"THE MONETARY SYSTEM OF SINGAPORE AND MALAYSIA: Implications of the Split Currency"

Edited by J. PURCAL

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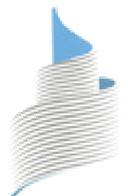

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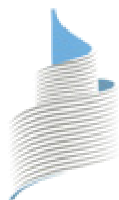

THE MONETARY SYSTEM OF SINGAPORE AND MALAYSIA: Implications of the Split Currency

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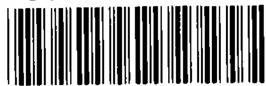

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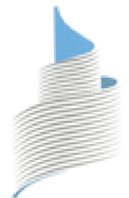

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FOREWORD

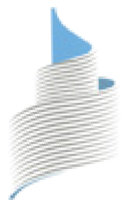
In 1867, exactly one hundred years ago, currency problems were one of the reasons that led to the transfer of the government of the Straits Settlements from the Indian Office to the Colonial Office. The newly established Legislative Council lost no time in legislating for the use of various dollars as legal tender. About thirty years later British trade dollars became legal tender in the Straits Settlements, the Malay States in the Peninsula, North Borneo, Labuan and Hongkong. In 1906 the Straits Settlements dollar notes were issued by the Board of Currency Commissioners, and this currency has been in use ever since.

Today, one hundred years later, as a result of the establishment of Malaysia and Singapore as two sovereign countries, this common currency in use for six decades will cease to be so after 12th June 1967. In its place there will be separate currencies for Singapore, Malaysia and Brunei.

This change has caused immense interest. The University Department of Extra-mural Studies and lecturers are to be congratulated for instantly responding to this situation by organising a course of lectures on the implications of the split currency. This is timely service to the public.

This course proved extremely popular and four of these lectures are now published in a book. It is hoped that they will serve a much wider public.

REGINALD QUAHE
Deputy Vice-Chancellor



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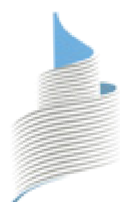
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A HISTORY OF CURRENCY IN MALAYSIA AND SINGAPORE

By CHIANG HAI DING, B.A., Ph. D.,

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INTRODUCTION

Currency problems engaged the attention of the inhabitants of Malaysia and Singapore almost from the beginning of the 19th century. They generated controversy and much heat during the 19th century; they still do today.

I propose to deal with the historical development of the currency system that we have today and which will not continue after 12 June 1967. Very briefly, the principal features of that system are:

(i) the circulation of a common dollar which is backed by 100 to 110 per cent reserves in Singapore, Malaysia [that is the former Federation of Malaya, Sabah (previously known as British North Borneo) and Sarawak] and Brunei,

(ii) the operation of a Currency Board system which allows for the automatic convertibility of Malayan dollars into pounds sterling (at the rate of $1 = 2/4d) and vice versa.

After 12 June 1967 there will be separate currencies in Malaysia, Singapore and Brunei. However, Singapore and Brunei will adhere to the Currency Board system while Malaysia will have a Central Bank.

I propose in this lecture to outline firstly, how our Currency Board system was evolved, and secondly, how the various constituent territories came together.

I. CURRENCY PROBLEMS BEFORE 1867

Our Currency Board system was introduced in 1906 and its fundamental features have not changed much in the last six decades. However, these features were the results of evolutionary changes that took place in the 19th century, when it could not be said that such a thing as a currency *system* existed in Singapore, Malaya or the Borneo states.

In the 19th century the currency in circulation in these territories, in Southeast Asia and in East Asia was silver dollars, which were valued by "touch" (that is by their silver content). Silver dollars came to Southeast Asia in the 16th century. They were introduced by the Portuguese in Malacca and by the Spanish in Manila, from where they were also sent to the South China ports such as Canton, Ningpo and Amoy. These early silver dollars were known as Spanish dollars, for they resulted from the Spanish conquest of Mexico early in the 16th century. The Spanish acquired control of the fabulously rich silver mines, established mints and produced over 2,000 million coins between 1535 and 1821. These coins invariably had the profile of the reigning monarch on

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one side. In 1821 Mexico became an independent republic. It continued to mint silver dollars of the same size, weight and quality, producing almost 1,500 million between 1821 and 1903. These were known as Mexican dollars and carried, instead of the royal head, the republican eagle.

These Spanish and Mexican dollars were the most widely circulated coins in history and came closer than any other to being a truly international currency. Despite their identical silver content, the older Spanish dollars commanded a higher value than the Mexican dollars, proving that in matters of currency familiarity breeds respect!

When Captain Francis Light acquired Penang from the Sultan of Kedah he paid him in Spanish dollars. Light stimulated the wood cutters he employed to cut down the trees to greater effort by loading a cannon with silver dollars and firing them into the jungle. Stamford Raffles paid the Temenggong and Sultan of Johore in Spanish dollars for the lease of Singapore.[1]

Penang, Singapore and Malacca [which the British acquired from the Dutch in 1824] constituted the Straits Settlements and formed part of the possessions of the East India Company. As such they were administered by the Government of India. The merchants of the Straits Settlements resented this position for they declared that the Indian administration had little knowledge of, and sympathy with, their problems. They pointed to attempts to violate the free trade principle which they claimed to be the basis of Singapore's prosperity. They resented also the attempts to impose the Indian currency system on the Straits Settlements: the rupee was made legal tender in 1837, from which year several efforts were made to get it to circulate and to replace the dollar; these attempts were only abandoned in 1857. These grievances, as well as some others, resulted in agitation for the transfer of the government of the Straits Settlements from the India Office to the Colonial Office, which took place in 1867.

One of the first acts of the newly established Legislative Council of the Crown Colony was to repeal all previous currency legislation, to abolish the rupee and to confirm the dollar as the unit of account. The Council also legislated that the silver dollars of Hongkong, Spain, Mexico, Peru, Bolivia and others to be specified from time to time were legal tender. It recognized the Japanese trade dollar (*yen*) and the American trade dollar in 1874.

II. Silver Dollars In Southeast Asia

Though the Spanish and Mexican silver dollars were produced in such large quantities they were in short supply in Southeast Asia. One contributory factor, no doubt, was the practice of hoarding by Asians. More important was the rapid expansion of world trade in the 19th century. This shortage of currency for trade purposes was experienced by the merchants in Singapore who brought it to the attention of the Governor-General of India when he visited Singapore in 1830. Repeated calls for a British trade dollar were made in succeeding years and in 1866 the British government relented and established a mint in Hongkong.

1. The Sultan of Kedah received $6,000 per annum for Penang, and $10,000 for Penang and Province Wellesley after 1800. The Temenggong and Sultan of Johore received $3,000 and $5,000 per annum respectively; they sold Singapore in 1824 for $26,800 and a monthly pension of $400, and $33,200 and a monthly pension of $1,300 respectively.

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It produced what came to be known as the Hongkong dollar, which had the same silver content as the Mexican dollar after which it was patterned. Over two million were struck in two years and then the mint was abandoned. The British government was discouraged by the high cost of minting and also by the fact that its coins passed at a discount in the market.

The Japanese government purchased the mint and employed the British mint master and went into business. From 1871 it produced the Japanese trade dollar or *yen*, also modelled on the Mexican dollar. It struck 110 million of these before production ceased in 1897.

The United States of America, also a major producer of silver, decided to mint trade dollars for export in 1873. It made its coins just a little heavier and more valuable than the Mexican dollars, so as to ensure their acceptability in the East. Only 36 million coins had been minted when production ceased in 1877. They did not survive when the Chinese discovered their higher silver content, and they were melted down.

The French from 1885 produced 13 million *piastre de commerce* or Saigon dollars. These were as heavy and as valuable as the early American trade dollars and suffered the same fate. From 1895 and until 1903 the French produced 55 million silver piastres which were modelled on the Mexican dollar. These were, however, never declared legal tender in the Straits Settlements.

The British government in 1895 decided once again to produce trade dollars, for two main reasons. Firstly, there was the perennial currency shortage as pointed out by merchants in the Straits Settlements and Hongkong. Secondly, after 1893 when India ceased to use silver as the basis of its currency, the Royal Mints in Calcutta and Bombay had been idle. These British trade dollars were declared legal tender in the British possessions of the Straits Settlements, Hongkong and Labuan, and in the Malay States in the Peninsula and North Borneo. A total of 150 million were struck between 1895 and 1903 and they proved to be the most serious rival to the Mexican dollars.

III. Paper Currency In The Straits Settlements

We have seen one method adopted to overcome the shortage of currency in the Straits Settlements—the use of silver dollars which were patterned after the Mexican dollar and which were minted outside the colony.

However, there was another method to overcome the shortage—the use of paper currency.

Bank notes were issued from 1849 by the commercial banks. These included the Asiatic Bank (which suspended payment in 1866), the Oriental Bank (which followed suit in 1884), the Marcantile Bank of India, the Chartered Bank of India, Australia and China, and the Hongkong and Shanghai Bank. These bank notes, unlike silver dollars, were not legal tender. The banks were required to redeem their notes in silver dollars which were the legal tender. The notes were backed in the first instance by a proportion of silver dollars and securities held by the issuing banks and they rendered the shareholders to unlimited liability. Under these conditions it is not surprising that the bank note issue was small: only $3.6 million in 1881 and $5.9 million in 1891.

The British Treasury in 1878 and 1879 had suggested that a government note issue might help to alleviate the currency shortage of the colony. Its sug-

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gestion was eagerly adopted by the Legislative Council in 1881 which declared that it would be "a great convenience". However, it was not proceeded with due to objection from the note-issuing banks.

The question of the government notes is directly relevant to us because the principles which governed its issue in 1899 are basically those that govern the issue of Malayan dollars today.

The first issue of government notes in a colony took place in 1849 in Mauritius. The Chartered Bank of Mauritius failed in 1847 and was unable to redeem its bank issue in current coins. The colonial government was forced, in the public interest, to guarantee and to undertake the redemption of these bank notes. In 1849 the government replaced the bank notes with a government issue. In 1864 it attempted to relinquish this responsibility but was forced by public opinion to continue to shoulder it. It decided, therefore, to establish the proper administrative machinery to handle the government note issue: a Board of Currency Commissioners was set up to issue the government notes and to redeem them in the current coin. The Board was required to hold a minimum coin reserve of one third and a maximum of one half of the note issue; it could hold the rest of the reserves in the form of Imperial and Island debentures which, however, had to be converted into cash to compensate any fall in the coin reserve below the specified minimum. The government notes, it can be seen, had 100 per cent backing.

The Oriental Bank failed in May 1884 in Ceylon and the Straits Settlements. In Ceylon it was the sole note-issuing bank, and to prevent panic the colonial government was forced to guarantee the redemption of the bank notes. In Singapore there were two other banks issuing notes: the Chartered Bank of India, Australia and China and the Hongkong and Shanghai Bank. They feared that the run on the Oriental Bank might spread to theirs and to prevent this, they voluntarily and wisely undertook to redeem the notes of the unfortunate bank. In 1885 a sober Legislative Council resolved "that the issue of the paper currency required by the Colony is a function which the government should assume or control". But nothing was done until 1893.

In that year there was a serious scarcity of silver dollars which was acutely felt during the occasion of the Chinese New Year celebrations. The commercial banks had issued bank notes to their permitted maximum and the Governor therefore urged as a solution to the perennial problem of currency shortage a government note issue. He was strongly supported by the Chambers of Commerce of Singapore and Penang. The Secretary of State for the Colonies approved a government note issue of denominations five, ten, fifty, one hundred and five hundred dollars and forwarded as a model, the British Honduras Currency Note Ordinance of 1894.

This Ordinance ensured that there was virtually absolute security for the government note issue, which was to be backed by a Note Guarantee Fund consisting of three parts. The first was the Coin Reserve, which was to constitute two thirds of the coins received in exchange for notes; this Coin Reserve could be reduced to one half. The second was the Investment Fund, made up of interest-bearing securities purchased with the remaining one third or one half of the remaining coins. From the income earned by these securities, after the administrative costs of the Currency Board had been met, a sum equal to one

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per cent of the purchase price of the securities was paid into the third reserve, the Depreciation Fund. When the accumulated payments equalled ten per cent of the purchase price of the securities, payments were discontinued and the income earned was paid into the general revenues of the colony. In the event of the market value of the securities falling below the purchase price plus the Depreciation Fund, the difference had to be made up by a transfer from the general revenues of the colony to the Note Guarantee Fund.

The government note issue was therefore backed by 100 to 110 per cent reserves in the first instance and by the general revenues of the colony ultimately.

The colony, however, protested against these "stringent provisions", for it had been assumed (incorrectly) that its legislation would be based on that of Ceylon, which had been based on that of Mauritius. The Secretary of State however, declared that the British Honduras Currency Ordinance

> . . . *was not originally drafted with special reference to circumstances of the British Honduras but was intended to be a model Ordinance including those provisions which, in the opinion of the highest financial advisers of Her Majesty's Government, should be embodied in the law of any Colony proposing to establish a Government Note Issue.*

The Straits Settlements Currency Note Ordinance was eventually passed in 1899, after considerable opposition from the note-issuing banks, whose right to issue bank notes was not renewed beyond the first decade of the 20th century. One dollar notes were only issued in 1906.

The government notes which were redeemable in legal tender silver dollars circulated not only in the Straits Settlements but also in the Malay Peninsula and British Borneo. So successfully did the colonial government manage the note issue that the Secretary of State permitted the Coin Reserve to be reduced to one-half in 1902, and even to one-third in 1909.

IV. The Shift To The Gold Standard In 1903

Before we see how our present currency system evolved from the Currency Ordinance of 1899, we have to examine another currency problem faced by the Straits Settlements in the last quarter of the 19th century. This was the fluctuation and decline in the gold value of silver, that is, the decreasing value of the colony's legal tender silver currency in terms of the currencies of other countries that were based on gold. Thus the silver dollar which was worth 4s. $4\frac{3}{4}$d. in 1873 fell to 2s. $11\frac{5}{8}$d. in 1892 and to 2s. $3\frac{3}{8}$d. in 1893. This period is known as "The Great Depression in Trade and Industry" and was characterised by the rapid fall in the value of silver and in prices generally. In this period most of the countries of Europe, which had previously used both gold and silver as the bases of their currency, abandoned silver and established gold monometallism.[2]

When the price of silver fell very sharply in 1893, and the value of silver dollars with it, the merchants, bankers and government officials of the Straits Settlements began to discuss the advantages and disadvantages of adhering to the Silver Standard and of converting to a gold currency. They argued back and

2. Britain had been using gold since 1816; the United States since 1871.

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forth for ten years. Only in 1903, on the recommendation of a Straits Settlements Currency Committee headed by Sir David Barbour, did the colony decide to convert to a Gold Standard currency, or more accurately, a Gold Exchange Standard. This currency system was one which was developed in India and used successfully in Japan, Mexico, the Philippines and Thailand, among others.

Very briefly, the Barbour Report called for the striking of a Straits Settlements silver dollar, which would have the same size, weight and fineness as the Mexican dollar. This would ensure its acceptability. When a sufficient quantity of these Straits dollars had been imported into the colony, all other silver dollars would be demonetised. The export of the new dollars could be prohibited as would also be the import of the demonetised silver dollars. When the demand for currency outstripped its supply the value of the new Straits dollar would rise above its *intrinsic* value; it would become in fact a token dollar and the connexion between the colony's currency and the value of silver would come to an end. When this was achieved the rate of exchange of the Straits dollars in terms of gold could be fixed by law and could be maintained by free convertibility between Straits dollars and gold at that declared exchange rate.

