

the
monetary
and banking
development
of malaysia
and singapore

lee sheng-yi

李繩毅 著

THE MONETARY.
AND BANKING
DEVELOPMENT OF
MALAYSIA AND
SINGAPORE

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PREFACE

The need for a book of monetary and banking development in Malaysia and Singapore is urgent, as Singapore is being developed fast as a financial centre and the recent development of money and capital markets in Malaysia and Singapore has great impact on the financial system. Bankers, financiers and government administrators desire to know the historical evolution and present framework of the system, as well as the problems and future prospects.

Students of economics are also in need of a suitable reference book of money and banking in Malaysia and Singapore. Most of the books written are in the context of the United Kingdom and the United States. The monetary and banking theories based on an advanced country have therefore to be much modified, when applied to Malaysia and Singapore.

I have tried in this book to address the economists, students, bankers, financiers, administrators and above all, the general readers, aiming at a wide audience.

The research work of this book is based on statistics and publications, supplemented by interviews with bankers, financiers and monetary authorities in Malaysia and Singapore. Conflicting views have been presented by them and it has been a difficult task to make a correct judgement from their contradictory ideas, arising from their particular circumstances, and to relate their ideas to statistical data.

Although the financial development in Malaysia and Singapore is rapid, and data are subject to changes, yet the theoretical framework and the underlying forces may probably be applicable to the two economies for some years to come. It is hoped therefore that this book will have some lasting value.

There is a gap between academic people and administrators and bankers. They have different concepts, terminologies and approaches, so that there is a lack of communication between them, and they talk to one another, as if chicken to ducks, to use a common Chinese saying. Civil servants have the most knowledge of data and current information, because much of the research work and surveys of the Statistics Departments and government offices which are not published, are accessible to them but are not accessible

to academic people. But civil servants cannot express freely their views without sanction from their superiors. Those who are in the field of banking and finance do not write. Hence it is my hope that this book may arouse their comments with their practical experience, thereby promoting a dialogue between academicians and decision-makers.

The University of Singapore Press has made a great contribution to society by publishing academic writings. Unlike commercial publishers which take profitability and hence saleability of a book as the prime concern, the Press, however, takes important regard of the cultural and educational value of a book. Many academic research works would not be published without the Press; they would then be forgotten and lost to the community through time.

Professor Lim Tay Boh, the late Vice-Chancellor of the University of Singapore, gave me the encouragement to write the Ph.D thesis, 'The Development of the Monetary and Commercial Banking System of Malaya and Singapore', on the basis of which this book has been rewritten or transformed. The research study was started in 1965 and has gone through many phases of revision under the guidance of many scholars—Professors George Betz, Lim Chong Yah, H.W. Arndt, J. Faaland, Joan Robinson and Harry Johnson—to whom I should pay my respect and gratitude.

Many commercial banks gave me valuable information and assistance; these included the Oversea-Chinese Banking Corporation, Overseas Union Bank, Algemene Bank Nederland, N.V., Chartered Bank, Hongkong and Shanghai Bank, Chung Khiaw Bank, Lee Wah Bank, Four Seas Communication Bank, United Overseas Bank, First National City Bank of New York, Bank of China, Indian Overseas Bank, and others. Their managers spent many hours in discussion with me and their practical experience helped to confirm my theoretical analysis. Many finance companies and financial institutions granted me interviews, data and information. The Bank Negara Malaysia, the Statistics Departments of Singapore and Malaysia, the Ministry for Finance, Singapore, The Monetary Authority of Singapore, the Commissioner of Banking, Singapore and the Singapore Currency Board also provided me with much assistance.

Mr. Tan Ee Leong, a retired banker and an early writer on the history of Malayan banking, provided me with much historical material from the Chinese sources.

Professor H.D. Fong, Emeritus professor of Nanyang University, gave me constant stimulation, advice and moral support through many long years of research.

I was invited as a research-fellow in Yale University in 1968; the Growth Centre and Southeast Asia Study Centre there provided me with research and computer facilities. Most of the regression equations in this book were worked out there.

I should also be grateful to Professor You Poh Seng, who was instrumental in providing me with the necessary facilities in research, to Mrs. Nellie Tan Kee Cheng and the late Miss Maggie Ng of our Economics Department, who kindly did the typing of the manuscript, and to Mrs. Sanda Simms the editor of the University of Singapore Press who has to go through my manuscript thoroughly.

The above by no means exhausts the list of scholars and institutions, who have helped me in this study. I have received assistance from many other sources which for lack of space are beyond enumeration. Needless to say, all mistakes and errors in this book are mine and I assume full responsibility for them.

