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Speech by Dr. Goh Keng Swee, Minister for Finance, at the 13th Anniversary Dinner of the Economic Society of Singapore held at the Dragon Room, Robinson Restaurant, Singapore, on Saturday, 20th September, 1969.

Since I shall be leaving Singapore next week to attend the Annual Conference of the World Bank and the International Monetary Fund a sense of occasion would dictate that I talk about money. At first I was sorely tempted to give my views on the present state of the international monetary system. However, on reflection, I resisted this temptation for two reasons. The first is that it would be prudent for a country like Singapore not to give unnecessary offence to the great. The state of the international monetary system being what it is, this is best achieved by withholding comment. The second and more immediate reason is that one should not go to a meeting of cardinals reeking of heresy. I have therefore decided to talk to you about more parochial matters, namely, our own monetary system, a subject which gives less scope for impious or irreverent thoughts.

When we left the Federation of Malaysia on the 9th of August, 1965, we were faced with urgent decisions about the kind of monetary system we should establish for the new Republic. The urgency was caused not merely by the fact of independence but by the previous notice given by the Government of Malaysia to the Board of Currency Commissioners of Malaya to terminate the old Currency Agreement which had provided for a common currency between the States of Malaya, Singapore and the Borneo territories. This meant that by the 11th day of December 1966 Malaysia would have its own currency and the old currency notes would be replaced and eventually de-monetised after that date.

What the Government had to decide was, first, whether to establish its own currency or to have a common currency with the Federation of Malaysia. Secondly, to decide on the nature of the new monetary authority, whether it should take the form of a Central Bank, or the old-fashioned Currency Board or some other form.

These were novel and challenging problems. We had no experience in managing our own currency and accordingly, decided to engage experts to advise us. Further, there was little time left for making the physical arrangements on note and coin issue. Even after more than two years of independence, we were virtually without any new coins when sterling devaluation occurred. It was necessary to rush emergency measures at great cost, airlifting 180 tons of coins

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in ten planeloads of chartered aircraft at a cost of nearly a million dollars between 5th and 25th December, 1967.

The currency problem was kept under close and continuous study by Cabinet. No less than seven Cabinet memoranda were prepared and discussed at length between 21st November 1965, when the subject was first brought up, and the 23rd July, 1966, when the final decision was made.

Having a common currency with Malaysia at that time had great attraction for many members of Cabinet. To have a joint currency would mean greater combined total reserves and hence a stronger currency than two separate currencies. Secondly, by established custom, Singapore has had a common currency for several years with the States of Malaysia. The introduction of a new currency may well encounter difficulties over confidence and acceptability. Finally, there was a fair amount of external pressure to retain as far as possible existing economic ties with Malaysia and it was thought that splitting the currency would be a retrograde step.

In spite of its attractions, Cabinet recognised that certain complex problems arise in sharing a currency with another State. There are, of course, precedents in other parts of the world. For instance, the principality of Monaco uses the French franc and in another principlaity, that of Liechtenstein, the Swiss franc circulates as currency. But Singapore stands in a somewhat different relationship with Malaysia and matters of ownership and control of reserve assets which do not arise in these two principalities are matters of importance for us. To have our own currency might mean smaller reserves and hence a weaker currency. It would sever an important tie with Malaysia. To have a common currency avoids these but creates problems over ownership and control of reserves. It was a complex and intricate problem. Cabinet finally arrived at a decision in the way human beings are prone to when faced with complex and difficult choices. It decided to have its cake and eat it too.

Without going into technical details, the proposal was to have currency notes of the same design but run on different serial numbers, each country to have its own series. The external assets will accrue to the respective monetary authority according to redemption of the old note issue and will be kept in two separate accounts. Nominally Bank Negara Malaysia would present a combined account; the Singapore

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Authority would maintain its own accounts but would keep Bank Negara informed of all changes in reserve assets.

It was an extraordinary compromise and with the assistance of experts to help out in negotiations between the two Governments, nearly all technical problems were solved to the satisfaction of both parties. However, finally, in respect of one detail, some legal technicality on ownership, agreement was not reached and negotiations broke down on this point. Singapore then decided to have its own currency.

As regards the type of monetary authority, whether it should take the form of a Central Bank or a Currency Board, a decision was reached without much difficulty. The test Cabinet decided to apply here was which type of institution would inspire more confidence in the new currency? There is little doubt that the Currency Board would fulfil this requirement better than a monetary authority of the Central Bank type.

I think Cabinet reached the right decisions on both these issues. My personal position was to support a separate currency right from the beginning as I did not believe that joint currency arrangements could work in practice. These are bound to lead to long and tiresome arguments between the parties concerned and in the interest of good relations between the two Governments, I thought it wiser they should go their separate ways. But I supported the compromise that was reached in Cabinet though without any confidence that agreement was possible. Somewhat to my surprise, negotiations made more progress and lasted much longer than I had expected.

