Institute for National Transformation

Lecture 27

The Role of Quality Financial Systems in National Transformation

Definition of the terms

Fiscal Policy:

Is the use of government expenditure and revenue collection (taxation) to influence the economy

Monetary Policy:

Monetary policy is the process by which the government, central bank, or monetary authority of a country controls

(i) the supply of money,

(ii) availability of money, and

(iii) cost of money or rate of interest to attain a set of objectives oriented towards the growth and stability of the economy.

Monetary theory provides insight into how to craft optimal monetary policy.

Definition of the terms

Gross Domestic Product (GDP):

Refers to the market value of all final goods and services produced within a country in a given period. It is often considered an indicator of a country ‘s Standard of living.

GDP Per Capita:

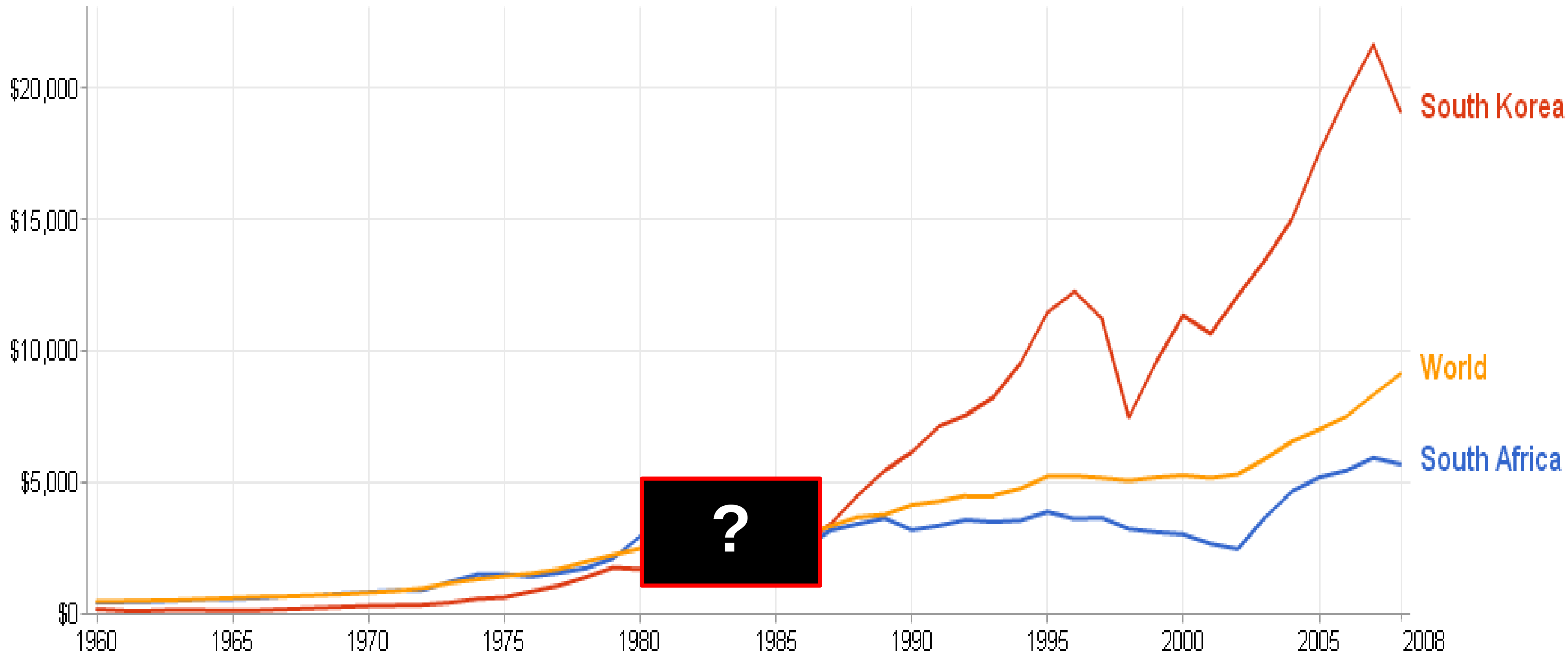
A measure of the total output of a country that takes the gross domestic product (GDP) and divides it by the number of people in the country. The per capita GDP is especially useful when comparing one country to another because it shows the relative performance of the countries. A rise in per capita GDP signals growth in the economy and tends to translate as an increase in productivity.