The coin reserves of the Government Note Guarantee Fund was reminted into Straits dollars which were declared legal tender in 1903, so that for the first time in its history, the colony had its own coins.

In 1906 the value of the Straits dollar was pegged at 2s. 4d. at which it has remained ever since. This was the market value of the dollar at that time for it was expected that the value of silver would continue to fall. But instead it rose and the coins had to be quickly re-minted to a lower silver content to save them from the melting pot. In 1917 the value of silver rose again and the Straits dollars had again to be reminted to an even lower silver content to save them. These Straits dollars were only demonetised in 1952, thus severing a link with the past going back almost four centuries.

Other changes were made to the Currency Note Ordinance of 1899 to effect the shift to a Gold Standard currency. In 1903 the Currency Commissioners could issue not only coins but also notes in exchange for gold deposited with them in Singapore or with the Crown Agents in London. In 1906 the Currency Commissioners could receive not only coins but also notes in exchange for gold. Another amendment permitted the Currency Commissioners to issue notes in Singapore for gold deposited with the Crown Agents in London. Yet another amendment permitted them to issue only notes and not coin in exchange for gold.

In 1906 therefore the principal features of the Currency Board system as we know it today could be distinguished:

(i) there was a Board of Currency Commissioners to manage the currency of the colony.

(ii) the Board would automatically expand the colony's supply of currency in response to gold being deposited with it and contract it when gold was taken from it (in exchange for its notes or coins). This was done at the exchange rate of 2s. 4d. to the dollar.

(iii) the Board guaranteed the stability of the currency by providing 100 to 110 per cent backing.

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Though in theory a Gold Standard currency was introduced in the Straits Settlements, in practice no gold circulated, only silver coins and paper notes. But these could be converted into gold. During World War I, however, when Britain banned the export of gold, this convertibility into gold was suspended. In 1923 it was abandoned altogether and recognition was at last given to the fact that the Straits dollar was really convertible into sterling. But sterling itself was convertible into gold so that the Straits currency was on a Gold Exchange Standard. But in 1931 Britain itself went off the Gold Standard so that the Straits currency became a Sterling Exchange Standard, as it is today.

V. THE STRAITS DOLLAR AND ITS CURRENCY AREA

I have mentioned earlier that one of the principal changes that will take place this year is the breaking up of the Currency Area served by the present Malayan dollar. But how did the states in this Area come together in the first place?

It has already been mentioned that Mexican dollars circulated in all of Southeast Asia which included the Malay States of the Malay Peninsula, so that virtually the entire region used the same currency. The British trade dollars of 1895 were legal tender in the Malay States and North Borneo in addition to the Straits Settlements, so that it can be said that for almost four centuries, the territories of Malaysia, Singapore and Brunei used a common currency as the medium of international trade.

When the matter of the Straits Settlements government note issue was discussed, the Governor of the colony and the Resident-General of the Federated Malay States proposed to the Secretary of State for the Colonies that the two territories should be made jointly responsible for the note issue. This was turned down.

The Malay States were quite pleased when the colonial government incurred initial losses due to the depreciation of some of its investments. However, in 1926 the Board of Currency Commissioners for the first time made a payment, amounting to $20 million, into the general revenues of the colony. In 1929-1930 the Board made a further payment of $29 million. The self-congratulation of the Malay States now turned to envy. They demanded a share in the profits derived from the note issue: it was pointed out, quite correctly, that the Straits currency circulated in the Malay States.

Sir Basil Blackett was appointed to look into the problem. He reported that though the Malay States had the sovereign right to issue their own currency, such a practice would cause them considerable inconvenience since their trade was conducted largely through the Straits Settlements. He agreed that they had a legitimate claim to a share in the profits and pointed out that they should also accept a part of the responsibility for the currency issue. Blackett divided the shares of the various states thus:

STRAITS SETTLEMENTS		37.00%
FEDERATED MALAY STATES		37.00
Perak	16.75	
Selangor	12.75	
Negri Sembilan	4.50	
Pahang	3.00	

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UNFEDERATED MALAY STATES		25.25
Johore	9.25	
Kedah	7.00	
Kelantan	5.25	
Trengganu	3.00	
Perlis	0.75	
BRUNEI		0.75
TOTAL		100.00%

This division was provided for by legislation passed in 1938 and 1939 and new currency notes of "The Board of Commissioners of Currency Malaya," which were legal tender in the Straits Settlements and the Malay States including Brunei, were issued in 1940.

They did not circulate for long. During the period of the Japanese Occupation, Japanese "banana notes", which were backed by nothing and printed according to the needs of the Army, were issued and declared to be on par with the British notes. What happened was a perfect illustration of the operation of Gresham's law that bad money drives out good: the British notes disappeared into hoards.

After the war, the British Military Adminstration demonetised the Japanese currency and revived the former government note issue at the old exchange rate of 2s. 4d. to the dollar. Though Malaya was re-organised into the Malayan Union, (comprising the nine Malay States, Penang and Malacca) and the Crown Colony of Singapore, the common currency was maintained. The Board of Currency Commissioners consisted of the Financial Secretaries of the Union and the Colony.

After the war, the position of the Borneo states also changed. Sarawak, which had been ruled by the famous white raja Brookes, became a Crown Colony. British North Borneo, which had been under Chartered Company rule, also followed suit. It was only logical that they should follow the example of Brunei, which was already a participant in the Malayan currency arrangements. The necessary legislation was passed in 1950 (by which time the Malayan Union had been replaced by the Federation of Malaya) and the British territories in Southeast Asia became a single (Malayan) Currency Area.

The legislation came into effect in 1952 and the new notes, which made their appearance in 1954, were issued by "The Board of Commissioners of Currency Malaya and British Borneo". The membership of the Board was enlarged to include one representative of the Borneo territories and two persons appointed jointly by the governments concerned but representing no particular territory.

Even after the attainment of independence of the Federation of Malaya in August 1957 the currency system was left unaltered. A Central Bank for the Federation was recommended by the International Bank for Reconstruction and Development Mission Report on Malaya in 1955. The idea was supported by the Watson and Caine Report in 1956. Both these reports envisaged a Central Bank for the Federation and Singapore. The Bank Negara Tanah Melayu of the Federation of Malaya was declared open in January 1959.

However, the Central Bank of the Federation of Malaya did not undertake to issue currency for the Federation and in fact did not exercise any control over

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the currency. The Board of Commissioners of Currency Malaya and British Borneo continued to issue the Malayan dollar which circulated in the independent state of the Federation of Malaya, the states of Singapore and Brunei and the British colonies of Sarawak and North Borneo.

A new Malaya British Borneo Currency Agreement of 1960 replaced the 1950 agreement on 1 January 1961. This provided for the Currency Board to be enlarged to seven members of which two came from Malaya, one from Singapore, one each from Brunei, Sarawak and North Borneo while the seventh was to be a person possessing recognized banking or financial experience who did not represent any specific territory and who was appointed jointly by the five participating governments. One of the Malayan members was to be the Chairman while the Singapore member was the Deputy Chairman. The relative importance of Malaya and Singapore was reflected in the voting arrangements. Three votes each were given to the Malayan and Singapore members and one vote each to the other members. Any duties not requiring unanimous agreement of the Board could be discharged or exercised by the Board if it secured seven votes. The Agreement also provided for a fiduciary issue not exceeding $300 million, which provision, incidentally, was not used. The 1960 Agreement also made provision for the discontinuation of the arrangements after notice of eighteen months had been served. The participating countries could then issue their own currencies.

VI. Separation And Separate Currencies

The 1960 agreement was continued without alteration when Malaysia was formed in September 1963. It will be noticed, therefore, that (excluding Brunei) political union followed currency union. In fact it was frequently pointed out in the days and months preceding the formation of Malaysia that the various components had many things in common, such as a British type of administrative machinery and a common currency.

Today, however, separation has taken place between the two major participants to the currency union. And as one of the governments takes the view that political union should precede currency union, the re-unification of Malaysia and Singapore must be a pre-requisite for a common dollar. And unless and until prospects of re-unification grow brighter the prospects of a common dollar must grow dimmer.

Malaysia has announced that it will maintain the value of its dollar at 2s. 4d. It already has a Central Bank, which will now take up the function of currency issue in addition to other central bank functions. Singapore has announced that it will also maintain its dollar at 2s. 4d. It has no Central Bank and will not have one but will instead continue the Currency Board system. Brunei will also have a Currency Board system and issue its own dollar, of the same value. Thus, though a common dollar will no longer be used in the states of Malaysia, Singapore and Brunei, common dollars of equal value in terms of sterling will circulate in these countries. If these dollars are legal tender or customary tender in all three territories the situation will not be unlike that obtaining before 1903 when various silver dollars comprised the currency of the three areas. If, however, these new dollars are legal tender only in their countries of issue, then this new situation will give rise to problems that were not present in the previous situation of a common currency.

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THE GROWTH OF COMMERCIAL BANKS IN THE STATES OF MALAYA AND SINGAPORE

By S. Y. LEE, M.Sc.,

Lecturer, Department of Economics, University of Singapore

The development of commercial banking in the States of Malaya and Singapore can be conveniently divided into four periods:

(i) The Early Period, 1840 to 1903
(ii) The Pre-War Period, 1903 to 1941
(iii) The Post-War Period, 1946 to 1957
(iv) The Post-Independence Period, 1957 to 1965

The Second World War caused a temporary break in the development. This period was an abnormal one and will not be dealt with in this survey of the growth of commercial banks.

I. The Early Period, 1840 To 1903

The first bank established in the area was the Union Bank of Calcutta which opened a branch office in Singapore in 1840 and after some years, it suspended its operations. Then came the Oriental Bank with British capital and management in 1846. By the 1850's there were already several well-established banks, the Oriental Bank, the Asiatic Banking Corporation, and the Commercial Bank of India. The bank notes of the first two banks had been in active circulation during that period. However, a financial crisis developed and the Asiatic Banking Corporation and the Commercial Bank of India failed in 1866 and the Oriental Bank in 1884. The early failures might be ascribed to the banks' speculative activities, meagre capital resources and unsound management.

This early period saw the successful establishment of three British Exchange Banks—the Mercantile Bank in 1856, the Chartered Bank in 1859 and the Hongkong and Shanghai Banking Corporation in 1877 as well as other non-British banks. All these three British banks issued bank notes until 1904 and they were fully backed by silver to the extent of 100 per cent and enjoyed good credit in the market.

The success of the three British Exchange Banks could be attributed to several factors. First, they were well managed and well organized, with adequate capital to meet a financial crisis, such as that in 1866 and again in 1872, and they had a good relationship with London as well as other international banking centres. Further, they had large amounts of sterling balances and securities in London to transact their foreign exchange business which was mainly with Britain and the rest of the British Empire. When the Currency Board system was introduced in 1899, with the currency reserve backed 100-110 per cent by

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sterling assets, the British Exchange Banks with their sterling balances and securities kept at London were in a particularly strong and favourable position, which was practically unchallenged until the gradual emergence of the local Chinese banks.

Second, the British banks enjoyed the co-operation and the good faith of the Straits Settlement government and the British Colonial Office. They were often advisers to the government in economic and financial matters, and were sometimes appointed to the Board of Commissioners of Currency after its establishment in 1899. During the Second World War, they were appointed by the government as government agent in the matter of foreign exchange control.

A third reason for the success of the British banks was their policy of orientating their outlook towards China, Hongkong and Japan instead of towards India, in trade and finance. The trade with the former area had been much greater than that with the latter, and the development of the British Banks in the former area was in harmony with the trading and financial conditions of that time.

Besides the British banks there were several Dutch banks such as Nederlandsche Handel-Maatschappij N.V. (N.H.M.), which was established in 1888. It was the forerunner of the present Algemene Bank Nederland N.V. Rotterdam Bank. This together with Escompto and N.I. Handelsbank were active in financing trade between the Strait Settlements and the Dutch East Indies. The First National City Bank of New York opened in Singapore in 1902 played an active part in the trade with America.

Banque de l'Indochine, established in Singapore in 1905, had its primary interest in financing trade with Saigon. Generally speaking, different groups of overseas banks were set up with the main interest of financing trade between their home countries and their oversea territories on one hand and the Straits Settlements on the other.

The numerous banking failures during the early period demonstrated the risks of the banking and financial enterprise. The confusion in the issue of currency and the lack of government regulation or control over note issue before 1899 had encouraged banks to speculate resulting in an unstable state in the monetary and credit system.

II. The Pre-War Period, 1903-41

The year 1903 marked a new page of development. The first local bank was founded and secondly, the Straits Settlement Dollar was introduced, inaugurating the reform of the currency which finally evolved into a Sterling Exchange Standard.

Development of Local Chinese Banks

The period 1903-41 saw the gradual emergence of local Chinese banks as well as the growing strength of the three British banks. The rise of local Chinese banks was in response to the demand of the expanding Chinese business community. As population, trade and production grew, accompanied by an increasing use of bank accounts and cheque payments, there was ample room for the expansion of both the local Chinese and the British banking systems; in fact

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they were complementary to each other. The Chinese banks relied much upon the British banks for foreign exchange transactions, and the British banks collected some deposits from the public through the Chinese banks.

The first local Chinese bank, Kwong Yik Bank, was founded in Singapore in 1903 by a Cantonese. However, it got into financial difficulties in 1913 and was then liquidated. Some of its shareholders organized a new bank, Kwong Yik (Selangor) Banking Corporation which was incorporated in July 1913. This was the first bank incorporated in Kuala Lumpur.

The Sze Hai Tong Bank (now known as Four Seas Communication Bank) was the second local Chinese bank incorporated in Singapore in 1906. Then came the Chinese Commercial Bank in 1912, the Ho Hong Bank in 1917 and the Oversea-Chinese Bank in 1919. In 1932, the three banks were amalgamated into the present Oversea-Chinese Banking Corporation as a consequence of the worldwide Great Depression of 1929-32. The amalgamation had several important features. First, the avoidance of competition and the pooling of financial resources, personnel, market connections and experience of the three banks provided the means of survival under critical circumstances, and maintained the confidence of the public in the local banks. Second, the amalgamation allowed for modernization with Western techniques of banking organization, accounting and management. The new bank has continued to progress; today it is the Chairman of the Association of Banks in Malaysia, and is undoubtedly the leader among the local banks.

Several other local Chinese banks were incorporated in this period—Lee Wah Bank, Bank of Malaya, and Batu Pahat Bank (now called the Pacific Bank) in 1920, Ban Hin Lee Bank and United Overseas Bank in 1935.