Once the two Governments decided to go on their separate ways, they both recognised that their two currencies and, indeed, their banking system stood in special relationship with each other as against the rest of the world. Accordingly, it was decided that this relationship should be enshrined in some kind of agreement to give special status of the currency of one in the territory of the other. The Interchangeability Agreement which spelt out this relationship was formalised in an exchange of letters. It is working well and is serving its intended function. It has survived the sterling devaluation crisis and all the other numerous crises which have plagued the international monetary system in the past three years.

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When Cabinet decided to establish a Currency Board instead of a monetary authority such as a Central Bank, the reasons were, as I described before, short-term. As such, the subject of establishing a Central Bank will no doubt hav^ to be seriously considered at some time in the future. There are, of course, many advocates of a Central Bank both in academic and other circles. But I think that the reasons they advance have limited relevance in an economy such as Singapore's.

Take, for instance, monetary policy. A Central Bank, as against a Currency Board with its automatic mechanism and a legally prescribed minimum reserve cover for the currency issue, is believed to have the virtue of flexibility in respect of control over monetary supply. It was thought that by means of credit creation during a down-turn of the economy and credit restriction in an up-turn, fluctuations of economic activity could be levelled out and more stability introduced in the system. There is one snag to this argument, and that is the question of import leakages. Anyone in the slightest doubt as to the seriousness of this problem would have his doubt quickly dispelled by a reference to Table 13.3 of the Yearbook of Statistics. In 1968, of an estimated private consumption expenditure on goods of $2,047 million, no less than $1,230 million or 60% consist of expenditure on imports. The percentage varies between class of goods, being around 75% in Recreational goods, Durable goods and Clothing and personal effects. Even as regards food; $493 million out of $880 million or 56% was imported. When some 60 per cent of expenditure on goods leaks abroad, the effect of the Keynesian multiplier which provides the raison d'etre for an expansionary credit policy during periods of low economic activity, is subject to severe constraints in its operations. If during a slump, Singapore decides to expand credit as a means of counteracting the recession, the result could be to compound our difficulties. An economic down-turn is likely to be accompanied by a run-down of our external reserves. When credit is expanded with the object of increasing expenditure, the result would be to accelerate the loss of reserves. Sooner or later we will be landed with the need to mount strict foreign exchange and import controls. A sea-port like Singapore, with a wide open economy, is a Controller's nightmare and the final result of financial miscalculations could be more traumatic than would be the case with other countries.

As a consequence of this, there is for Singapore no easy way out. The way to stabilise the economy would lie less in monetary than in fiscal measures. During a down-turn, it would be possible to mitigate the harsher effects of a recession if the Government were to run budget deficits financed not by Central Bank credit creation but by spending accumulated overseas assets or proceeds of foreign loans raised on the collateral of these assets. But this would imply the accumulation of such funds during good times. This is what we are doing and for this we don't need a Central Bank, as the instrument for such measures of stabilisation would be normal Government budget. But even here, the efficacy of a stabilisation programme through fiscal policy is subject to the same constraints as monetary policy. The advantage is that these limitations are more immediately apparent and the risk of over-playing one's hand is accordingly less.

So I am afraid the solution is prosaic and unglamorous. For us in Singapore, the road to greater wealth is through thrift, enterprise and hard work. The road to stability lies in prudence and foresight in prosperity and patience and fortitude in adversity. In the swinging age of the new economics, all this sounds old-fashioned and Victorian. No doubt it is, but I think it is unrealistic to expect that doctrines worked out for developed economies where foreign trade forms a relatively small part of the GNP would apply in their entirety to the exceptional situation of ours.

I would like to give you a brief outline of how our present monetary system works. There are some misconceptions about this. Some are inclined to think that our monetary system on the Government side consists of the Currency Board and no more. Others find distasteful the idea of the Accountant-General performing certain functions of the Central Bank, such as, for instance, lender of last resort. The present position is quite complex and no less than ten Government departments or authorities are involved.

There is first, of course, the Currency Board of Singapore whose functioning is determined by the Currency Board Ordinance and the automatic mechanism of its operations is known to all. Then there is the Exchange Control Department. This is a shadow of its former self when, in the immediate postwar years, exchange control within the sterling area was a powerful instrument of policy. Because it operates sterling area rules which are becoming increasingly irrelevant to Singapore, the Control wears an increasingly Byzantine aspect. However we are still in the sterling area and we must observe the sterling area rules.

Then there is the Accountant-General's Department. I should mention in passing that the Accountant-General is the Deputy Chairman of the Currency Board as well as the Deputy Controller of Foreign Exchange. The Accountant-General comes into the monetary picture as he keeps the deposits which banks have to maintain with the Government under the Banking Ordinance. He also issues Treasury Bills on tap to banks. In a limited sense, he is lender of last resort in the banking system.

The fourth component of our monetary system is the Commissioner of Banking. He enforces the Banking Ordinance which is intended to see that banks keep sufficient liquid funds, engage in sound banking practices, whatever this means. I have always thought that for a Government official to tell banks what they should do is like teaching one's grandmother how to suck eggs, but the experts assure me that this is not the case and that it is necessary to keep banks under constant surveillance. Then there is the Registrar of Loans who is really the Accountant-General wearing yet another cap. He has just floated, as you know, a loan of $187 million, a record in the Republic's history.

