase global imbalances. Hence, there is a strong need to redesign and strengthen global financial safety nets. To this aim; we should make concrete progress in (i) improving the coordination between IMF and Regional Financing Arrangements, (ii) doubling our efforts on enhancing local currency bond markets, and (iii) supporting local currency trade. Unless we do not have such concrete advances, we cannot speak about a healthy and sustainable global adjustment process.

In my view, there is a close connection between the progress in the IMF reform and the global adjustment process. The current **representation gap** weakens emerging market countries' ownership towards the IMF. This in turn undermines the Fund's effectiveness in playing its role in promoting global financial stability and in supporting the global adjustment process. There has been a strong demand from emerging markets to reform the Bretton Woods Institutions since 2005. This demand was taken up by the G-20 Leaders in 2010 and a landmark agreement was reached in the Seoul Summit. However, this agreement has not been completed as envisaged. At this critical conjuncture, I believe that both the IMF membership and the G-20 should focus on a viable strategy to overcome this uncertainty.

However, I believe we all must acknowledge one important progress on this area. As some of you have probably followed very closely, in 2012, a new constituency which is commonly known as the **"Central and Eastern European Constituency"** was established in the IMF. Under this new constituency agreement, following Austria during the 2012–2014 period; Turkey, the Czech Republic and Hungary will assume the executive director position at the Fund. The spirit behind this new constituency and its envisaged structure prove that our group had a very visionary, forward-looking and prudent decision. In that regard, I would like to extend my gratitude to Austria for their key role to facilitate this process in a very constructive way. I strongly believe that the mutual understanding and good cooperation among us is a good example for the rest of the Fund membership.

We do not see the IMF reform as limited to only so-called **"shares" and "chairs"** issue. There are many other challenges faced by the Fund, and we need further and timely steps pertaining to the **resource adequacy, lending instruments, surveillance, and governance functions.**

Regarding the **resource issue,** we highly appreciate the recent efforts to increase the resources of the IMF through borrowing in order to meet the rising needs. However, we should not overlook the fact that, the IMF is a quota based institution; and therefore borrowing should be a temporary solution.

Concerning the lending instrument, we believe that the Fund should have a more pronounced role in assisting countries with a **wider use of its precautionary lending tools.** Despite the recent improvements in these tools, further work may be needed to enhance their availability and attractiveness.

On the **surveillance function,** the Fund has undertaken major initiatives to modernize the monitoring and oversight methodologies to respond to a more globalized and interconnected world. However, the job is not done yet. Further works on strengthening the assessment of spillover effects and developing global liquidity indicators are clearly 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 surveillance function to ensure that it is run 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 domestic policies.

Finally, on the governance aspect, the initiatives to increase the effectiveness of the Executive Board and to increase political engagement are worth discussing. In this sense, I would like to underline the importance of providing an open and transparent selection process for the top management and improving the working processes of the International Monetary and Financial Committee.

In concluding my remarks, I would like to reiterate my call to the international political community that the dynamism of the emerging markets should be duly reflected to the international financial architecture if we wish to achieve a smooth and fast global adjustment. In this regard, we need many reforms from the IFI's side and a continued traction and close interest on the emerging economies part.

I thank you all for your kind attention.