Several characteristic features of the local Chinese banks could be noted. First, they were an outgrowth within the economy, as distinct from the overseas banks with head offices in London or other financial centres. The sponsors and directors of these local Chinese banks were prominent merchants, mainly in rubber and tin. Second, although some of them started as old Chinese banking houses, they were commercial banks in the modern sense and were different in organization and policy from the traditional Chinese banking and remittance houses prevalent in China or Hongkong today. They accepted deposits, provided loans and advances, financed trade bills and transacted foreign exchange business along the lines of modern commercial banks. Third, these banks were founded by distinct Chinese dialect communities; Kwong Yik Bank and Lee Wah Bank by Cantonese; Chinese Commercial Bank, Ho Hong Bank and Oversea-Chinese Bank by Hokkien; Sze Hai Tong Bank by Teochew. In the beginning not only directors and officers but also customers and depositors were mainly drawn from the same respective communities. Fourth, the banks maintained a highly liquid position (as did all banks in Singapore and Malaya, overseas and local) in view of the fact that Malaya was an export economy depending heavily on the fluctuating fortunes of rubber and tin. Fifth, because of the highly fluctuating export earnings a cautious policy in loans and advances to customers was adopted. At the same time loan policies were often based on good faith arising from personal and communal relationship rather than on property or other collaterals for the loans. This type of personal guarantee or trust would not be regarded as a sound banking principle by Western standard, but in the Chinese social setting, family and communal relationships played an

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important part in credit and finance. As there was no Central Bank, no money and capital market and no government or central bank regulations to supervise the activities of the commercial banks, the credit policy of the local Chinese banks was entirely at their own discretion.

Development of the British Exchange Banks

Parallel to the growth of local Chinese banks was the further development of the three British Exchange Banks. With the rapid development of the rubber and tin sectors, the banks began to set up branches and agencies in many towns on the peninsula. They played an important role in expediting the inflow of British capital to Malaya and in serving as a bridge between the money and capital market in London and the development of the Malayan economy. This close relationship, coupled with the trust placed on the British banks by the government and by the Currency Board, gave the banks a unique and dominant position for financing trade, providing credit for the processing of rubber, tin and Straits produce, and the handling of foreign exchange remittances.

Other Developments

Two new British banks—the P. and O. Banking Corporation and the Eastern Bank—were established in this period but were later acquired by the Chartered Bank. Three Indian banks were established—the Oriental Bank of Malaya in Kuala Lumpur in 1936, the Indian Overseas Bank in Singapore in 1937 and the Indian Bank in 1941. The Bank of China opened an office in Singapore in 1936 and the Kwang-tung Provincial Bank in 1939, with the main purpose of expediting trade with China. Two Japanese banks were active, the Bank of Taiwan and the Yokohama Specie Bank. They were closed after the end of the Second World War.

III. The Post-War Period, 1946-57

The Second World War caused a temporary disruption in the currency and banking system. The Japanese army issued their military notes, and a Japanese bank, the Southern Development Bank, was established for exploiting resources in Southeast Asia and financing the Japanese army in the area. It was closed after the War.

The immediate post-war task was one of reconstruction and rehabilitation, in which the three British Banks and the Oversea-Chinese Banking Corporation played an important part, in conjunction with other banks. The government guaranteed bank advances for rehabilitation and reconstruction, and loans were granted to the estate and mining establishments at a low rate of interest of three per cent through the three British banks. Several banks gave liberal loans to enable old businesses to be resumed and new ones to be set up.

The aftermath of the War saw the continual expansion of the banking system. New local Chinese banks were established—the Overseas Union Bank incorporated in Singapore in 1947 (business commenced in 1949); the Chung Khiaw Bank incorporated in Singapore in 1947 (business commenced in 1950); the Industrial and Commercial Bank incorporated in 1953; and the Bank of Singapore (affiliate of the Oversea-Chinese Banking Corporation) in 1954.

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There was indication in this period that the banks were more prepared to play a role in the financing of development.

The growth of the three British Banks continued unabated. After the War many overseas banks established branch offices in Singapore and Malaya—and there would have been more, had government regulations not been so strict with regard to banking licenses. The new branch banks comprised the United Commercial Bank set up in 1948, the Bank of India in 1951, Bank of Canton in 1953, the Bank of America in 1955, the Bank of Indonesia in 1955, the Bank of Tokyo in 1957, and the Bangkok Bank in 1957.

IV. The Post-Independence Period Since 1957

The post-independence period ushered in a new epoch in banking history in Singapore and Malaya. Under the Currency Board system, there had been little scope for monetary and banking policy. In 1954, the International Bank for Reconstruction and Development Mission examined prospects for economic development in Singapore and Malaya and recommended in its report the establishment of a Central Bank for the effective management of the money, credit and banking system. In consequence of that report, two experts were appointed to study the problems in more detail—Mr. G. M. Watson and Sir Sydney Caine. The Central Bank Ordinance was passed in 1958; Bank Negara Tanah Melayu commenced operation on 29 January 1959.

The principal objectives of Bank Negara are as follows:

(i) To issue currency in Malaysia and to keep reserves

(ii) To act as the banker and financial adviser to the Government

(iii) To promote monetary stability and a sound financial structure in the country

(iv) To influence the credit situation to the advantage of the country.

In short, Bank Negara would endeavour to formulate and actively implement the monetary and credit policy of the country. It supervises the credit policy of the commercial banks. The Banking Ordinance was also enacted in 1958, whereby commercial banks were brought under proper banking regulations for the first time.

Since the establishment of Bank Negara, there have been several new developments. First, under its direction, clearing house facilities have been established in Kuala Lumpur, Penang and Singapore. Second, it had encouraged the development of a money market—the Short Deposits (Malaysia) Limited, a discount house. Third, it encourages the development of a sound capital market through the Stock Exchange of Malaysia. Fourth, it is the policy of the governments and the Bank Negara to promote the development of local banks. Fifth, the governments encourage the policy of the commercial banks to set up branch offices, particularly in rural areas and in areas where new industrial development is taking place. Sixth, there has recently developed a tendency on the part of commercial banks to set up subsidiary or associate finance companies as a means to attracting deposits.

Independence gave a further impetus to the growth of local banks—Far Eastern Bank established in Singapore in 1958, Asia Commercial Banking

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Corporation in Singapore in 1959, United Malayan Banking Corporation in Kuala Lumpur in 1959, Malayan Banking in Kuala Lumpur in 1960, Bank Bumiputra in Kuala Lumpur in 1965, and Southern Banking in Penang in 1965. Three new branches of overseas banks were also established—Mitsui Bank in Singapore in 1963, Chase Manhattan Bank in 1964 (which having purchased Nationale Handelsbank N. V. and took over their business), and Habib Bank in 1964. After Independence Kuala Lumpur has developed rapidly as a financial and banking centre.

According to the Bank Negara Malaysia, Annual Report 1965, there were 33 licensed commercial banks in Malaysia and 34 in Singapore at the end of 1965. Of these, 23 banks had offices in both Malaysia and Singapore. The number of banks in the two countries totalled 44, of which 23 were local and 21 foreign. They had 133 banking offices in Singapore and 277 in Malaysia. This is an average of one banking office for every 14,000 persons in Singapore and for every 34,000 persons in the States of Malaysia.

Bank deposits have increased fourfold since 1947. At the end of 1965 the total deposits of commercial banks amounted to $2,766 million.

V. The Changing Functions Of Commercial Banks

In the early period, 1840-1903, the function of the banks was mainly to deal with foreign exchange; that is to remit money and to finance export and import bills. For this reason the first commercial banks, which were incorporated overseas were then called exchange banks. The composition of export trade then was somewhat different from what is at the present time. Then opium trade was important, and banks often advanced loans against the security of cases of opium kept at their vault. Other export commodities were pepper, spices, gambier and other Straits produce. Tin became important only after the First World War with the application of modern mining techniques. Rubber was not an important export commodity until after 1920. With the developments of the economy British capital began to flow into tin mines, rubber plantations and other industries through the three British Exchange Banks. These banks dealt with the Chinese merchants through compradors, who were the 'credit guide' of the banks in the market. The chettiars also obtained funds from the exchange banks for re-lending to small traders, dealers and the salaried class for private spending. But among the Exchange Banks' customers, European trading companies, particularly the British, were dominant.

Another important function until 1904 of the three Exchange Banks and other overseas banks was to issue bank notes which were backed by silver kept at their vaults, and thus to provide the medium of exchange in the economy. From 1867 to 1903 the Straits Settlements and the Malay States were on the Silver Standard. The 1899 legislation provided for the setting up of a Board of Commissioners of Currency which would have the sole right to issue currency notes. In October 1903, the new Straits dollar, the first coinage of silver by the Straits Settlements Government, was declared as legal tender, in order to standardize the currency in circulation. In 1906, the Malayan dollar was pegged to sterling at the exchange rate of 2s. 4d. to the dollar and this value has been maintained till the present day.

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The three British Exchange Banks, as an integral part of colonial banking, were closely related to the banking system of the United Kingdom and served as a bridge between the source of funds for development, *viz.* the money and capital market in London, and the demand for funds in developing the rubber plantations and tin mines in Malaya. The later development of local Chinese banks was a natural growth within the economy in response to the financial needs of the local Chinese community. The complementary development of the local and the overseas banks led to an integrated banking system, in which the British banks linked the economy with the United Kingdom and the sterling area at large while the local Chinese banks financed trade, credit and foreign exchange remittance in a complex of credit and financial network throughout Southeast Asia wherever the overseas Chinese were active in trade and industry.

Under the Currency Board system, and given the dependence of the Malayan economy on rubber and tin exports, it was not possible for the government to have any general credit policy vis-a-vis the commercial banks. In the depression of 1929-33, the commercial banks reacted in a passive manner, and were cautious in their credit policy. The local Chinese banks were in their infant stage and faced great difficulties in view of world-wide business failures. By and large, they followed an orthodox policy of credit expansion during a boom and credit contraction during a recession.

Since the most fundamental principle of commercial banking is to maintain liquidity, banks are willing to provide short-term credit for trade and commerce, but they are reluctant to lock up their funds on a long-term basis in industrial projects. Thus during the inter-war period and the post-war period until 1957, the banks' attention was directed mainly towards commercial activity and little towards industrial activity. They did not take an active role in making use of local funds or bank deposits to finance local industries or investment. Local loans and advances were relatively small. Instead, the banks used to remit their surplus funds to London to be accumulated there as sterling balance or securities. A lack of suitable investment outlets or opportunity in the local market was given as excuse for not investing locally. But that was not the whole story; the reality was that banks did not take an active part in creating suitable investment outlets by encouraging local ventures.

Since Independence and the establishment of the Central Bank, commercial banks both local and foreign have changed their outlook and policy. They now take a more active role in sponsoring and financing new industrial ventures. The proportion of local loans and advances in the banks' asset structure has increased and banks now hold more treasury bills and government securities.

With the separation of Singapore from Malaysia on 9 August 1965, the introduction of new currencies in June, 1967, the commercial banks face new problems and difficulties. They have been operating in the States of Malaya and Singapore for years as if the two areas were the same country with political unity, and funds remitted between Singapore and Kuala Lumpur have been of the nature of day to day operation. When the two countries issue separate currencies on 12 June 1967, commercial banks on both sides of thc Causeway would have to adjust themselves to the different economic policies prevailing in the two countries.

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THE MONETARY SYSTEM OF MALAYSIA AND SINGAPORE
AN ANALYTICAL DESCRIPTION

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The monetary system of Malaysia and Singapore is unique in the sense that since 1959 a Central Bank has been operating side by side with a Currency. Board, with the latter having sole right of issue and redemption of currency. The first section of this paper is concerned with the Currency Board and the second with the Central Bank and the commercial banks. In the third section the basic features of the separate currencies of Malaysia and Singapore are indicated.

I. The Currency Board

Today the Malayan dollar circulates not only in Malaysia and Singapore, but also in Brunei, which is also a party to the Malayan Currency Board arrangements. The Malayan dollar is legal tender and one is required by law to accept it in discharge of any debt, provided it is offered in the correct amounts.[1] One part of the supply of money consists of currency notes and coins, for which the Board of Currency Commissioners has sole right of issue and redemption. The other part of the money supply is composed of commercial bank demand deposits, the volume of which may be influenced by a monetary authority. In

Table 1

Estimated Money Supply, Malayan Currency Area, 1957-1965
($ Millions)

	PERIOD (End of)								
	1957	1958	1959	1960	1961	1962	1963	1964	1965
1. Active circulation of notes and coin*	889	892	1022	1071	1071	1117	1166	1262	1350
2. Demand deposits in:									
Malaya	466	461	466	477	497	520	556	587	71[illegible]
Singapore	376	398	413	386	367	418	443	424	447

*Active circulation of currency is gross circulation less holdings of banks and treasuries.

Source: *Monthly Statistical Bulletins of the States of Malaya, Kuala Lumpur.*
Monthly Digest of Statistics, Singapore.

1. Malayan currency notes are legal tender for any amount; however, coins are legal tender up to the value of two dollars only.

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the Malayan Currency Area today currency notes and coins account for 53.5 per cent of the money supply;[2] bank demand deposits account for the remainder. Table 1 shows the money supply of the Area from 1957 to 1965.

Any discussion of the monetary system of this area has therefore to take place at two levels: first, the issue and redemption of currency notes and coins by the Currency Board under statutory regulations, and second, the creation and destruction of deposit money, which leads us to an examination of the banking structure. In this section we shall be concerned with the first.

A Malayan Board of Currency was set up in 1938[3] with headquarters in Singapore, to issue a new currency to replace the Straits dollar.[4] The Board was statutorily charged to exchange upon demand Malayan dollars for pounds sterling in London, and sterling in London for local currency at specified rates of exchange and for a small commission. The chief function of the Board therefore is merely to satisfy the demand for local currency and not to regulate the currency issue. In other words the Board has no discretionary authority over the note issue; hence over the total supply of money. It is for this reason that Currency Boards are sometimes referred to as passive money changers.

As a result of the above arrangements, the Malayan monetary standards is the Sterling Exchange Standard, with the Malayan dollar pegged to pound sterling at the rate of two shillings and four pence to the dollar. The Board is empowered to charge a maximum commission of $\frac{3}{16}$th of a penny for the conversion of dollars into sterling and vice-versa, but in fact charges only $\frac{1}{8}$th of a penny. The commission seems to limit the range within which the rate of exchange can fluctuate. This is a more basic consideration than the amount of income which the Board can earn by charging a commission.

In addition the Board deals only in minimum amounts, £10,000 or $100,000, so that in practice most of the ordinary, individual exchange transactions take place through the commercial banks. Since the Currency Board deals only in amounts above the specified minima, the usual method of transfer is by means of sale and purchase of "sterling exchange" in which there is an active inter-bank market, especially in Singapore. Transactions in the Singapore inter-bank market do not change the supply of currency but only change the asset distribution between the banks and the members of the public. Only when the exchange transaction takes place through the Board is there any change in money supply.

Foreign currencies which are earned in international trade are converted into sterling and can be sold to the Currency Board for exchange into local

2. This figure is based on the estimated money supply at the end of June 1966 for Malaysia and Singapore only. See Bank Negara Malaysia, *Review of Economic Conditions—August 1966*, p. 20 (mimeographed).

3. In 1938, only Singapore and Malaya were part of the arrangements; Sabah, Sarawak and Brunei were included in the currency arrangements from 1952.

4. For a discussion of the conditions that led to the 1938 arrangements, see Sir Basil Blackett, *Report on the Question of Malayan Currency*, Straits Settlement Council Paper, No. 78, 1934.

5. In each currency area there is a "national" currency which is used for the payment of goods and services within the boundaries of the currency area. The "national" unit of currency is referred to as the standard of value. This is different from a monetary standard which denotes its base and expresses its relationship to other currencies.

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currency. The local currency is thus a liability of the Board, while sterling is its asset.