University of Singapore
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Lee Sheng-yi

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PART ONE

I

INTRODUCTION

Singapore is a small island of 225 square miles. It is now an entrepot-manufacturing economy with 2.1 million people. It had a high gross national product per capita of about S\$3,687 in 1972¹, and had an average annual growth rate of gross domestic product of 13.2 per cent from 1963 to 1972 (see Table 13.3). West Malaysia on the other hand has a large land area for the production of a number of commodities including rubber, tin, rice, palm oil, timber, and iron ore. It has a much bigger population of about 9.8 million. In 1972, the Gross National Product per capita of Malaysia was about M\$1,103,² and the average annual growth rate of G.N.P. from 1964 to 1972 was 6.5 per cent (see Table 13.2). Both were lower than the corresponding figures in Singapore. These figures indicate that Singapore is an international port with good banking and financial facilities, whereas West Malaysia is predominantly a primary producing country, with a large rural population.

The monetary and banking frameworks of Malaysia and Singapore diverged after the separation of Singapore from Malaysia in 1965 and the Currency Split in 1967. At present, Malaysia pursues the central banking system with some flexibility of currency issue, as there is an allowance of fiduciary issue of \$300 million—hence the minimum currency reserve in gold and foreign exchange is 80.59 per cent of currency issue. Singapore has established the Monetary Authority of Singapore which performs the major functions of a central bank. But nominally she continues the Currency Board system with 100 per cent currency reserve in gold and foreign exchange. Since the international reserves are so strong, being about 5.5 times of currency issue, the availability of gold and

1. See the *Singapore Annual Budget Statement* for the financial year, 1973/74, presented by the Minister of Finance, Mr. Hon Sui Sen to Parliament in March 1973.

2. In 1972, G.N.P. of Malaysia was \$12,906 million and the population was about 11.7 million. See *Bank Negara Malaysia Annual Report*, 1972.

foreign exchange would not cause a constraint to the currency issue of Singapore; and so the balance of payments position would not have a rigid link to the currency issue, in spite of the Currency Board system.

Dual banking groups of foreign banks and local banks have grown out of historical development. There are today 37 commercial banks in Malaysia with 247 banking offices (see Appendix 5.1); and 48 commercial banks in Singapore with 203 banking offices (see Appendixes 5.2, 5.3 & 5.4). In recent years the establishment of new local banks in Kuala Lumpur contrasted with the in-coming of foreign banks and financial institutions, the merging movement of local banks and the rise of merchant banks in Singapore. The development of the Asian Dollar Market and Asian Bond Market in Singapore opens an epoch of a new and more competitive banking system as distinct from ordinary commercial banking. Emphasis on industrial finance has become marked in both countries. The banking frameworks have been transformed with an objective of providing an efficient financial arrangement for economic development. More term loans for industries are provided by commercial banks, development banks, and other specialised financial institutions. The composition of bank loans has changed in favour of industrial loans.

How do these movements come about? What has been the evolution of the monetary and banking systems? What are the problems and the future prospects? These questions will be explored in the book in four parts—(i) monetary development, (ii) banking development, (iii) monetary and exchange rate issues and (iv) monetary analysis.

The political organization in the 'Malayan Peninsula'³ has undergone a number of important changes. Before World War II there were the Straits Settlements (Singapore, Penang and Malacca), the Federated Malay States (Perak, Pahang, Selangor and Negri Sembilan), and the Unfederated Malay States (Johore, Kelantan, Trengganu, Kedah and Perlis). After the War, there was the Malayan Union (1945–7), followed by the Federation of Malaya (1948–63); the Malayan Union and the Federation of Malaya covered the Federated and Unfederated Malay States, Penang and

3. Geographically, the 'Malayan Peninsula' is defined as the Malayan Peninsula proper plus the two off-shore islands of Penang and Singapore.

Malacca. Singapore was made a separate colony. Malaysia was formed in September 1963, comprising West Malaysia (the States of Malaya or the former Federation of Malaya), and East Malaysia (Sarawak and Sabah). Singapore joined Malaysia in 1963, but was separated from the latter on 9 August 1965. The word 'Malaya' used in this book means geographically the Federation of Malaya, the States of Malaya or West Malaysia, as they were called in different times.

This book is written on the Pan-Malayan basis. Pan-Malayan includes Malaya and Singapore, or in other words, the whole 'Malayan Peninsula'. Hence local banks and local money and capital markets are defined as banks incorporated and markets existing in Malaya and Singapore respectively.

