A NEW "ISTANBUL CONSENSUS"

This paper looks at the significance of Istanbul as host of the October Governors' meeting of the World Bank Group. This meeting in part reflects Istanbul's growing importance as a global financial node but also suggests a shifting balance of power towards emerging markets. Istanbul will be an occasion to consider the interdependence of global finance much in the way that December's summit on climate change in Copenhagen will consider the issue of shared responsibility for environmental concerns. The message of the Istanbul meeting should be that is in their own interests for the more developed world to listen to those nations least capable of coping with the aftermath of recession.

Suzan Sabancı Dinçer*

TURKISH POLICY QUARTERLY

*Suzan Sabancı Dinçer is the Chairman and Executive Board Member of Akbank.

If not yet optimism, certainly a sense of relief has begun to percolate through world markets and this means that when the IMF and World Bank convene in Istanbul this October, the mood will not be as anxious and gloomy as many once feared. Recession has had its roots in the most sophisticated economies and the actions taken so far have been successful in breaking the fall. Massive stimulus packages, bailouts of financial behemoths deemed “too big to fail” have allowed many of the largest economies to catch their breath. What shape the recovery will take – whether there will be a sharp rebound like a “V” (as we all hope), or a “W-like” wiggle (as some suspect), remains to be seen. If the crisis has taught us anything, it is that we must remain alert to new dangers, hoping for the best but being prepared for the worst.

I would argue that the current crisis will produce a paradigm shift. While the Emerging Markets (EMs) still look towards the consumers of the developed world to spend their way out of crisis, we also increasingly recognize EMs as the engines of growth. The IMF expects EMs will grow by 1.5 percent in 2009, while developed economies will contract by 3.8 percent. The share of EMs in global GDP was 20 percent in 2000, but will reach a projected 30 percent in 2009.[1] The G20 which precedes the Istanbul meeting has an importance now that begins to exceed that of the G8.

Unity of purpose might seem utopian, but if we need an encouraging example of how to build a new economic consensus, we need to look no further than the meeting of 192 nations in New York last June, which also represents the 1.4 billion people who get by on less than 1.25 dollars a day. The final communiqué of the United Nations Conference on the World Financial and Economic Crisis represents the new common denominator on globalization with its emphasis on the moral obligations that mutual interdependence brings.

> The ongoing crisis has highlighted the extent to which our economies are integrated, the indivisibility of our collective well-being and the unsustainability of a narrow focus on short-term gains. We reaffirm the principles of sustainable development and underscore the need for a global consensus on the key values and principles that will promote sustainable, fair and equitable economic development.[2]

[1] More information on Emerging Markets can be obtained at the International Monetary Fund web site: https://www.imf.org

[2] *Addressing Economic Crisis, Governments Reaffirm Importance of Principle-Based Business*, New York, 26 June 2009 available at http://www.unglobalcompact.org/newsandevents/news_archives/2009_06_26.html

This language is similar to that used to discuss climate change and in that sense the arguments about fairness, global balance and about responsibility which will occur in Copenhagen will occur first in Istanbul. As leaders in business, in politics, in the arts and media, it now becomes our obligation to ensure that we are no longer blinded by the narrow short-term.

Istanbul should become synonymous with a plan to engage the rest of the world in sustainable growth.

Turkey is already looking for evidence of greater realism from its own business and political leadership. Conventional wisdom is that Turkey put its own financial house in order after a self-induced crisis in 2001, and that it will therefore be among the first off the block in the race to recovery.

Indeed, we can be proud of how Turkey's own financial sector has responded to the challenge of the new global environment. Our own tough regulative system, reinforced in the wake of 2001, held firm. Capital adequacy ratios in the banking sector stands at 19 percent, exceeding the target of 12 percent. There is a healthy mix of foreign and domestic participation and domestic capital. Some 28 billion dollars of foreign direct investment poured into the banking sector between 2005-2008. Foreign banks accounted for a mere three percent of banking assets at the start of this expansion and now make up for 25 percent. That figure goes up to 41 percent when you include public shares held by foreign investors. Many of the indices that attracted these foreign investors, notably the low (40 percent) ratio of credit to GDP, are the very things which stood Turkey in good stead. The expansion of credit has been gradual. Turkish banks had little exposure to derivative instruments or toxic loans. Indeed, the ratio of non-performing loans (NPL) is low at five percent and the rise in NPLs has been slow in comparison to many Emerging Europe countries. The ratio of loans to deposits (80 percent) is also significantly lower than that of many EM's where domestic loans exceed deposits. This healthy loan to deposit ratio has reduced liquidity risk.

However, while Turkish banks in particular can pride themselves on having withstood a shock which humbled their richer cousins, the real economy was weakened by the damage done to Turkey's export markets. Just because we were wearing our seatbelts, does not mean no one got hurt. There will be a price to pay later for the measures we take now to relieve the effects of the crisis. We must calculate those costs well and we must work to develop our strengths.