Through the Currency Board the monetary system of Malaya is linked to that of the United Kingdom, and monetary conditions in the latter will have some effect on monetary conditions in the former, particularly since a fairly large number of Malayan commercial banks have their headquarters in London. Historically, the commercial banks in the Malayan Currency Area have also relied on the London money market through which they have borrowed or loaned funds. It is in this connection that our monetary system is sometimes referred to as being 'dependent'. Generally the currency of a 'dependent' area does not have an independent exchange rate with another foreign currency other than the prevailing exchange rate of sterling (or any other reserve currency) with that foreign currency.[6]

The size of the monetary circulation[7] depends primarily on changes in the balance of payments position of the Currency Area. The quantity of money is increased by depositing an equivalent amount of sterling in London, and reduced only by redemption of sterling in London. If the balance of payments is in surplus, that is when the value of exports and other capital inflows exceeds the value of imports and other capital outflows, more foreign exchange is earned than is paid out. This surplus can be converted into Malayan dollars and the note issue is increased. Conversely, a deficit in the balance of payments tends to reduce the note issue.

Since the total supply of money includes not only the note issue but also bank demand deposits, any expansion or contraction of the supply of money takes place at two levels. At the first level, when the balance of payments is in surplus, the note issue is increased. At the second level the new currency issue in the hands of the commercial banks is subject to a multiple expansion of credit, that is of demand deposits. Other things being equal, so long as a known cash ratio is maintained by commercial banks, the volume of bank deposits is closely influenced by the quantity of cash in the economy.

The discussion thus far can be usefully summarised: Malayan Currency notes issued by a Currency Board are an irredemable paper currency, but are fully convertible into sterling at a fixed rate of exchange and for a small commission. In order to meet this statutory obligation, the Board keeps reserve funds in sterling.

The income of the Board is divided between two funds, a Currency Fund and a Surplus Fund. Related to these funds are the investment and profit distribution policies of the Board. We consider these next.

A Currency Fund is maintained in London for the purpose of meeting demands for redemption of local currency into sterling. All sterling which is received in exchange for notes and coins is paid into the Fund. The resources of the Fund may only be used to meet redemptions of currency, to purchase

6. See Ida Greaves, *Colonial Monetary Conditions*, London, H.M.S.O. 1953, p. 12.
7. When this is disaggregated the following components are revealed: net receipts from abroad *plus* net increase in assets of Currency Board and banks, *plus* net increase in local advances, and investments of banks, *less* increase in official sterling balances and net increase in official bank deposits. In recent years, changes in money supply have emanated largely from changes in bank credit to the private sector rather than from changes in the balance of payments position. This is discussed further in section II below.

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metal for minting into coin, transport of currency to the currency area, cost of printing notes, and other related expenses.

This Fund consists of two parts, a liquid portion and an investment portion. The aim of the Board is to keep ten per cent of the Fund in liquid form and to invest the remainder, but this standard is not necessarily adhered to.[8] Generally only a small amount of currency is likely to be presented for redemption at any one time hence it is possible for the Board to operate on the principle of fractional reserves. In order to arrive at the fraction the Board has to decide on the forms in which to hold reserves; it has to estimate its cash needs on the basis of current expenses and demand for currency redemption; and on the basis of expected cash needs, it has to decide on a portfolio of securities with a certain maturity pattern that will satisfy these needs.

The liquid portion at present consists not only of funds held on deposit in London, and Treasury Bills (of the British government), but also of sterling securities maturing within two years.

The investment portion consists mainly of sterling securities and securities of other Commonwealth Governments. Since 1960 the Board has been empowered

> "*to hold among its assets publicly issued dollar securities of, or guaranteed by, the Participating Governments up to a maximum of $300 million, with not more than $100 million in the first year, $200 million in the first two years, and $300 million in the first three years. The maximum sum which may be invested in the securities of any Participating Government shall be determined by the proportion of the profits payable to that government in respect of the year preceding the date of purchase of the securities in question*".[9]

Thus the 1960 Agreement provided for a maximum fiduciary issue of $300 million or about 25 per cent of the currency circulation at the end of 1960.[10] Some provision therefore exists in the Currency Board arrangements for the parties to the Agreement to have access to funds for financing economic development, or the fiduciary issue could be used as a cushion to a certain extent against a deficit in the balance of payments. It is thus possible for this portion of the Currency Fund to become a tool for a Participating Government's fiscal policy. However this 'local' investment portion has not been utilised.

A further change, with respect to investment policy in recent years has been to allow the Board to have a more diversified portfolio. Since 1960, the Board has been allowed to purchase, in addition to sterling and Commonwealth Government securities, securities guaranteed by international monetary institutions, and non-sterling securities maturing within five years, issued by any government other than the Participating Governments. Generally a more diversified portfolio would tend to minimise losses due to changes in the market values of securities.

8. See P.A. Wilson, "Money in Malaya," *Malayan Economic Review*, Vol. II, No. 2, October 1957, p. 54.
9. *Report of the Commissioners of Currency, Malaya and British Borneo, 1960*, Singapore, 1961, p. 3.
10. Bank Negara Tanah Melayu, *Annual Report and Statement of Accounts, 1960*, Kuala Lumpur, 1961, p. 4.

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The Board earns an income from its investments and from commissions charged for the issue and redemption of currency. This is paid into a Currency Fund Income Account and against it are charged all expenditures incurred in connection with the administration of the Currency Board. Further, one per cent of the value of the Currency Fund is transferred annually from the Income Account to that of the Currency Fund, and the balance is paid into a Currency Surplus Fund which is distributed to the Participating Governments in the following proportions: Malaysia 74 per cent, Singapore 18.3 per cent and Brunei 7.7 per cent. The percentage share is based on the estimated currency circulation in each area.

The Currency Board system envisages a minimum of 100 per cent reserves against currency in circulation. The value of the Fund is calculated on the basis of valuing investments and other assets at current market prices. From these is deducted an allowance for the cost of realisation of assets and depreciation. The value of the Fund in 1965 was $1,635,831,056.43 or 108.87 per cent[11] of the face value of currency notes and coin in circulation. The Fund is kept above 100 per cent by the annual one per cent appropriation. This appropriation may be stopped when the value of the assets of the Currency Fund is 110 per cent of the face value of the notes and coins in circulation.[12]

If at any time the cost of administering the Currency Board is greater than the income from its operations, the deficiency must be made up by the Participating Governments, in the same porportion as the profit distribution. It must be emphasised that Participating Governments *guarantee* the Currency Fund which is required by law to be at all times sufficient to meet legal demands upon the Board for the conversion of Malayan dollars into sterling.

The provisions and policies discussed above ensure that the currency is backed 100 per cent by external reserves. In effect the reserves are always in excess of 100 per cent.

Thus far we have considered the mechanics of Currency Board operations. Next we shall discuss some of the characteristics of the Currency Board system. They are stable and fixed exchange rates and automatic equilibrium in the balance of payments without any room for monetary management as ordinarily understood.

Stable exchange rates are obtained, as we have seen, by holding reserves that at all times exceed the nominal value of all currency issued and are therefore more than sufficient to meet demands for currency redemption. There is no doubt that stable exchange rates are useful in promoting trade and investment in the area. Not only do stable exchange rates encourage forward contracts but also make for wide general acceptance of the currency thereby promoting the trade of the country concerned. Further, full convertibility of the currency into sterling, an internationally accepted currency, is an essential prerequisite for multilateral trade; it allows foreign trade to be conducted with little exchange control. The development of this area has been, and will be for some

11. *Report of the Board of Commissioners of Currency Malaya and British Borneo, 1965*, Kuala Lumpur, 1966, p. 6.

12. During the post war period there were only two years, 1962 and 1963, when the one per cent appropriation was not made. In these two years, the value of the Fund was 110.15 per cent and 110.03 per cent respectively. See Annual Reports of the Currency Commissioners, 1946–1965.

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time in the future, dependent on international trade and investment, and the Currency Board arrangements have provided a considerable advantage to this area in this particular connection.

Equilibrium in the balance of payments is brought about automatically under the Currency Board arrangements. Thus it is often pointed out that the sterling exchange standard makes it impossible for a balance of payments problem of the usual sort to arise; so long as Malayan dollars are available and freely convertible into sterling, there is always a certain amount of foreign exchange (*i.e.* sterling) available.[13]

For us the problem becomes one of an excess or shortage of domestic liquidity. For example, when imports and other payments exceed exports and other receipts, there is a deficit in the balance of payments. This deficit is paid for in sterling, by converting Malayan dollars into sterling. The result of this is a contraction in the supply of money, both in terms of the note issue and demand deposits which also contract because of a decrease in local loans and advances; money incomes in the Malayan Currency Area contract; expenditures of households and businesses both on domestic and foreign goods are reduced and ultimately a point is reached when imports and other payments are no longer greater than exports and other receipts; the deficit is corrected. In the process, of course, incomes and employment have contracted.[14] Thus the effects of changes in the balance of payments are amplified domestically.

Thus while balance of payments problems are precluded, the economy is subjected to instability, for it is not possible to exercise any discretionary control on the money supply. The Malayan Currency Area is well known for its dependence on primary production and trade, and the instability associated with these is probably exaggerated by the monetary system. For, here the money supply can be changed primarily in response to changes in the external payments position. Or, any expansion in the monetary circulation is generally predictated by an export surplus. It might be argued that at a time when export earnings are low, economic activity elsewhere in the area should be stimulated by expanding the supply of money, and to reduce the quantity of money at such a time would check production and employment. Yet deflation sets in simply because the balance of payments is in deficit.

Although the Currency Board system precludes monetary policy,[15] some measure of stability may be introduced by moving the sterling balances accumulated by the governments between banks in London and the Currency Area.[16] In this way the cash base of the commercial banks may be altered and

13. Sterling is always available even to meet expenditure from hoards.
14. The opposite holds true when the balance of payments is in surplus.
15. Some of the instability may, of course, be reduced through the use of fiscal measures.
16. Similarly the cash base of commercial banks may be altered by moving the government's deposit balances between commercial banks and the Central Bank domestically. An effect similar to that of open market operations may be achieved if the government holds balances with both the central bank and commercial banks. Payments into and out of them could be regulated to influence the commercial bank balances with the central bank. For example, in order to reduce the cash reserves of commercial banks the government could finance its current expenditures rather more from commercial banks than from the central bank. Similarly it could credit its revenue receipts rather more into its account with the central bank and rather less with the commercial banks. The value of such a technique presupposes that the government's

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thus theoretically also the money supply. Whether this will in fact happen depends on two factors: the size of the sterling balances and the extent to which banks are sensitive to changes in their liquidity positions.

Finally, the one hundred per cent backing of the currency by sterling has been considered to be burdensome, since it seems to have frozen a large volume of resources which could otherwise have been used for economic development.[17] Probably a part of the 'frozen' resources could have been used for domestic investment as opposed to being invested in sterling securities. But the important point would be to determine whether the foreign exchange could have been better spent, at least in earlier time periods.

Probably some additional cost was imposed on the economy by the use of Currency Board arrangements, but it cannot be denied that such a system by providing monetary stability enhanced the ability of the Participating Governments to borrow overseas. Further the lack of discretionary power over currency supply has prevented that supply from becoming excessive. This is an extremely useful safeguard.

However, it must also be recognised that the structure of this Currency Area is undergoing some change; these economies are not as much externally oriented as they used to be. As the Area develops and becomes more economically diversified the lack of discretionary control over money supply inherent in the existing system becomes more undesirable. There would however, be difficulties in the use of monetary policy in this Area, because of the Area's dependence on primary production and trade, the relatively underdeveloped nature of the money market and the importance of the foreign banks. This does not mean that monetary policy methods could not be developed to suit the Area's peculiar needs.

II. Central Bank And Commercial Banks

In the first part of this section, the general objectives and powers of the Central Bank are briefly reviewed. Other financial institutions may be classified in a variety of ways. However it is analytically convenient to classify them into deposit creating institutions, the commercial banks, and non-bank financial institutions. The last group of financial institutions is not treated specifically owing largely to a lack of systematic data. They belong to the money and capital markets; these markets are included in the section on the Central Bank, since it has been instrumental in their development.

The Central Bank

The Central Bank has a short history; it was established only in 1959, initially having jurisdiction over the Federation of Malaya and which was later extended to the rest of Malaysia. The Bank is endowed with statutory powers common to many western central banks.[18] Its twin goals are to promote mone-

current receipts and expenditures are of a sufficiently large magnitude. See Milton Friedman, *A Programme for Monetary Stability*, New York, Fordham University Press, 1961, pp. 55-56.

17. The 1960 Currency Agreement, referred to above, made allowance for a $300 million fiduciary issue, thus making it possible to expand the monetary circulation without the necessity of having sterling deposits.
18. For details see, *Central Bank of Malaya Ordinance 1958*, No. 61 of 1958.

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tary stability and a sound financial structure in the country, by influencing both the cost and availability of credit. But the Bank has no direct control over the currency supply since it has not yet assumed its powers as the note-issuing authority. At the time of its inception it was felt that "*. . . it would be unwise for the Federation to issue its own currency immediately thus possibly precipitating an irrevocable severance of monetary relationships with Singapore and the Borneo territories.*"[19]

The Bank's own resources comprise mainly deposits of the government and the commercial banks and are in themselves fairly meagre; it does not have access to the assets backing the note issue. In spite of this limitation the Bank has become an extremely effective institution in a very short space of time.

At the same time as the legislation for the Central Bank was enacted, the Banking Ordinance, 1958 was passed; it provided for the licensing and regulation of commercial banking in the Federation of Malaya.[20] This was an important piece of legislation; prior to that, banks were licensed under the provisions of the Companies Ordinance, 1940 which did not attempt to *regulate* the activities of commercial banks. They had operated virtually free from any governmental intervention apart from certain aspects of exchange control against the non-sterling area.

The Central Bank has a wide range of powers, both regulatory and supervisory in nature, which allows it to 'intervene' in the activities of the commercial banks. These changes are now reviewed briefly.

Since demand deposits are a part of money supply and commercial banks are the deposit-creating institutions, it follows that if a central bank wants to control the supply of money it must have powers to control the lending policies of commercial banks. The Malaysian Central Bank is therefore empowered to stipulate reserve and liquidity requirements, local assets ratios, interest rates and the direction of bank credit. In addition it is also endowed with powers to regulate interest rates charged by non-bank financial institutions, in order that it may exercise effective control over the operations of these institutions.

To begin with, the Central Bank has imposed minimum statutory reserve and liquidity requirements, amounting to four per cent and 25 per cent of deposit liabilities respectively. It is interesting to consider the type of assets which a bank may hold for the purpose of calculating the liquidity ratio or secondary reserves. Assets allowed were some foreign liquid assets, Treasury Bills and other local liquid assets, and Government securities with maturities longer than three months, subject to the last being limited to five per cent of deposit liabilities.[21] Since February 1965 a new liquidity ratio of 20 per cent was introduced and now housing loans to individuals and approved housing institutions subject to a maximum of ten per cent of saving deposits,[22] may be included in the computa-

19. Bank Negara Tanah Melayu, *Annual Report and Statement of Accounts, 1959*, Kuala Lumpur, 1960, p. 4.
20. This ordinance together with the central bank ordinance was amended and extended in 1965 to cover the larger federation of Malaysia, which then included Singapore,
21. Bank Negara Malaysia, *Annual Report and Statement of Accounts, 1965*, Kuala Lumpur. 1966. p. 3.
22. *Loc. cit.* The Bank has varied the statutory reserve requirement from 4 per cent to 3½ per cent since February 1965.