The period covered is from the end of the 19th century to the present, but the emphasis is on the period after World War II, and the Pan-Malayan statistics are presented and analysed up to 1965. Since Singapore was separated from Malaysia in 1965, there is no point of combining the statistics of the two independent countries after 1965. Current problems such as the currency split, the sterling devaluation in 1967, the international monetary crises in 1971-3 and monetary policies of Malaysia and Singapore are more thoroughly discussed.

Monetary problems in different periods are also appraised, particularly the problem of stabilisation and development. However, there are four main themes which run through the book, and which characterise the development of the monetary and banking system of Malaya and Singapore:

- (1) The transformation from colonial to independent economies—the reduction of the dependence on the London money and capital market, the recent development of local money and capital markets, the government regulations of local asset ratios for banks, insurance companies, and other financial institutions, the decrease in the holding of sterling balances and securities by monetary authorities, banks and other financial institutions, the eventual departure from the sterling exchange standard in 1967, the replacement of colonial Currency Board system by a central bank in Malaysia, the substitution of a rigid currency issue by a flexible one in Malaysia, and the increasing importance of local banks vis-a-vis foreign banks, are the significant evidences.

- (2) The change from '*laissez faire*' attitude to government intervention and control—Currency issue was evolved from bank notes to Currency Board (government) notes. Foreign banks as well as local banks were developed in an atmosphere of free enterprises, but in recent years the Central Bank of Malaysia, the Monetary Authority of Singapore, the Malaysian Industrial Development Finance Ltd., the Development Bank of Singapore, Bank Bumiputra, Agricultural Bank of Malaysia and other financial institutions have been set up by the Malaysian and Singapore governments for government participation in the banking and financial system.
- (3) The change from the economies exporting primary commodities (mainly rubber and tin) and having much entrepot trade, to the economies undergoing the process of industrialisation and diversification—Singapore has been transformed from an entrepot to an entrepot-manufacturing economy. The attitude of banks in Malaysia and Singapore in financing trade on short-term only has to be changed; banks have to take a bigger role in financing new manufacturing industries and economic development.
- (4) The change in the relationship between Singapore and Malaysia. In the colonial time, Singapore was the capital of the Straits Settlements and also the banking and financial centre of the whole 'Malayan Peninsula'. The headquarters of the Currency Board were at Singapore until 1960, when they were moved to Kuala Lumpur. Foreign banks and most of the local banks had their main offices in Singapore. The Independence of Malaya in 1957 followed by the establishment of the Central Bank of Malaysia in 1958, promoted the growth of Kuala Lumpur, the Federal capital, as a banking and financial centre in rivalry to Singapore. The separation of Singapore from Malaysia in 1965 and the Currency Split in 1967 caused some changes in the banking and monetary relationship between Singapore and Malaysia.

The above changes have gradually taken place through the past years; the underlying forces which manifested themselves in most important events are still at work.

II

EVOLUTION OF THE CURRENCY BOARD SYSTEM

2.1 SILVER STANDARD 1786-1903

In the early period 1786-1867, when the Straits Settlements (Penang, Malacca and Singapore)¹ were under the control and direction of the East India Company (1786-1858) and later the India Office, (1858-67), various silver coins such as the Mexican dollar, the rupee, the Spanish dollar, and the Dutch guilder were in circulation in the Straits Settlements and also in the Malay States. In 1823, the Resident, John Crawford, declared the Spanish dollar the legal tender of the Settlements. But, the East India Company intended to make the Indian rupee the official currency in place of the Spanish dollar. The Currency Acts of 1835, 1847 and 1855 stipulated and confirmed rupees and other Indian subsidiary coins to be the legal tender of the Straits Settlements. However, the currency in circulation in fact comprised mainly the Mexican dollar and various other silver dollars, but not much the rupee. After the transfer of the political administration of the Straits Settlements from the India Office to the Colonial Office in London in 1867, it was realised that the rupee as the legal tender served only as a unit of currency in public accounts, whereas transactions were actually conducted in Mexican and other silver dollars; thus forcing the rupee into circulation and making it the only legal tender in all transactions would cause needless labour and confusion in the market. So, the Straits Settlements Legislative Council passed the legal Tender Act 1867 which repealed the previous Currency Acts, thus discontinuing the legal tender status of the rupee and other Indian subsidiary coins; instead, Mexican, Hong Kong, Spanish, Peruvian, Bolivian and other silver dollars to be specified from time to time by the Governor in Council would be the legal tender.

1. In 1826, the three Settlements of Penang, Malacca and Singapore were brought together to form the Straits Settlements under the rule of the India Office in Calcutta.