Institute for National Transformation

GDP Per Caps

GDP per capita at current prices

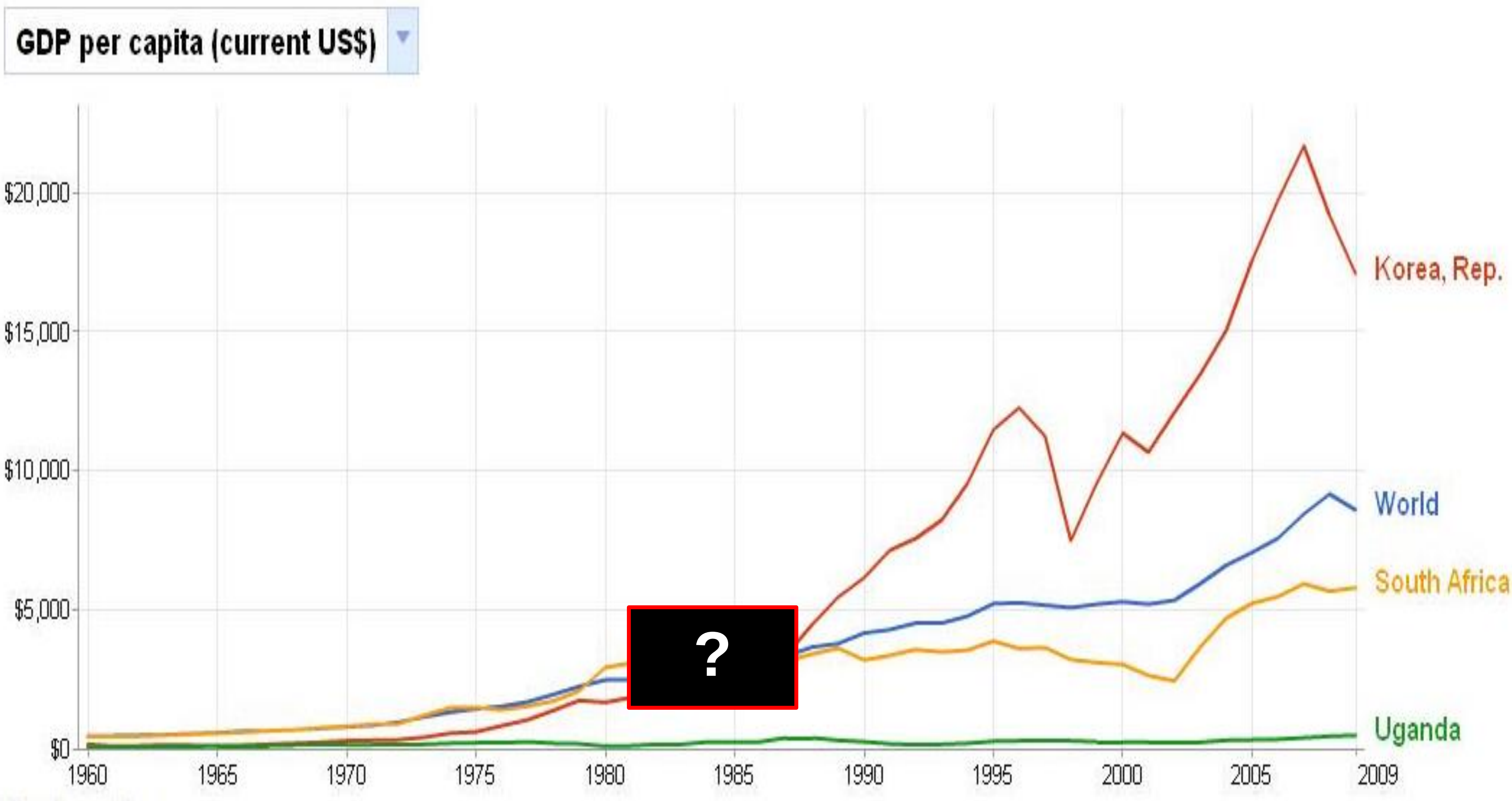
Gross Domestic Product per capita at current prices. Not adjusted for inflation and converted to US dollars applying market exchange rates. More info »



Data source: World Bank, World Development Indicators - Last updated October 2, 2010

Institute for National Transformation

GDP Per Caps



The Role of Central Banks

A **central bank**, **reserve bank**, or **monetary authority** is a public institution that:

1. Usually issues the currency
2. Regulates the money supply, and
3. Controls the interest rates in a country.
4. Often also oversees the commercial banking system of their respective countries.
5. In contrast to a commercial bank, a central bank possesses a monopoly on printing the national currency, which usually serves as the nation's legal tende

Wikipedia

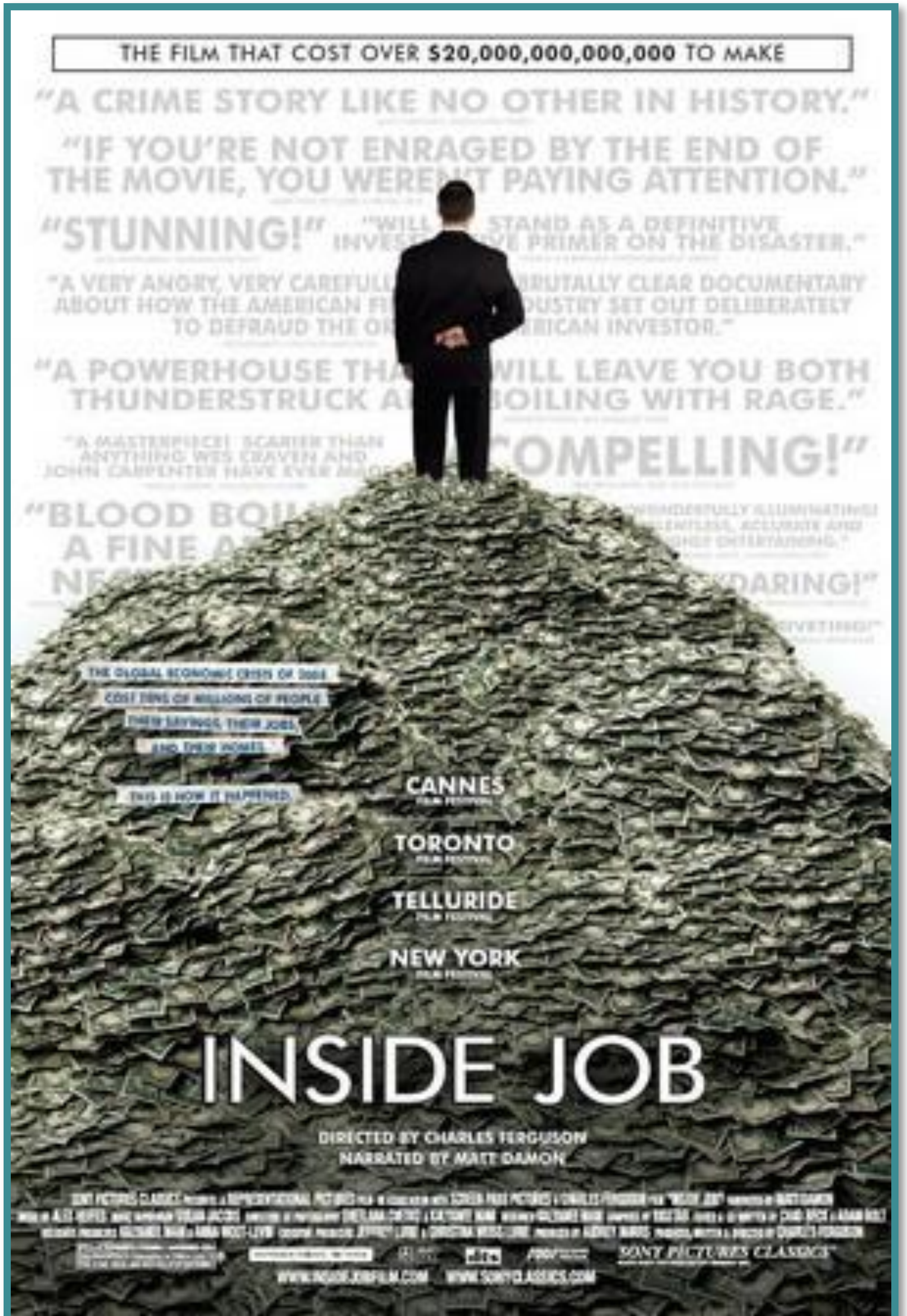
Bank Of Uganda

1. Issue Uganda's national currency/legal tender, the Uganda Shilling (UGX)
2. Regulate money supply using monetary policy
3. Act as Banker to the Government of Uganda
4. Act as Banker to Commercial Banks
5. Supervise and regulate Financial Institutions in Uganda
6. Manage the country's external/foreign reserves
7. Manage Uganda's external debt
8. Advise the Government of Uganda on financial and economic issues

From Wikipedia

Video Clip

What Happens When Central Banks and Financial Regulators Fail on the job?