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tion of this ratio. All foreign liquid assets are now excluded from its computation while a minimum ten per cent of local assets is prescribed. The type of assets that are allowed are those considered desirable by the Bank from the standpoint of protecting depositors' funds as well as encouraging bank lending in certain activities. At the same time it serves to widen the market for local liquid securities as well as to influence the credit situation. As a result of this liquidity requirement, the asset structure of banks in Malaysia and Singapore[23] has undergone some changes. For example, bank holdings of local liquid assets, as opposed to foreign liquid assets have increased substantially, while there has been a reduction in the net foreign assets of the banks.[24]

Statutory provision has also been made for the operation of a "local assets" ratio, by which banks may be required to hold a prescribed portion or their deposit liabilities in approved assets within the Federation.

One other function of the Bank is to "influence the credit situation to the advantage of the Federation". Before 1959, the Malayan Exchange Banks' Association in consultation with the government established minimum rates of interest on advances that their members could charge. With the establishment of the Bank, the Malayan Exchange Banks' Association agreed to consult with it in respect of rates on advances.

The Bank also decided to impose maximum interest rates on deposits in order to prevent excessive and wasteful competition for deposits and a distortion of other rates, especially rates on Treasury Bills and Treasury Deposit Receipts. Consequently from October 1st 1959 maximum rates were imposed (Table 2).

Generally interest rates in Malaya[25] have tended to move in the same direction as the London rates due to a number of factors: Malaya is on the Sterling Exchange Standard; most banks in the Currency Area have close connections with the London money market and there is free movement of funds between Malaya and the rest of the sterling area. These factors still obtain, yet, the Central Bank has attempted to pursue a fairly independent interest rate policy in order first, to keep interest rates appropriate to domestic needs, and second, to align them with international trends. There have been since 1959 a number of occasions when Malayan rates were not changed in response to changes in the United Kingdom rates, for example in January, October and December 1960, and October and November 1961. Today the minimum advance rates are roughly in line with the United Kingdom rates while "rates of interest on deposits (and short term government securities) are a shade higher than comparable rates (plus exchange)"[26]. This is necessary if the economy is to keep its investible funds. Changing the cost of credit, as a policy tool is likely to be of some importance here especially in the absence of exchange control (apart from that against the non-sterling area).

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23. Singapore commercial banks also observe the same cash and liquidity requirements.
24. Bank Negara Malaysia, *Annual Report and Statement of Accounts, 1965*, p. 4.
25. Interest rates in Singapore have been the same as those in the states of Malaya; those in Sabah and Sarawak are generally higher.
26. D. McKenna, "Financial Developments since Independence", in Silcock and Fisk (ed). *The Political Economy of Independent Malaya*, Singapore, Eastern Universities Press, 1963, p. 202.

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TABLE 2

INTEREST RATES IN THE STATES OF MALAYA (% p.a.)

I. Commercial Banks maximum fixed deposit rates:	1 mth.	3 mths.	6 mths.	9 mths.	12 mths.	Saving deposits
effective 1.10.59	-	3-3½	3-3½	3½-3¾	3½-3¾	2½
effective 29.6.60	-	4	4	4	4	2½
effective 28.7.61	-	5	5	5	5	2½
effective 2.2.62	-	4½	4½	4½	4½	2½
effective 30.8.62	-	4	4	4	4	2½
effective 1.1.64	2	4	4	4	4	2½
effective 25.11.64	2½	5	5	5	5	2½
effective 1.8.65	2½	5	5	5	5	3
II. Treasury bills-discount rates:	3 mths.		6 mths.	9 mths.	12 mths.	
effective 29.7.59	3		3	3¼	3¼	
effective 1.7.60	4		4	4	4	
effective 10.8.61	5		5	5	5	
effective 15.2.62	4½		4½	4½	4½	
effective 30.8.62	4		4	4	4	
effective 25.11.64	5		5	5	5	
III. Commercial Banks' minimum advance rates:	Effection from					
	1.12.58	1.7.60	28.7.61	2.2.62	30.8.62	25.9.64
Advances against Government and/ or municipal securities	5	6	7	6½	6¼	7
Clean Advances	5	6	7	6½	6¼	7
Advances against commodities	5	6	7	6½	6¼	7
Advances against stocks and shares	5½	6½	7½	7	6¾	8
Advances against property	6	7	8	7½	7¼	8

Source: Bank Negara Malaysia, *Annual Report and Statement of Accounts*, 1959-65.

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It is generally recognised that an organised and developed money market is necessary in order that Central Bank policies especially of the quantitative kind are to be significantly operative. What is a well developed money market? In so far as the institutional arrangements[27] are concerned, there must exist an effective central bank to serve as the ultimate source of liquidity and a well developed commercial banking system as the main suppliers and demanders of loanable funds. As in the case of other markets there should exist a sufficient demand for the type of services that a money market can supply. There must also exist a fairly large supply of temporarily idle funds which are seeking short term investment opportunities. At the same time there must be a demand for these funds, either from commercial banks in order to adjust their liquidity positions, or from the government when it chooses to finance its activities, by issuing short term securities.

Do these institutional arrangements exist in this Currency Area? The Central Bank is still not the lender of last resort; however, a well developed banking system exists and banking habits are well developed especially in the urban areas. Today the money market is still relatively narrow; nonetheless its scope has been widened since the establishment of the Central Bank in 1959. It need hardly be emphasised that such widening has been carried out in spite of the limited resources available to the Central Bank.

The Bank has utilised the 3-,6-,9 and 12-month Treasury Bill as the basis for the money market activities. Malayan Treasury Bills are available on *tap* to approved investors while Singapore Treasury Bills are available on *tap* to statutory bodies and on *tender* to other institutions. The Bank has both encouraged the commercial banks to hold Treasury Bills as well as offered rediscounting facilities (to both commercial banks and other institutions) at a rate $\frac{1}{8}$th per cent above the Treasury Bill rate current at the time of rediscounting. Between 1961 and 1965, the volume of transactions in Treasury Bills has expanded substantially (Table 3). . . . As a result of increased activity in this security, the statutory ceiling on the issue of Treasury Bills has been raised from $150 million to $300 million in 1964; subsequently it has been raised to $600 million in 1965.

The market has grown primarily through increased holdings of this liquid asset[28] by the commercial banks in Malaysia and Singapore, in order to satisfy the new liquidity requirements. One result of increased activity in Treasury Bills has been a reduction in the holding of foreign assets by commercial banks. The other has been a reduction in the drawing down of government's accumulated overseas assets since budgetary deficits may now be financed locally.[29]

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27. Alternately the stage of development of a money market may be considered in terms of its adequacy in meeting current demands made upon it. In this connection the Singapore money market is described in the following manner: ". . . it is institutionally rudimentary but functionally adequate given the present orientation of the banks towards financing international trade".

    D. Williams, "Money Markets of South-East Asia", *The Banker*, July 1963, p. 485.
28. The market for other, longer-dated government securities has also expanded in recent years.
29. Bank Negara Malaysia, *Annual Report and Statement of Accounts, 1965*, p. 34.

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TABLE 3

CENTRAL BANK OPERATIONS IN TREASURY BILLS, 1961-1965

Period (end of)	Malayan Treasury Bills ($ million)						Singapore Treasury Bills ($ million)	
	Total Redis-counted	Discounted for		Bank's sale of T.B. from own portfolio to		Bank's purchases of Treasury Bills	Pur-chases & redis-counts	Sales
		Com-mercial banks	Other institu-tions	Com-mercial banks	Other institu-tions			
1961	20.9	17.1	3.8	50.3	3.0	55.5	-	-
1962	7.2	7.2	-	29.0	-	61.0	-	-
1963	43.8	41.84	1.96	71.75	9.01	93.94	-	-
1964	132.2	97.2	35.0	90.9	63.5	97.6	23.3	17.6
1965	285.9	171.3	114.6	121.5	112.2	139.5	58.1	60.8

Source: Bank Negara Malaysia, *Annual Reports and Statements of Accounts, 1961-1965.*

The expansion of the Treasury Bill market has been one change in the money market; another has been the establishment of a discount house towards the end of 1963. This institution accepts deposits paying interest between $2\frac{1}{2}$ and $5\frac{1}{4}$ per cent,[30] and invests funds in Treasury Bills and short dated government securities. It is subject to supervision by the Central Bank which extends to it rediscounting and lender of last resort facilities. Its services are increasingly being used by commercial banks and other institutional investors The establishment of a discount house means further institutional specialisation in the money market.

Apart from actively encouraging the development of a money market, which is a market for short term funds, the Bank has also taken several measures as manager of the public debt and government's financial adviser, to set up an organised capital market, the source of funds for industry and long term government borrowing. Initially the development of a market for long term government securities was handicapped by a lack of marketable securities and an organised stock exchange. There was little scope for trading since the bulk of the funded debt of the government was 'captive', being held by the Employees' Provident Fund and a few other institutional investors till maturity. In order to make the market for such securities more attractive, the Central Bank suggested the following measures which have now been implemented: that shorter maturing securities (that is maturing in 2 and 5 years) be introduced; that transactions in these securities be exempt from stamp duty; that the government accept these securities as payment for estate duty; that facilities be provided for advance subscriptions; and that higher rates of commission be payable to brokers.[31] As a result of the above there is increased participation of commercial banks, insurance companies and other financial institutions in securities.[32]

30. *Ibid.*, p. 44.
31. Bank Negara Tanah Melayu, *Annual Report and Statement of Accounts, 1960*, p. 17.
32. In recent years 3 unit trusts have been established; these are a means of mobilising and utilising the funds of small investors.

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A stock exchange was established in Kuala Lumpur in 1961, under the Bank's guidance and encouragement. In order to increase the turnover on the stock exchange, the Bank suggested the establishment of branch share registers in Malaya of "companies incorporated in the United Kingdom whose main business is in the Federation of Malaya, and whose shares are actually traded locally"[33]. This measure has now been implemented.

In conclusion, in spite of the fact that the Central Bank has been without control over the note issue, it has been able to bring about a number of changes in the monetary and credit situation. Apart from the measures discussed above, the Bank has also acted as a banker to the government, managed the local funded debt of the Central Government, administered the Exchange Control Ordinance 1953 as well as serviced the requirements of commercial banks.

Commercial Bank

Commercial banking in Malaysia is very closely related to that in Singapore due to a number of factors: the two areas have shared a common monetary system, hence movement of funds between Singapore and Malaysia has been free; many of the banks operating in one country have offices in the other. Therefore this discussion makes no distinction between banks of these two areas. It is the purpose of this section to briefly review recent developments in the operations of commercial banks, bearing in mind the changes (discussed in the previous section) brought about in the banking situation by the Central Bank.

Today in terms of numbers, the local banks predominate; for example, at the end of 1965 out of a total of 44 banks in Malaysia and Singapore, 23 were locally incorporated, 13 in Malaysia and ten in Singapore.[34] Considered in terms of resources however, the foreign banks are more important; they accounted for about 94.5 per cent of the total resources of the banking system at the end of 1965.[35]

In so far as recent changes in the money supply are concerned these changes have been more internal in origin (Table 4). In particular it is changes in bank credit to the private sector which have been a major cause of change in the supply rather than changes in the external payments position.

At the end of 1965 total deposits of commercial banks stood at $2,966 million, approximately $310 million above their level at the end of 1964. The growth in total deposits may be attributed to rising levels of income, growth in banking facilities and banking habits. In the period 1960-1965 demand deposits increased moderately; but the growth in fixed and savings deposits has been quite dramatic. (Table 5). The large and continuing increase in interest bearing deposits reflects probably the preference of the public for these types of deposits. This development has probably been helped to a certain extent by the higher rates of interest payable on fixed deposits since late 1964 and on savings deposits since August 1965.

33. Bank Negara Tanah Melayu, *Annual Report and Statement of Accounts, 1961*, Kuala Lumpur, 1962, p. 21.

34. Bank Negara Malaysia, *Annual Report and Statement of Accounts, 1965*, p. 37. This should be contrasted with the situation in 1959 when there were only 4 local banks in Malaya. This expansion has been primarily due to the policy of the Central Bank.

35. *Ibid.*, p. 38. The foreign banks however, accounted for 48.8 per cent of total deposits.

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TABLE 4

FACTORS AFFECTING MONEY SUPPLY
($ Million)

	Change 1963/1964		Change 1964/1965	
Gold and foreign exchange/ reserves (net)				
Currency Board*	+ 73.5		+ 125	
Central Bank	+ 70.7		+ 42	
Commercial Banks	—153.8	— 9.6	— 53	+ 114
Government debt held by †				
Central Bank	+ 8.1		+ 27	
Commercial Banks	+ 60.5	+ 68.6	+ 195	+ 222
Commercial bank claims on private sector ‡				
Loans and advances including local trade bills	+ 192.8		+ 152	
Private securities	+ 9.2	+ 202.0	+ 2	+ 154
Less Increase in Government deposits at †				
Central Bank	+ 31.5		+ 42	
Commercial Banks	+ 21.0	— 52.5	+ 38	— 80
Miscellaneous items including asset revaluations		+ 274		— 57
		+ 235.9		+ 353
Less Increase in fixed and savings deposits of private sector		—151.1		—208
CHANGE IN MONEY SUPPLY		+ 84.8		+ 145

Notes: * Based on Malaysia's and Singapore's share of the assets of the Currency Board.
† Central and State Governments only.
‡ Includes statutory authorities and local governments.

Source: Bank Negara Malaysia, *Annual Report and Statement of Accounts, 1964 and 1965.*

TABLE 5

MALAYSIA AND SINGAPORE, DEPOSIT GROWTH, 1960-1965

Period (end of)	Type of Deposit								Total
	Demand		Fixed		Saving		Other		
	$ m	%	$ m	%	$ m	%	$ m	%	$ m
1960	914	47	704	37	274	14	32	2	1,924
1961	917	44	822	39	303	15	37	2	2,079
1962	994	44	900	40	350	15	31	1	2,275
1963	1,070	43	980	39	412	17	28	1	2,490
1964	1,083	41	1,084	41	466	17	23	1	2,656
1965	1,160	39	1,276	43	508	17	22	1	2,966

Source: Bank Negara Malaysia, *Annual Report and Statement of Accounts, 1965.*

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TABLE 6

MALAYSIA AND SINGAPORE: SOURCES AND USES OF COMMERCIAL BANK FUNDS
($ Millions)

	Period (end of)					Annual Change				
	1961	1962	1963	1964	1965	1961	1962	1963	1964	1965
SOURCES OF FUNDS										
Local:										
Capital and reserves (local banks only)	112	128	142	166	186	+13	+16	+14	+24	+20
Deposits of public sector	169	169	132	148	186	+8	—	—37	+16	+38
Deposits of private sector	1,910	2,106	2,358	2,508	2,780	+147	+196	+252	+150	+272
Others (net)	102	124	108	72	103	—10	+22	—16	—36	+31
	2,293	2,527	2,740	2,894	3,255	+158	+234	+213	+154	+361
Foreign:										
Net inter-bank funds	—	—	—	67	111	—	—	—	+67	+44
Others (net)	7	—	4	12	12	—	—7	+4	+8	—
	7	—	4	79	123	—	—7	+4	+75	+44
TOTAL	2,300	2,527	2,744	2,973	3,378	+158	+227	+217	+229	+405
USES OF FUNDS										
Local:										
Cash in hand and with Central Bank	174	179	191	194	237	+11	+5	+12	+3	+43
Investment in the public sector	163	187	238	292	487	+10	+24	+51	+54	+195
Investment in the private sector	27	32	45	61	62	+1	+5	+13	+16	+1
Loans/advances and local trade bills	1,465	1,648	1,847	2,040	2,193	+230	+183	+199	+193	+153
Fixed assets	110	117	130	171	193	+15	+7	+13	+41	+22
	1,939	2,163	2,451	2,758	3,172	+267	+224	+288	+307	+414
Foreign:										
Net inter-bank funds	157	165	86	—	—	—84	+8	—79	—86	[illegible]
Trade bills	86	84	97	111	113	—3	—2	+13	+14	[illegible]
Investments	118	115	110	104	93	—22	—3	—5	—6	—11
	361	364	293	215	206	—109	+3	—71	—78	—9
TOTAL	2,300	2,527	2,744	2,973	3,378	+158	+227	+217	+229	+405

Note: Public sector refers to Central and State Governments only. Private sector includes statutory authorities and local governments.