I suppose we should include the Registrar of Companies as he is concerned with the processing of applications for Stock Exchange listings. I should certainly include the Clearing House by which inter-bank settlements of cheques are effected twice daily. The Clearing House is managed by none other than the Accountant-General. Then there is the Commissioner for Finance Companies who is really the Commissioner of Banking administering a different Ordinance. An important element in the system is the Department of Overseas Investments. This used to be the alter ego of that versatile public official, the Accountant-General. The need to set up a separate department to look after our overseas assets became increasingly urgent as a result of the exceptionally fast rate at which these were increasing. Last reported at $2,200 million, they are now heading for the $2,400 million mark.

Finally, there is the Ministry of Finance itself which directs and co-ordinates the activities of these ten separate authorities and departments. It is an untidy system, consisting of units that grew up ad hoc in course of time in response to urgent requirements. In the aggregate, they can be said to perform Central Banking functions in the Republic. The task of co-ordinating and directing the policies of these ten departments is not a simple one. It cannot be done entirely by conventional methods of government procedures, that is, by writing minutes to one another. A system developed in the Ministry of weekly conferences, whereby staff in various departments meet me early on Monday morning. Reports and study papers are circulated the previous Saturday for week-end reading. During periods when the financial centres go through a crisis of one kind or another, I hold an additional staff meeting on Friday and during periods of acute tension, on Thursday as well.

How has this system been performing? A recent assessment made in the London Times which published a Singapore Supplement on the 9th September this year goes as follows:-

> " In the financial area too there is an atmosphere of optimism and confidence in the future. The currency is strong .... Money is easy, with interest rates among the lowest in the world. The budget is balanced, there is no inflation, and no balance of payments problems or restrictions on credit."

In sum, the system is doing well. I would add a word of caution for the Singaporean is apt to attribute his good fortune to some superior merit or high virtue which only he possesses. In this instance, there are some favourable technical factors of a temporary nature. With luck, these may persist till the middle of next year. Be that as it may, I now pose the question which is the subject of my talk, "Should Singapore have a Central Bank?" The answer, in my opinion, is "Yes".

Some of you who have been following my arguments closely may say that this is a complete non-sequitur but this view really misses the point which I am trying to establish. This is that we do not need a Central Bank for the purposes of credit creation or flexible control over money supply. Even without a Central Bank, we have the means whereby credit can be created through the Accountant-General's operations, though some ingenuity has to be exercised for this purpose. Similarly, control over the supply of bank money can be exercised through the Commissioner of Banking. It is doubtful, though, whether open market operations would be the efficacious instrument that they are in countries with a well-developed money market. Having or not having a Central Bank makes no practical difference in this respect.

The case for establishing a Central Bank in Singapore rests on other grounds. First, the untidy scatter of elements making up the Government structure of the monetary system can be collected together in one house. Apart from administrative tidiness, itself by no means a derisory consideration, the assemblage of these units into a coherent structure would give the organisation a sense of purpose and direction which is now lacking and which is only partially supplied by the Monday morning meetings. Only in this way can we develop a high level of professional expertise which is needed in the conduct of monetary affairs.

I would add two provisos as regards the timing. Firstly, the move to a fully-fledged Central Bank should be taken in two steps. The first step could be to collect the disparate units into a central monetary authority which will work closely under the direction of the Ministry of Finance. In course of time with the growth of professionalism and the development of appropriate financial doctrine, a proper Central Bank will emerge from this authority. In this way we can have a Central Bank worthy of its status as an independent monetary institution.

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My second proviso is that it will certainly be necessary to wait until the present reforms contemplated for the international monetary system have proved their worth and the financial world has moved into a period of tranquility. In the meantime, I fear, there is no substitute for the inordinate amount of time and effort which my staff and I devote to the study of current monetary developments.

There is another more sophisticated reason for establishing a Central Bank. Perhaps I can best describe this by analogy. It is related to the way in which man makes his decisions in the face of difficult situations. The most difficult decisions to make, I expect, are those connected with the conduct of wars when decisions have to be made under stress, in the face of imponderables and on the basis of imperfectly known data. It is instructive to see how man has tried to escape from the horns of dilemma. Let us take the Roman generals. When they find themselves in a state of extreme perplexity they kill a sheep and examine its entrails. On the basis of portents which they read from the condition and configuration of the sheep's entrails, they often reach their most fateful decisions.

We moderns of the twentieth century find such procedures laughable. So we have generals of modern states arriving at their decisions with the assistance of systems engineers and electronic computers. I suppose that it can be said that this method of decision making is more rational than the Roman system. And yet I wonder if it results in more correct decisions or whether generals equipped with computers can always beat the daylights out of generals who don't have computers. I doubt if this is the case, for if it were so, the Vietnam conflict would have been resolved long ago.

The point about this incursion into the esoteric field of military decision-making is that if you have to make mistakes, it is best to do it by the most modern scientific method. To me this is an un-answerable argument for setting up a Central Bank in Singapore. And it has the advantage of many distinguished precedents. But I must not pursue this line of thought for reasons I gave at the beginning of my talk.

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