CENTRAL BANK FUNCTIONS IN TURKEY AND THE WORLD ON THE THRESHOLD OF THE 21ST CENTURY

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The developments of the last twenty years, and the new worldwide environment, have profoundly affected the functions of central banks. The growths of the financial markets and the advances in telecommunications in particular have pushed globalization to lengths undreamed of during the 1960s and 1970s. The result is that nowadays the repercussions of economic events and decisions are spread by market forces to the ends of the earth.

These developments have unquestionably affected the fundamental functioning of the central banks as well. As we all know, central banks have two basic responsibilities: first, to ensure monetary stability, and second, to preserve financial stability. The world's increased reliance on market mechanisms has heightened the importance of independence for central banks. It has become clear that price stability can best be secured by means of transparent, open, and independent central banks.

Another idea which is gaining popularity is that banking supervision can be conducted more effectively by independent agencies not connect with the central bank. But two additional tasks are being assumed by central banks: that of ensuring the stability of payment systems, and that of minimizing systemic risks.

Innovations in information technology have made some central bank functions less costly and others more expensive. For example, central banks generally are no longer opening new branch offices, which are very expensive to operate; indeed, they are closing existing branch offices. Central banks are getting smaller. In Europe, the functions of many central banks were drastically reduced on the establishment of the European Central Bank (ECB). These central banks will no longer be responsible for the monetary policies of their own countries. In general, all these changes have created a need for more highly qualified but smaller central bank staffs.

A survey of the vicissitudes of worldwide central banking on the eve of the 21s century reveals significant changes in the functions, goals, and strategies of monetary policy. Let me examine these three points briefly.

1- Functional Changes

Although there are doubtless variations worldwide in how they are accomplished, the functions of central banks are generally centered on six issues.

Deciding and applying monetary and exchange rate policies are obviously among the primary functions of a central bank. The drive to make monetary policies more independent, which generally began during the 1990s, has lately gone into high gear. The kind of central bank independence being sought has to do with ends rather than means, goals rather than instruments. And although there may be some arguments and even some actual resistance to the idea of central bank autonomy, it is generally acknowledged that central banks should be independent to design and pursue their monetary policies.

In the area of exchange rate policy, there is a wider variation of views and actions. In general, some countries have allowed their exchange rate policies to be designed by the government, while their execution was left to the central banks. The European Central Bank is one of the latest examples of this. The reason for letting the government run a country's exchange rate system is that the exchange rate is a kind of price anyway, and that the exchange rate is directly linked to government policies which produce political results. In some countries, the government and the central bank determine exchange rate policy jointly. But this does not preclude debates about which exchange rate regime would be better.

Banking supervision is another important traditional function of central banks. But the new way of handling banking supervision is to hand it over to an autonomous agency outside the central bank, and to ensure banking sector stability by making sure there is close cooperation between the central bank and the autonomous agency. But this is another area where as yet there is no worldwide standard way of handling these relationships.

The payment systems are now among the functions of central banks all over the world, in many cases for the first time. Central banks are responsible for controlling their operation, ensuring that they function smoothly and without threat to the soundness of the financial system.

In addition, central banks have retained such traditional functions as printing banknotes, providing banking services to the government, compiling statistical data, doing research, and aiding their country's international relations. But these traditional activities have become more sophisticated.

2- Changes in Goals

At the same time that monetary stability and financial stability have become two basic goals of central banks during the 1990s, such functions as financing public expenditures, acting as financial consultant to the government, and acting as lender of last resort have lost their importance.

The goal of monetary stability is to create, by achieving low inflation in the medium term, an economy with sound growth and low unemployment. According to U.S. Federal Board Chairman Alan Greenspan, keeping economic growth at its maximum sustainable level will bring about higher employment as well. These are the reasons price stability is so important.