Source: Bank Negara Malaysia, *Annual Report and Statement of Accounts, 1965.*

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The funds obtained from an expanding supply of deposits over the last five years enabled commercial banks to make substantial additions to their holdings of earning assets. The total resources of commercial banks in Malaysia and Singapore amounted to $3,378 million at the end of 1965, an increase of approximately 14 per cent over 1964.

The data presented in Table 6 show the sources and uses of commercial bank funds for the period 1961-65. With respect to the sources of funds, two items are significant: the expansion of private sector deposits, a local source of funds and the growth of net inter-bank funds. The latter in effect represents a net inflow of inter-bank funds from overseas. In other words there has been a reduction in the foreign asset holdings of the commercial banks. The reasons for this have been noted in the preceding section.

With respect to the uses of funds, the significant growth items are bank investments in the public and private sectors and loans and advances. The principal reason for the growth of the former is the introduction of new liquidity requirements which increased bank investments in securities of the Malaysian and Singapore Governments, chiefly Treasury Bills.

Total loans and advances, including trade bills also show substantial growth. It is more interesting to disaggregate loans and advances in order to observe the pattern and direction of bank lending. This is shown in Table 7.

TABLE 7

MALAYSIA AND SINGAPORE: PATTERN OF LOANS AND ADVANCES OF COMMERCIAL BANK, 1963-1965

Period (end of) / Purpose	1963		1964		1965	
	$ m	%	$ m	%	$ m	%
Agriculture	114.2	5.9	126.4	5.9	108.5	4.7
Mining & Quarrying	42.2	2.2	34.3	1.6	37.5	1.6
Manufacturing	186.8	9.6	282.8	13.1	331.4	14.4
Construction	110.2	5.7	140.4	6.5	163.7	7.1
Commerce	1,002.4	51.5	999.2	46.5	1,114.1	48.3
Professional & private individuals	306.2	15.7	344.1	16.0	331.6	14.4
Others	182.2	9.4	224.0	10.4	219.3	9.5
Total	1,944.2	100.0	2,151.2	100.0	2,306.1	100.0

Source: Bank Negara Malaysia, *Annual Report and Statement of Accounts, 1965*

As indicated by Table 7, almost one half of total loans and advances goes into commerce[36] which consists of import, export, wholesale and retail trade. This is to be expected since both the Malaysian and Singapore economies are heavily oriented towards international trade. Over the years 1963-65, there has been a small but perceptible increase in bank lending to manufacturing activities. This reflects increasing bank participation in industry as opposed to trade. In general however, the pattern of bank lending has largely remained the same.

36. The various types of commercial credits in use are described in detail in D. Williams, "Commercial Banking in the Far East", *The Banker*, June 1963.

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As the economies of Malaysia and Singapore undergo some structural changes in the future, the pattern of bank lending and investments will also undergo some change. In fact some changes are noticeable especially if the current situation is compared with that of the early post-war period. For instance, there has been a shift of bank resources into local financing and a relative decline in the importance of foreign banks in the overall banking structure. The growth in bank credit to the private sector represents a greater local involvement of the banking system. And finally the rapid expansion of branch banking (especially of the local banks) in recent years, reflects in part a deliberate policy of the Central Bank which desires an extension of banking services throughout the economy as opposed to its concentration in the major urban areas.

III. The Future

At present Malaysia and Singapore are still fully integrated in the field of currency, central banking and commercial banking. The parting of ways will begin in June 1967 when the two countries issue separate currencies. Proposals on these two currencies are briefly indicated here.

In so far as Malaysia is concerned, Bank Negara Malaysia will become the currency-issuing authority, thus replacing the Currency Board. The parity of the Malaysian dollar will be maintained with sterling at the rate of two shillings and four pence, and the currency will continue to be backed mainly by sterling securities.[37] The major difference will be that changes in the money supply will no longer be automatic; the Central Bank will attempt to exercise some measure of discretionary control over the money supply.

Singapore is to establish its own Currency Board; the new Singapore dollar will continue to be backed 100 per cent by foreign reserves and will remain fully convertible at the rate of two shillings and four pence sterling.[38]

Both the new Malaysian and Singapore dollars are expressed in terms of sterling. It does not follow from this that currency reserves of both these areas whether held by the Central Bank or the Currency Board must be only in sterling securities. Indeed it would be prudent to hold a diversified securities portfolio. Further in the event of sterling devaluation, a currency expressed in sterling need not be automatically devalued. Whether it is devalued would depend on the decision of the monetary authority, and this decision in turn would depend on the pattern of trade of the country concerned.

37. The Central Bank Ordinance 1958, requires the Bank to hold a reserve of external assets composed of the following: gold coin and bullion; notes, coin and bank balances, money at call in the United Kingdom and in other places approved by the Minister; Treasury Bills of the U.K. and other governments not exceeding 93 days; bills of exchange with at least two good signatures drawn and payable at any place in the U.K. and other places, with maturities not exceeding three months; securities of U.K. and other governments, including international financial institutions maturing in less than five years and not exceeding 30 per cent of the reserve specified. The aggregate value of external assets should not be less than (a) such percentage of notes and coin as the Minister may declare to correspond to the minimum reserves of the Currency Board, and (b) 35 per cent of deposit liabilities of the Bank.

38. The International Monetary Fund requires all currencies of member nations to be expressed in terms of gold. Thus the new Singapore dollar expressed in terms of gold is equivalent to 0.290299 grammes of fine gold. The Malaysian dollar will also have the same par value in gold.

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THE IMPLICATIONS OF SEPARATE CURRENCIES ON PLANNING FOR ECONOMIC DEVELOPMENT IN MALAYSIA AND SINGAPORE

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1. Economy of Malaysia

The Malaysian economy is mainly an export economy; its total exports amount to about half of its national income. It can also be termed an agricultural and mining economy for the products of these two sectors account for a major proportion of its national income and domestic exports.

Table 1

West Malaysia: Gross Domestic Product By Sector Of Origin, 1960, 1965 and 1970 (in current prices)

Sectors	1960 $ millions	% of Total	1965* $ millions	% of Total	1970 (Target) $ millions	% of Total
Agriculture, forestry and fishing	1,976	38	2,005	29	2,435	28
Rubber	*1,233*	*24*	*1,015*	*15*	*1,115*	*13*
Agriculture and livestock	*568*	*11*	*715*	*10*	*910*	*11*
Forestry	*85*	*2*	*120*	*2*	*205*	*2*
Fishing	*90*	*2*	*155*	*2*	*210*	*2*
Mining and quarrying	306	6	600	9	475	6
Manufacturing	453	9	665	10	1,070	13
Construction	158	3	360	5	530	6
Electricity, Water and Sanitary Services	70	1	125	2	200	2
Ownerships of Dwellings	245	5	305	5	370	4
Wholesale and retail trade	817	16	1,100	16	1,370	[illegible]
Public administration and defence	339	6	425	6	515	6
Other Services	856	16	1,230	18	1,645	19
Gross domestic product at factor cost	5,220	100	6,815	100	8,615	100

Source: Malaysia, *First Malaysia Plan 1966-1970*, Kuala Lumpur. 1965

* Preliminary estimate

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Among the agricultural products rubber plays a dominant role although this role will decline in importance as the economy becomes more diversified in the future. But so far rubber has been the mainstay of the nation's economy. In 1960, its contribution amounted to almost one quarter of the national income (GDP) generated in West Malaysia, but this share has fallen to fifteen per cent in 1965. (Table 1)[1].

The rubber industry has played a crucial role in providing employment in the economy of West Malaysia.[2] It has also been a major source of revenue for the government.

What will be the future contribution of rubber to the Malaysian economy?

TABLE 2

MALAYSIAN RUBBER EXPORTS, 1960-65 AND 1970

Years	1960	1961	1962	1963	1964	1965	1970
Volume ('000 tons)	838.8	861.1	857.2	907.5	922.1	941	1,286
Price (cts./lb.)	106.5	81.2	76.9	72.6	67.6	69	55
Value ($ millions)	2,000.6	1,566.9	1,476.9	1,475.7	1,395.9	1,454	1,584

Source: Malaysia, *First Malaysia Plan, 1966-70,* Kuala Lumpur, 1965.

Since 1960 the price of rubber has shown a downward trend and as a result the total value of rubber exports has fallen in 1964 to about 70 per cent of the 1960 figure in spite of an annual growth rate of output of 2.3 per cent over the years (Table 2). The export value of rubber was higher in 1965 because of comparatively higher prices.

Rubber price has fallen since 1966 and it is now around 57 cents per pound*. It is estimated that the price of rubber is likely to fall further while production is estimated to increase to over a million and a quarter tons by 1970. A fall in price of one cent per pound in rubber is estimated to reduce Malaysian export earnings by 25 million dollars a year. So by 1970 despite the increase in output at an annual growth rate of 6 per cent per year, the total value of rubber exports is expected to increase by only 1.7 per cent per year.

Tin, Malaysia's second largest export, expanded its export value during the years 1960 to 1965 thanks to a favourable increase in prices (Table 3). In recent years the volume of exports of tin has fallen owing to the gradual depletion of known resources. During the period 1966 to 1970, it is expected that the total value of exports would fall by 4 per cent per annum as a result of declining production of tin. This fall would be greater if the price of tin also falls. Since the end of 1964, the price of tin moved steadily downward until at the beginning of 1967, it levelled off at around 10,285 dollars a ton.

1. If the Gross Domestic product for 1965 were calculated at constant 1960 prices, the share of rubber would be 21 per cent.
2. In 1957, total employment in the rubber industry accounted for 24 per cent of the total employed in the Federation of Malaya.

* in March, 1967

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TABLE 3
MALAYSIAN EXPORT OF TIN, 1960-65 AND 1970

Years	1960	1961	1962	1963	1964	1965	1970
Volume ('000 tons)	76.6	74.2	81.4	84.6	71.1	70	57
Price ($ ton)	6,623	7,414	7,571	7,539	10,166	11,760	11,760
Value ($ millions)	507.3	550.1	616.3	637.8	722.8	823	670

Source: Malaysia, *First Malaysia Plan, 1966-70,* Kuala Lumpur, 1965

Export performance of other products of Malaysia has not been particularly favourable during the five years from 1960 to 1965. As a result the total value of merchandise exports of Malaysia has fallen between 1960 and 1964. Because of the favourable prices in 1965 for Malaysian exports, export value recovered to the position reached in 1960 (Table 4).

TABLE 4
TOTAL MALAYSIAN EXPORTS 1960-65 AND 1970 ($ millions)

Years	1960	1961	1962	1963	1964	1965	1970
Total Merchandise Exports	3,622	3,212	3,236	3,301	3,366	3,622	3,790
Service ("invisible") Exports	324	365	390	412	478	493	443
Total Exports	3,946	3,577	3,626	3,713	3,844	4,115	4,233

Source: Malaysia, *First Malaysia Plan 1966-70,* Kuala Lumpur, 1965.

It is estimated that the prospect for further growth in exports in the five years from 1966 to 1970 is not particularly favourable with falling prices for rubber, iron ore, oil palm and coconut products. Therefore the total export receipts are expected to increase by less than $120 million between 1965 and 1970.

The Malaysian economy in the past has depended heavily on the expansion of exports for economic development. But it has been found, of late, that it cannot rely on this "engine of growth" for economic development. Production for domestic use has to provide the stimulus for growth. During the period 1960 to 1965 production for the domestic market grew at a very rapid rate of over 9 per cent per annum. As a result production for domestic use in 1965 amounted to 52 per cent of the total Gross Domestic Product for the whole of Malaysia, while export production was reduced to 48 per cent.

The increase in production for domestic use between 1960 and 1965 was stimulated and encouraged by the rapid increase in both private and public investment. Gross investment in Malaysia increased by 11.5 per cent per annum during the period 1960 to 1965. In 1965, it amounted to $1,715 million accounting for 19 per cent of total gross domestic product for Malaysia as a whole.

The population of Malaysia is increasing at a very rapid rate of 3 per cent per annum and at this rate the labour force of Malaysia would be increasing by

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TABLE 5

POPULATION AND LABOUR FORCE OF MALAYSIA, 1965 AND 1970

(thousands)

	1965	1970	Annual Growth rate (%)
Population			
West Malaysia	8,052	9,334	3.0
Sabah	520	613	3.3
Sarawak	839	963	2.8
Malaysia	9,411	10,910	3.0
Labour Force			
West Malaysia	2,678	3,055	2.7
Sabah	214	250	3.2
Sarawak	334	382	2.7
Malaysia	3,226	3,687	2.7

Source: Malaysia, *First Malaysia Plan, 1966-70*, Kuala Lumpur, 1965.

461,000 during the five years from 1966-70 (Table 5); in West Malaysia, it would be increasing by 377,000. With the rapid increase in population and with labour force increasing by 90,000 persons a year, it is important to raise the level of investment in the various sectors so as to enlarge their capacity to provide employment for the larger numbers coming on to the labour market every year.

If investment and output grow as planned, 377,000 jobs will be created in West Malaysia alone by 1970, and another 80,000 jobs in East Malaysia. If this employment target is reached in West Malaysia, the rate of unemployment will fall from 6.0 in 1965 to 5.2 per cent in 1970 (Table 6). It is expected that some sectors like manufacturing will be expanding rapidly to absorb about 36,000 persons in the five years from 1966 to 1970.

TABLE 6

WEST MALAYSIA EMPLOYMENT BY SECTORS, 1960, 1965 AND 1970

(thousands)

Years	1960	1965	1970
Agriculture, forestry and fishing	1,277	1,388	1,553
Mining and manufacturing	196	234	270
Construction, utilities and transport	150	210	252
Public administration and defence	200	257	312
Other services	351	429	508
Total	2,174	2,518	2,895
Unemployed	138	160	160
Total Labour Force	2,312	2,678	3,055
Unemployment	6.0%	6.0%	5.2%

Source: Malaysia, *First Malaysia Plan, 1966-70*, Kuala Lumpur, 1965.