In the first quarter of 2009 the GDP contracted by 14 percent, a more radical decline than 2001 when the greatest quarterly contraction (4Q) was closer to 10 percent. Even so the expectation is that growth will drop in 2009 by 5.5 percent, compared to the previous crisis year (5.7 percent). Not surprisingly, the government has tried to reflate the economy. The budget has gone from surplus to deficit, a situation which strikes warning bells for those whose memories precede 2001. Unlike Turkey's inflationary decades, however, the Central Bank now has been able to cut interest rates assisted by low interest rates globally and the general deflationary environment.

What should be our own priorities during these critical times? It goes without saying that we must be investing in human capital and training a new generation. Their strength and imagination will ultimately determine the nation's future. Turkey has a young population, which contrasts with the ageing population of its westerly neighbors. The average age in Turkey is around 29, while in the EU this figure is closer to 40. Coupled with a large population over 70 million, Turkey's favorable demographics is an essential prop of its claim to be a regional power. Turkey is a large economy and a large domestic market. However, to fulfill its demographic advantage, Turkey must continue to invest in not just more but more intelligently in education.

Unemployment is the scourge with which we must all engage. To allow the potential of young people to fester is to court terrible consequences which we must avoid. This means identifying and committing to sectors where we do well and sustaining the shift to higher value added goods and services. Turkey must think of itself as Europe's manufacturing hub and utilize an advantageous geographical position and flexible and intelligent workforce to compete in a new "China-centric" world. International competitiveness depends on developing higher skills and the production of higher value added products and services.

We should search for ways to promote and reward the spirit of innovation among our young people. We cannot encourage a spirit of economic competition by imposing uniformity in education. There are certain values in the education system we must nurture – a belief in the equality of opportunity regardless of birth and genders and in advancement based on merit. Education funded through the taxpayers' purse has to be accountable. However we should not try to micromanage the education of young minds. We need to consider how we can better reward the search for innovation. This also means increasing budgets for research and development (R&D). In other OECD countries, private enterprises take the initiative, working with academic institutions as the needs arise. In Turkey, it is the universities that take the lead. So it becomes incumbent on higher education not to become divorced from the needs of productive industry. This is another reason why we need to explore new models of particularly higher education. At the same time, there is much work to be done in encouraging younger children to engage and experiment with the world of enquiry while rooting their endeavors in the real world.

The challenges of which I speak are not unique to Turkey. Human capital, employment, competitiveness based on research and innovation are challenges which nearly all the countries participating at the Istanbul meeting must face. Globalization is not just some inexorable force but a realization that we must first cooperate to compete.

The annual Governors' meeting of the IMF and the World Bank, by modern custom, takes place every third year outside Washington DC and the venues chosen have a symbolic importance. Singapore, Dubai and Prague have all recently hosted meetings, highlighting fast-developing economic regions and shifts in global power. Istanbul was a previous host in 1955 when the city was the West's lonely sentinel at the edge of Europe in the middle of the Cold War.

Today's Istanbul is a very different place. No longer on the edge, it is now at the centre of interconnecting regions – Southeast Europe, the Balkans, the Middle East and Eurasia. This is reflecting in the growth of the city as a financial centre. Istanbul is the fifth largest global bond market[3] in terms of value of bonds traded. In terms of economic might, Istanbul's GDP on its own exceeds that of the Czech Republic or indeed any of the new EU accession states with the exception of Poland. Turkey is the eighth largest economy in Europe. The country already enjoys a legal and regulatory framework that brings it into near convergence with international standards. The recent Nabucco pipeline deal and talks with Russia confirm the country's status as a conduit not just of civilization but hydrocarbons. Turkey's share in world trade has nearly doubled since 2000 and Turkey's trade volume grew on average 20 percent per year. Istanbul represents genuine dynamism.

[3] Statistics obtained from World Federation of Exchanges, http://www.world-exchanges.org/statistics

Often seen as a bridge between cultures and as a facilitator of dialogue between different parts of the world, Istanbul this October will be the place for a necessary conversation between two halves of the globe. We should not be surprised if this conversation is heated. Those who have been on the receiving end of lectures about fiscal prudence can be forgiven a moment of irritation at those who made little attempt to practice what they preached. The developed world will be aware that they have incurred the resentment of nations who found themselves the victims of a system which did as much to manage risk as reward recklessness.

The time has come to meet each other half way and Istanbul is the place to do it. We must put the current critical atmosphere to good use. There is a time-window during which people and their governments can be persuaded to take the hard preventative measures that will serve them in the long term. At the moment there is momentum for reform. The day after tomorrow, this might not be the case.