This is what we understand by monetary stability. But it is easy to see that the industrialized, developing, and less developed countries pursue different practices in the area of monetary policy. This is because they rely on different structural transformation processes and different methods of public financing, and have different productivity rates and different exchange rate policies. All these factors taken together can alter the goals of monetary policy and affect the pursuit of monetary stability.

Financial stability, which is the second main target of a central bank, has nowadays become more important than before. When I speak of financial stability I mean a stable financial marketplace, stable behavior on the part of financial agents, and a stable payments system. Stability in these three areas generally promotes sound and stable functioning of the financial system. In Turkey we are cultivating these kinds of stability by introducing arrangements, performing supervision, and setting up preventive systems.

Central banks generally use similar approaches in pursuit of financial stability. They only monitor those banks that operate in the financial markets. Securities brokers, insurance companies, and hedge funds are excluded. In contrast, the capital markets are to be controlled by the institutional arrangements, which govern and supervise them. Central banks monitor the entire markets but put special emphasis on certain institutions. The soundness of the payments system is an issue of the first importance. In addition, central banks daily make fine-tuning liquidity adjustments aimed at keeping the general liquidity level of the economy in line with monetary policies.

There is not yet any consensus on who should be responsible for supervision. It is generally agreed that central banks should leave the supervision to an autonomous agency, but should retain its access to the information obtained.

3. Changes in Monetary Policy Actions and Strategies

As the new century approaches, the actions and strategies of central banks are undergoing some sweeping changes and innovations.

The interest rate is becoming the primary instrument of policy. Raising or lowering short-term interest rates has gradually become a widespread means of conducting monetary policies.

This can be accounted for by the increasing popularity of floating exchange rates, which has left interest rates as the best means of transmitting policy decisions about the money base, the monetary aggregates, and inflation; and by the simplicity of regulating interest rates in the short-term. The new prominence of interest rates has also caused some problems. For example, overnight interest rates have become an important instrument, while monthly and quarterly interest rates have become leading indicators. The movements of short-term interest rates have now become determinants of expectations, and the level of medium- and long-term interest rates now has implications for the substitution mechanism.

Another change in the conduct of monetary policy has to do with liquidity control. Compulsory reserve requirements have gradually lost their importance as instruments of liquidity control and have now been transformed into a form of indirect taxation. Open-market operations have turned out to be very effective for controlling liquidity. Open-market operations have given rise to other novel tools of monetary policy. Maturities have become shorter, and the need for swift reactions has increased. All these developments in the area of liquidity control have clearly increased the effectiveness of monetary policy.

Monetary policy increasingly relies on sending signals and building confidence. Signaling has become an important tool. It has the advantages of making central banks more transparent by revealing monetary policy strategies to the markets. Signals from central banks on the behavior of interest rates, exchange rates, inflation, and expectations are now becoming the indicators on which the markets principally rely.

Let me hasten to point out that worldwide, there is variation in the amount and frequency of economic "tuning" by means of monetary policies. For example, the Bundesbank does favor small but frequent adjustments, but the central banks of a number of other industrial countries claim that massive sporadic actions produce better results.

To summarize, the increasing importance of short-term interest rate, innovations in liquidity control, and the effectiveness of signaling clearly illustrate how much the conduct of monetary policy has changed. I believe that all these changes are appropriate and compatible with market mechanisms.

Global central banking, characterized by greater transparency and accountability, and reliant on the trends and changes described above, is arriving as the world crosses the threshold of the 21st century. I hope that central banks, will confirm and strengthen this transformation by accepting the achievement and preservation of price stability as their central purpose, and will continue to find new ways and means of accomplishing it.

The Central Bank of Turkey is closely following this transformation path. It is adopting the changes that enable it to function in harmony with the markets, and continues to seek greater independence. But our very first task must absolutely be to bring inflation down right now. A new and better era can open up only after we have had succeeded in conquering inflation. I do not just think that the processes now under way may end by creating a highly modern Turkish central bank; I consider this outcome to be certain.