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In order to provide employment to the larger numbers it is important that investment should increase. Increased investment is also needed to provide higher income levels for the population. The per capita national income in Malaysia is planned to increase from $920 in 1965 to $980 in 1970.

With these objectives in view it is planned to increase the annual investment expenditure to $2,120 million in 1970. Of this total annual investment, the private sector is expected to provide $1,405 million. Such a high rate of annual investment would involve a cumulative total development expenditure of $10,500 million or cumulative total capital formation of $9,730 million of which the private sector investment would by $6,160 million over the five years from 1966 to 1970.

If this huge investment and development programme is to materialise, both consumption and investment goods have to increase at a fairly rapid rate. Those goods which cannot all be produced at home have to be imported from abroad. Imports from abroad are estimated to create a deficit on current account of $470 million in 1970 or a cumulative deficit of $1,686 between 1966 and 1970 (Table 7).

TABLE 7

MALAYSIA: BALANCE OF PAYMENTS, 1965-70 ($ millions)

Year	1965	1970	Cumulative total, 1966-70
Current account			
Goods and services			
Receipts	4,115	4,233	20,581
Payments	3,956	4,724	22,160
Net Position	+159	—491	—1,579
Private Transfers			
Receipts	25	36	161
Payments	225	190	1,035
Net Position	—200	—154	—874
Balance on goods, services and private transfers	—41	—645	—2,453
Government transfers			
Receipts	156	200	900
Payments	82	25	133
Net Position	+74	+175	+767
CURRENT ACCOUNT BALANCE	+33	—470	—1,686
Capital account			
Long-term capital (net)			
Private	+260	+200	+1,000
Public	+107	+250	+1,000
Monetary movements and short-term capital, including errors and omissions	—400	+20	—314
CAPITAL ACCOUNT BALANCE	—33	+470	+1,686

Source: Malaysia, *First Malaysia Plan, 1966-70*, Kuala Lumpur, 1965.

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The private sector is expected to raise most of the capital for investment locally from its own profits (Table 8). A capital inflow of $1,000 million is expected to finance some of the investment in the private sector. Banks are also expected to play an important part in financing local investment expenditures.

TABLE 8

FINANCING OF PRIVATE INVESTMENT, 1966-70
($ millions)

	Cumulative Total
Self-finance and other non-bank financing sources	4,450
Bank lending to private sector	500
Investment finance from domestic sector	4,950
Government transfers and loan to private sector	210
Total domestic financing	5,160
Private long-term capital inflow	1,000
TOTAL PRIVATE INVESTMENT	6,160

Source: Malaysia, *First Malaysia Plan, 1966-70,* Kuala Lumpur, 1965.

TABLE 9

MALAYSIA: CONSOLIDATED PUBLIC SECTOR FINANCE, 1960-65
($ millions)

Year	1960	1961	1962	1963	1964	1965 (preliminary)	Cumulative Total, 1961-65
Government current revenue	1,304	1,356	1,418	1,500	1,574	1,671	7,519
Government recurrent expenditure	973	1,033	1,120	1,253	1,420	1,626	6,452
Government current surplus	331	323	298	247	154	45	1,067
Surplus of public corporations	31	33	33	33	36	49	184
Public sector current surplus	362	356	331	280	190	94	1,251
Development expenditure+	244	401	606	662	661	779	3,109
Overall surplus (+) or deficit (—)	118	—45	—275	—382	—471	—685	—1,858

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TABLE 9 (continued)

Year	1960	1961	1962	1963	1964	1965 (prelim)	Cum. Total 1961-65
Sources of financing—							
Net domestic borrowing‡	196	148	160	236	183	311	1,038
Net foreign borrowing	52	28	51	91	16	119	305
Foreign grants	51	45	28	26	66	90	255
Use of accumulated assets*	—320	—114	†55	†98	†226	†51	†316
Other	—97	—62	—19	—69	—20	114	—56
TOTAL	—118	†45	†275	†382	†471	†685	†1,858

† Includes security capital expenditure.
‡ Includes increase in assets of the Employees Provident Fund.
* denotes accumulation and + denotes draw-down.

Source: Malaysia, *First Malaysia Plan, 1966-70*, Kuala Lumpur, 1965.

The public development expenditure will be financed partly from domestic borrowing and partly from foreign loans and grants. Government surplus available for development expenditure is rather limited in view of the increasing expenditures on education and defence. Between 1960 and 1965, government was able to meet a substantial portion of the development expenditure from its current account surplus which amounted to $1,067 million (Table 9).

Since 1960, this surplus showed a declining trend especially with the sluggish expansion of the export sectors. This slow rate of expansion has increased the overall foreign borrowing and the use of accumulated assets (Table 9).

It is estimated that for the next five years the government current surplus would be only $200 million. Hence, heavy reliance is placed on domestic borrowing and foreign borrowing (Table 10).

TABLE 10
MALAYSIA, ESTIMATED PUBLIC INVESTMENT AND ITS FINANCING, 1966-70
($ millions)

	Cumulative Total
Government surpluses	200
Public authorities surpluses	425
Domestic non-bank borrowing	1,025
Bank credit and government accumulated assets	1,000
Foreign borrowing (net)	1,000
Foreign grants	900
TOTAL	$4,550

Source: Malaysia, *First Malaysia Plan, 1966-70*, Kuala Lumpur, 1965.

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It is also planned to make use of some of the external reserves. The total foreign exchange reserves of Malaysia amounted to $2,760 million in 1965 and it is estimated that these reserves are sufficient to pay for ten months' imports at the 1965 level (Table 11).

TABLE 11

MALAYSIA: GOLD AND FOREIGN EXCHANGE RESERVES ($ millions)

Years	As at December 31		
	1963	1964	1965*
Central Monetary Authorities (net) including IMF gold tranche	1,308	1,357	1,511
Central Government	1,004	819	747
State Governments	95	80	87
Government agencies and public authorities	141	130	123
OFFICIAL (NET)	2,548	2,386	2,468
COMMERCIAL BANKS (NET)	176	176	292
TOTAL NET RESERVES	2,724	2,562	2,760

Source: Bank Negara Malaysia, *Annual Report*, Kuala Lumpur, 1965.
* Preliminary.

Heavy reliance on foreign loans and aid is placed to meet the short fall in investment of the next plan. If this assistance is not forthcoming as expected to the sum of $1,900 for investment in the public sector, serious pressure on the reserves is likely to occur.

The total investment expenditure expected to be financed from bank credit both in the private sector and public sector amounts to over $1,200 million of which financing of the public sector amounts to $700 million. In addition to bank credit,provision has been made in the plan for the government to borrow $1,025 million from the non-banking sources. So long as these expenditures financed from these sources are offset by savings of private persons, it is possible to avoid inflation during the plan period. Any fall in savings, which in a broad sense include savings and current account deposits and holdings of cash, below the sum expected is likely to result in an increase in prices or a fall in reserves.

The trend of development in Malaysia in the past and the planned development envisaged in the next plan show a gradual change from the type of development in the past. Stimulus for earlier development in Malaysia was provided mainly by the growth in exports.

The growth in the value of exports in the past, especially with a favourable swing in the terms of trade, resulted in an increase of liquidity of the banking system, and also of private enterprises. The money supply was thus closely bound up with the state of international trade and balance of payments.

Of late, the crucial role of balance of payments as a factor in money supply has been replaced by other domestic stimuli to the money supply. During the last five years the important factors that have influenced the increase in money supply were the expansion of credit by the banks to the private and the public sector. For instance bank credit increased by $154 million to the private sector

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in 1965 and there was also an increase of $222 million of bank lending to the government in the same year.

The change from the external stimulus to development and growth, provided by the increase of exports, to the present stimulus to production from domestic causes, and the factors contributing to the increase in money supply being internal show that Malaysia is moving from a dependent export economy to an integrated national economy. In such an economy, a central bank has a vital role to play and this role is taken cognizance of in the impending change of the monetary system in Malaysia.

The change from a Currency Board system to a managed currency system in Malaysia is the logical development in the pattern of changes affecting the economy since Merdeka in 1957. These changes made Malaysia less dependent on exports and this trend is expected to continue in the future.

Despite the decreasing dependence on export-oriented stimuli for growth and development, Malaysia will have to depend increasingly on foreign aid and assistance for its development. This would increase the external debt of Malaysia which stands in 1965 at $509.8 million (Table 12).

TABLE 12
PUBLIC DEBT OF MALAYSIA
($ millions)

	1964	1965
Treasury Bills	221.5	449.8
Treasury deposit receipts	30.2	0.1
Other Government Securities		
2 - year	53.7	32.1
3 - year	—	13.0
5 - year	98.0	97.0
Long-term	1,365.1	1,579.1
National Defence Bonds	—	10.2
Advance Subscriptions	10.7	1.9
DOMESTIC DEBT	1,779.2	2,183.2
Sterling Loans	187.2	187.2
Brunei Loans	140.0	140.0
U.K. War Damage Compensation Loan	51.2	46.4
U.K. Export Credits Guarantee Department Loan	12.7	11.1
U.S. Development Loan Fund Loans	45.1	45.2
Federal Republic of Germany Loan	1.4	3.4
U.S. Bond Issue	—	7[illegible]
EXTERNAL DEBT	437.6	509.8
TOTAL PUBLIC DEBT	$2,216.8	2,693.0

Source: Bank Negara Malaysia, *Annual Report*, Kuala Lumpur, 1965

In order to attract foreign investment especially in the industrial sector special incentives are given to the foreign entrepreneur besides guaranteeing the security of his investment. Moreover, it is planned to adopt credit and fiscal

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policies with the objective of maintaining a stable monetary and financial climate within Malaysia. Repatriation of capital and remittances from Malaysia to the Sterling Area will be free of any restrictions and control as at present; and only nominal control will be exercised in the movement of funds to non-sterling countries.

Further the government will be pursuing policies which will encourage the accumulation of domestic savings, as it is the largest single source in the financing of the plan.

Despite these encouragements, if foreign assistance and domestic savings are not forthcoming as expected, Malaysia will have to cut its plan according to its resources. If the development-minded public does not allow any pruning of the present target envisaged in the plan, Malaysia may have to resort to other policies in financing the plan. Deficit financing is an obvious alternative and the machinery for such an operation is at hand with the Central Bank assuming control over the management of currency. This solution has been tried, in neighbouring countries like Indonesia, India and Ceylon with some unfortunate consequences. Malaysia takes pride in having a currency, the Malayan dollar, which has maintained its stability over the last 60 years and is now accepted in international circles as a stable currency for lending purposes[3]. Would it run the risk of ruining the international confidence in such a currency by resorting to large scale credit creation to finance the first Malaysia plan?

II. Economy of Singapore

The economy of Singapore has depended largely on entrepot trade with her neighbours of Southeast Asia and it has contributed towards a substantial proportion of its National Income in recent years. This trade has become stagnant in recent years and shows no great prospects for expansion (Table 13). In 1961 it accounted for about $400 million; in 1964 it had dropped to $351.7 million; in 1965 it recovered to $396.2 million, the position held in 1961.

Table 13

Singapore—Estimate Of Value Added By The Entrepot Trade

($ millions)

Year	1958	1959	1960	1961	1964	1965
Value added by processing	160.1	188.9	182.9	196.7	—	—
Value added by trade activities	172.5	177.6	207.5	201.4	—	—
TOTAL	332.6	366.5	390.4	398.1	351.7	396.2

Source: International Bank for Reconstruction and Development, *Report on the Economic Aspects of Malaysia*, Kuala Lumpur, 1963, p. 110. Finance Minister's *Budget Speech*, 5 December 1966 Singapore.

3. Mr. Tan Siew Sin announced on his return from International Monetary Fund and World Bank meeting in September 1966 in New York that I.M.F. has requested Malaysia that it be allowed to use the Malayan dollar in its future lending transactions. He said "This means Malaysia will be the first developing nation whose currency is being used for I.M.F.'s transactions". In March, 1967 the Malayan dollar was used in a loan to Ceylon by the World Bank.

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The population of Singapore is increasing rapidly at the rate of 2.5 per cent per annum. This increase demands the creation of more job opportunities for those coming on to the labour market in the next few years—to the extent of 19,000 more jobs every year during the next five years. In addition some jobs will have to be made available for the unemployed who now comprise about 10 per cent of the total economically active population[4] (Table 14).

TABLE 14

EMPLOYMENT PATTERN IN SINGAPORE

(thousands)

Increase in Employment expected in the First Plan	70,000
Actual Increase in Employment (1961-65)	57,600
No. of Unemployed (1965)	56,300
Numbers entering the Labour Market (1966-70)	95,000
No. of jobs to be created (1966-70)	151,300
Rate of Unemployment (1965)	10%

Source: Finance Minister's *Budget Speech*, 5 December 1966

Manufacturing industries are being developed to provide a strong base for the economy and the output of this sector shows a high potential for growth. Last year (mid 1965 to mid 1966), the output of the manufacturing sector increased to $1,350 million[5] and its contribution to the national income in 1965 has increased to 13 per cent (Table 15).

TABLE 15

OUTPUT AND VALUE ADDED BY MANUFACTURING FIRMS

($ millions)

Firms employing more than five Workers			*All firms*
Year	Output	Value added	Value Added
1963	889	269	not known
1964	977	300	350
1965	1,105	352	390

Source: Economic Development Board, *Annual Report*, Singapore, 1965

For the development of the industrial sector as the crucial sector of the economy, it is necessary to find raw materials and resources. Singapore lacks these resources and most of them have to be imported. More important still Singapore will have to find markets for her products abroad.

4. *Ibid.*
5. Prime Minister's *Independence Day Speech*, 9 August 1966, Singapore

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TABLE 16

SINGAPORE: EXPORTS AND IMPORTS

Year	Imports	Exports
	$m	$m
1961	3,963.3	3,308.5
1962	4,035.9	3,416.7
1963	4,279.0	3,474.5
1964	3,478.8	2,771.9
1965	3,807.2	3,004.1
June 65/July 66	3,904.2	3,193.7

Source: Singapore, *Monthly Digest of Statistics*, November, 1966.

The external trade of Singapore has increased by about 10 per cent during the year June, 1965 to July, 1966[6] and it shows an import surplus of about $700 million a year (Table 16). This surplus of imports over exports has been a normal feature of the balance of payments of Singapore (Table 17).

TABLE 17

BALANCE OF PAYMENTS ESTIMATES, SINGAPORE, 1960-1963

	1960	1961	1962	1963
Exports f.o.b. (adjusted)	2,964.1	2,750.4	2,859.7	3,474.4
Imports c.i.f. (adjusted)	3,497.4	3,357.8	3,430.5	4,156.1
BALANCE ON TRADE	—533.3	—607.4	—570.8	—681.7
Invisible transactions and adjustments(net)	+292.4	+315.5	+347.1	+546.2
Balance on current account excluding official donations	—240.9	—293.9	—223.7	—135.5
Official donations	+0.2	+5.0	+6.0	+6.1
NET BALANCE ON CURRENT ACCOUNT	—240.7	—288.9	—217.7	—129.4

Source: Bank Negara Malaysia, *Annual Report*, Kuala Lumpur, 1964.

A good proportion of Singapore's foreign trade consists of entrepot trade. Almost half of the imports is retained imports and in 1965 this amounted to $1,809 million.[7] Domestic exports, excluding petroleum, amounted to $345.8 million in 1965.[8] At present this gap between retained imports and domestic exports is made up by entrepot earnings and other payments which Singapore receives by selling its services to foreigners. These include expenditure in Singapore by U.K. government forces which amounts to about $600 million. These earnings have enabled Singapore to have retained imports about 5 times that of its domestic exports. This high level of imports was also made possible by the regular inflow of capital in the form of reinvestment of profits in Singapore.

6. *Ibid.*
7. Finance Minister's *Budget Speech*, 6 December 1966, Singapore.
8. *Ibid.*

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Total investment in Singapore has increased substantially during the last few years. As a proportion of gross domestic product the gross capital formation has increased to over 15 per cent (Table 18). Slightly over one half of this total is accounted for by the private sector.

TABLE 18

SINGAPORE: NATIONAL INCOME AND CAPITAL FORMATION, 1960-1965

Year	Gross Domestic Product ($ Mil.)	Mid-year Population ('000)	Per Capita Income ($)	Gross Capital Formation ($ Mil.)	Gross Capital Formation as % of G.D.P.
1960	2,016	1,634.1	1,236	138.5	6.8
1961	2,304	1,687.3	1,368	226.4	9.8
1962	2,407	1,732.8	1,389	255.1	10.6
1963	2,745	1,775.2	1,546	323.2	11.8
1964	2,811	1,820.0	1,544	414.7	14.8
1965	3,024	1,865.0	1,621	474.9	15.7

Source: Economic Development Board, *Annual Report*, 1965, Singapore.

This high rate of investment has increased the rate of growth of gross domestic product during last year. In 1965, the rate of growth was of the order of 9 per cent. This has raised the per capital income to $1,621 in 1965.

To maintain this rate of growth of income and investment the second plan envisages a public investment expenditure of $1,520 million of which almost two thirds would be on economic development project (Table 19). The plan emphasises the development of export-oriented industries. It is estimated that this high level of public development expenditure will induce private investment of the order of $1,300 million in the next five years.[9]

TABLE 19

SINGAPORE: SECOND PLAN—SECTORAL ALLOCATION OF EXPENDITURE

($ millions)

	$ million	per cent
Rural and Land Development	130.1)	
Public Utilities	316.1)	64.2
Industry and Trade	342.8)	
Transport and Communications	186.7)	
Social Development	484.0	31.8
Public Administration	61.4	4.0
TOTAL	1,521.1	100.0

Source: Finance Minister's *Budget Speech*, 13 December 1965, Singapore.

9. President of Singapore, *Opening Address to Parliament*, 8 December 1965, Singapore.

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A good proportion of the public development expenditure will be met from domestic borrowings, which will raise the public debt of Singapore, which amounts to over $500 million at present, and the cost of servicing the public debt.

Thus far the government has managed to balance its budget, so as to avoid the running down of external reserves (Table 20). In the past most of the development expenditure was met by revenue surplus as well as domestic borrowings. External assistance was minimal and this is seen in the low level of external debt which amounted to $61.75 million in December 1966.

For the financing of the next development plan heavier dependence will be placed on borrowing, as current budget surplus is expected to decline. Some funds will also have to be raised from abroad. It is estimated that during the

TABLE 20

SINGAPORE: ESTIMATES OF REVENUE AND EXPENDITURE, 1966 AND 1967

($ millions)

Year	1966	1967
Government Revenue	537.3	590.7
Expenditure including a transfer of $30 each year to the development fund	531.6	590.2
Current Surplus	5.7	0.3

next plan period there will be a foreign exchange gap of $350 million. The public sector has to borrow a third of this sum from the World Bank, and balance will be met either by borrowings from other sources abroad or by a reduction of reserves.

At the end of September 1965, the official reserves of Singapore were estimated at $915 million. A recent estimate of foreign reserves gives the figure as $1,038 million (Table 21). This, together with the unofficial reserves, would be adequate to finance retained imports for about 8 months.

TABLE 21

SINGAPORE: OFFICIAL EXTERNAL RESERVES

($ millions)

Year	1965	1966
Government Reserves	484.7	554.3
Statutory Authorities	153.6	183.7
SUB-TOTAL	638.3	738.0
Estimate of currency reserves	276.4	300.0
TOTAL	914.7	1,038.0

Source: Finance Minister's *Budget Speech*, 5 December 1966, Singapore.

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Maintaining close economic and trading relationship with the neighbouring countries is very important to Singapore as it has to rely on the present pattern of trade and commerce for quite some time to pay for its imports. Even when the manufacturing industries are fully developed, it will still have to do so because of the small domestic market. Under such a situation a stable currency is all the more important to Singapore which *has to and will have to* rely on international trade for its earnings and on overseas capital for its development. This stability is guaranteed by the retention of the Currency Board system which involves little or no change from the stringent method of monetary management of the past.

The economy of Singapore has been regarded as part and parcel of the larger economy of Malaya[10] until the separation of Singapore in 1965. Since then the structural differences between the two economies have become more prominent especially with the erection of barriers at the border—the Causeway.

Previous to separation the economy of Singapore was complementary to the economy of Malaysia and its function as the financial centre and port of the peninsula was well appreciated. Now it is strongly felt that Singapore has become increasingly competitive with the economy of Malaysia, through industrialisation.

The economic and trading relations between Singapore and West Malaysia have been very close. The total trade with West Malaysia amounted to over 22 per cent of the total trade of Singapore before 1963 (Table 22). Since then the trade with Indonesia has fallen and the trade with West Malaysia has become greater, in proportion, to total trade of Singapore. It now accounts for over one quarter of total trade of Singapore. It is showing a declining tendency since 1964.

TABLE 22

SINGAPORE TRADE WITH WEST MALAYSIA AS A PROPORTION OF ITS EXTERNAL TRADE

Year	1960	1961	1962	1963	1964	1965	1966 Jan./June
Imports	20.9	18.3	18.0	17.7	22.8	23.2	23.3
Exports	24.3	26.8	27.6	29.1	33.4	31.2	27.0
TOTAL TRADE	22.4	22.2	22.4	22.8	27.5	26.8	25.0

Source: Singapore, *Monthly Digest of Statistics*, various issues.

In its trade relations with West Malaysia Singapore enjoyed a favourable balance in the past years. If this trade relationship is upset by recent moves which include the separation of currencies, both the economies of Malaysia and Singapore would be adversely affected.

III. ADVANTAGES OF A COMMON CURRENCY

A common currency for two or three territories or a currency union of them would be beneficial to the countries concerned if they use such a union as an instrument for the eventual economic union of the countries. Initially it would mean that the territories have some of the arrangements which will lead

10. Malaya includes both Singapore and West Malaysia (former Federation of Malaya).

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to the establishment of a common market. They include free movement of funds and banking and the unhindered movement of men and materials.

Under such an arrangement, a common currency paves the way for the economic unification of the territories, and industries operating in the territories would benefit from the enlarged market which would enable them to reap the economies of large scale production. The common currency in such a situation acts as the lubricant to the engine set up to achieve a common market by allowing complete freedom of payment from one territory to the other. In this way a common currency has generally been the harbinger of a common market or economic union.

Although such an arrangement of having a common currency would lead to some limitation in the manoeuvres of the governments in economic matters, countries join in such a venture because the advantages resulting from a common market more than offset the disadvantages.

Under a currency union, each territory would have limited scope in using its credit and monetary policy instruments because of the free banking and movement of funds within the currency area. In all economic policy matters the territories would have to consult each other.

So a common currency demands economic co-operation in many fields and when this co-operation is realised, the territories would be ready for an economic union, which might eventually lead to a political union.

IV. Implications of Separate Currencies

In the case of Malaysia and Singapore a common currency has been a feature of the close economic relationship in the past and as a result the two territories were considered as a single economic unit. Of late, with the political separation of Singapore and the recent barriers erected at the Causeway, especially with regard to the movement of labour and goods, this single economic unit has become two separate units, with distinct and separate characteristics. In such a situation the *raison d'etre* of having a common currency is undermined.

The maintenance of a common currency would have dictated close consultation in all economic matters affecting the two territories. After political separation, although co-operation in a broad sense is still possible, it is difficult for one to see close consultation in all policy matters when governments differ widely in their approaches to political and social problems, and their solutions.

After separation of currencies, if the monetary and fiscal policies of the two countries are drastically different, the result might be different exchange values for the two currencies. There might develop a black market for currencies, accompanied by smuggling of goods between the territories.

The most important question after the separation of currencies is that of maintaining the confidence of currencies both internally and externally. Internal confidence can easily be achieved by the governments concerned except in a few difficult cases. But the question of maintaining confidence of the currencies abroad especially after the separation is important.

Under the present monetary system, both Malaysia and Singapore function as a single banking unit. This will not be possible after June, 1967. It would be advisable then for every bank and commercial firm to keep their books separate and these changes would add to the costs, especially the overhead costs.

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Costs would also increase as transactions between the territories would have to undergo an additional exchange operation. Again these changes could be achieved with minimum difficulties on either side of the Causeway.

What is most important is that the separation of currencies introduces a change which will be a sharp break with the monetary system prevailing in this area for over 60 years. Externally this might have serious effects on confidence.

External confidence is important to both Malaysia and Singapore. Malaysia is an export-oriented economy and its development in the past depended on the growth of exports. Of late, it has found that the exports show a slug gish rate of growth and would not provide the stimulus for development in the future. The stimulus for growth has to come from domestic production. In such an economy, the Central bank has an important role to play in the future. However Malaysia is planning for rapid development in the future, whichinvolves an enormous capital expenditure of about 10 billion dollars. It depends heavily on foreign aid and loans to meet the short fall in investment. If these assistance and loans are not forthcoming as expected, serious pressure on reserves is likely to occur. So in order to attract foreign investment, the confidence in currency abroad has to be maintained.

Singapore with its entrepot economy and dependence on trade and commerce also feels that the earnings from trade are not sufficient to provide for growth and development. Manufacturing industries are being developed to provide a strong base for the economy. In order to develop this sector it is important that investment in overhead facilities be increased and this requires public investment of about $1.5 billion in the next five years. A small proportion of this capital has to be raised from abroad. Moreover it is expected that private investment from abroad would increase as a result of the public development programme.

Hence to facilitate the growth of export-oriented manufacturing industries, it is important for Singapore to improve its trade connections as well as confidence in its future dollar.

Both the governments are doing their best to provide this confidence: one through an independent monetary system with a Central Bank and the other through the traditional Currency Board system which prevailed in this area for the past 60 years.

LIST OF COMMERCIAL BANKS IN SINGAPORE AND STATES OF MALAYA *

(Showing Place and Date of Incorporation)

I. EXISTING BANKS (DEC. 31, 1966)

A. Overseas Banks

1. Mercantile Bank, Singapore, 1856.
2. Chartered Bank, Singapore, 1859 (agency), 1861 (branch); Penang, 1875.
3. Hongkong and Shanghai Banking Corporation, Singapore, 1877; Penang, 1884.
4. Algemene Bank Netherland, N.V.—formerly called Nederlandsche Handel-Maatschappij N.V. (Netherlands Trading Society), Singapore, 1883, Penang, 1888.
5. First National City Bank of New York, Singapore, 1902.
6. Banque de L'Indochine, Singapore, 1905.
7. Eastern Bank, Singapore, 1928.
8. Bank of China, Singapore, 1936.
9. Indian Overseas Bank Ltd., Penang, 1937.
10. Kwangtung Provincial Bank, Singapore, 1939.
11. Indian Bank Ltd., Singapore, 1941.
12. United Commercial Bank Ltd., Penang, 1948.
13. Bank of India, Ltd., Singapore, 1951.
14. Bank of East Asia, Singapore, 1952.
15. Bank of Canton, Singapore, 1953.
16. Bank of America, Singapore, 1955.
17. Bank of Tokyo, Singapore, 1957.
18. Bangkok Bank Ltd., Singapore, 1957.
19. Mitsui Bank Ltd., Singapore, 1963.
20. Chase Manhattan Bank, Singapore, 1964.
21. Habib Bank Ltd., Singapore, 1964.
22. Bank Negara Indonesia, Singapore, 1955; closed after Indonesian Confrontation 1963; reopened in Oct. 1966.

B. Local Banks

1. Four Seas Communication Bank Ltd. (also called Sze Hai Tong Bank Ltd.), Singapore, 1906.
2. Kwong Yik (Selangor), Banking Corporation, Kuala Lumpur, 1913.
3. Oversea-Chinese Banking Corporation, Singapore, 1932.
4. Lee Wah Bank Ltd., Singapore, 1920.

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* Compiled by Mr S.Y. Lee

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5. Batu Pahat Bank Ltd., Singapore, 1920; changed its name to The Pacific Bank Ltd., in 1963.
6. Ban Hin Lee Bank Ltd., Penang, 1935.
7. United Overseas Bank Ltd., (formerly called United Chinese Bank Ltd.), Singapore, 1935.
8. Oriental Bank of Malaya, Ltd., Kuala Lumpur, 1936.
9. Overseas Union Bank Ltd., Singapore, 1947.
10. Chung Khiaw Bank Ltd., Singapore, 1947.
11. Industrial and Commercial Bank Ltd., Singapore, 1953.
12. Bank of Singapore, Singapore, 1954.
13. Far Eastern Bank Ltd., Singapore, 1958.
14. Asia Commercial Banking Corp. Ltd., Singapore, 1959.
15. United Malayan Banking Corp. Ltd., Kuala Lumpur, 1959.
16. Malayan Banking Ltd., Kuala Lumpur, 1960.
17. Bank Bumiputra Malaysia Ltd., Kuala Lumpur, 1965.
18. Southern Banking Ltd., Penang, 1965.
19. Public Bank Berhad, Kuala Lumpur, 1966.

II. FAILED OR NON-EXISTING BANKS

1. Union Bank of Calcutta, Singapore, 1840.
2. Commercial Bank of India, Singapore; failed in 1866.
3. Oriental Banking Corporation, Singapore, 1846; bankruptcy in 1884.
4. Asiatic Banking Corporation; failed in 1866.
5. N.I. Handelsbank, Singapore, 1901. (Later changed to the name of 'Nationale Handelsbank N.V.' and it was bought by Chase Manhattan Bank in 1964).
6. Kwong Yik Bank, Singapore, 1903; failed in 1913.
7. Chinese Commercial Bank Ltd., Singapore, 1912.
8. Ho Hong Bank Ltd., Singapore, 1917.
9. Oversea-Chinese Bank Ltd., Singapore, 1919.
10. Bank of Communication, Singapore 1910; closed in 1920-21.
11. Bank of Malaya Ltd., Ipoh, 1920.
12. P. and O. Banking Corporation, Singapore; wound up in 1939.
13. Bank of Taiwan; closed after the Second World War.
14. Yokohama Specie Bank; closed after the Second World War.
15. Southern Development Bank; closed after the Second World War.

Note: There is also a branch of Kwong Lee Bank which was incorporated in Kuching in 1934, operating in Singapore.

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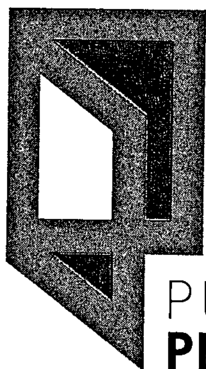

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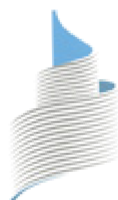

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