THE FILM THAT COST OVER $20,000,000,000,000 TO MAKE
"A CRIME STORY LIKE NO OTHER IN HISTORY."
"STUNNING!"
THE GLOBAL ECONOMIC CRISIS OF 2008
COST TENS OF MILLIONS OF PEOPLE
THEIR SAVINGS, THEIR JOBS,
AND THEIR HOMES.
THIS IS HOW IT HAPPENED.
CANNES
TORONTO
TELLURIDE
NEW YORK
INSIDE JOB
DIRECTED BY CHARLES FERGUSON
NARRATED BY MATT DAMON
SONY PICTURES CLASSICS

ICELAND

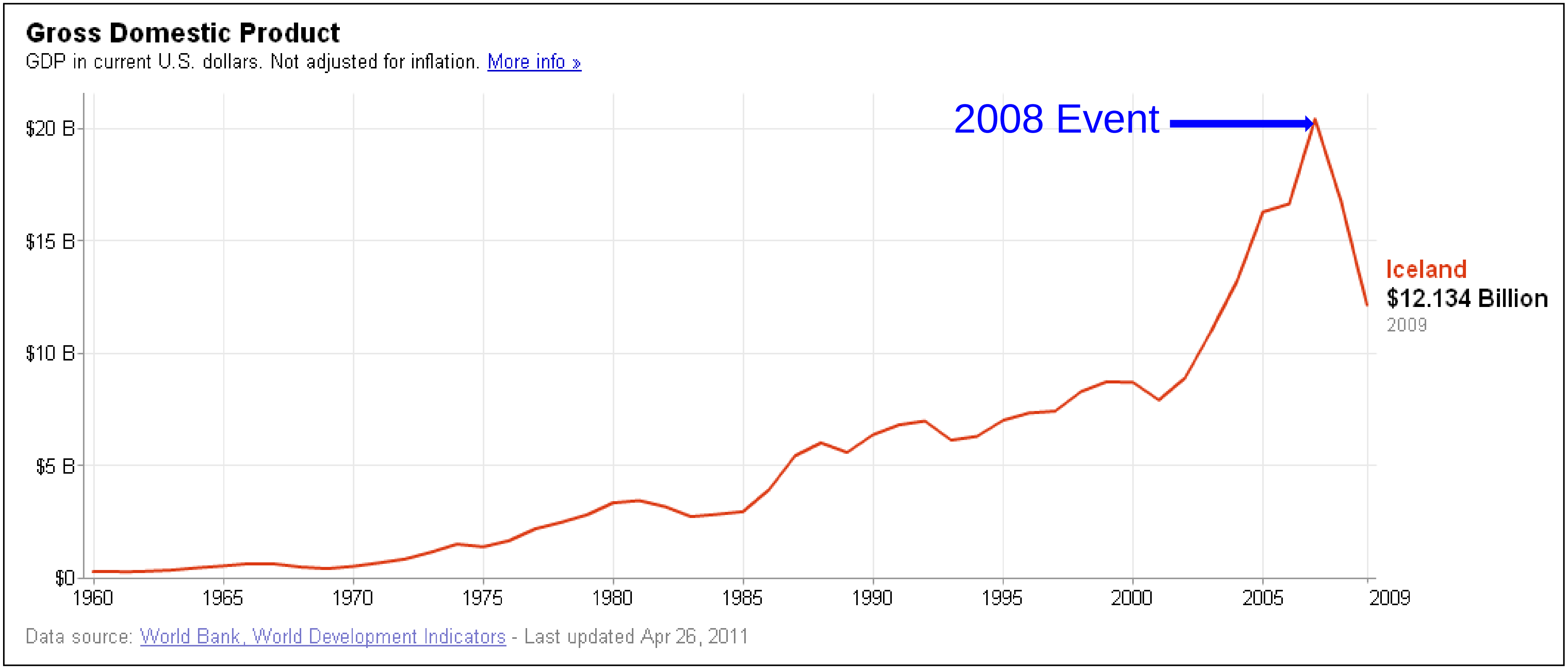
Population: 320,000

Gross Domestic Product: $12Billion (65k – 38k)

Bank Borrowing: $120 Billion (3 Banks GDP x 10)

Bank Losses: $100 Billion + (De-regulation)

Global Financial System

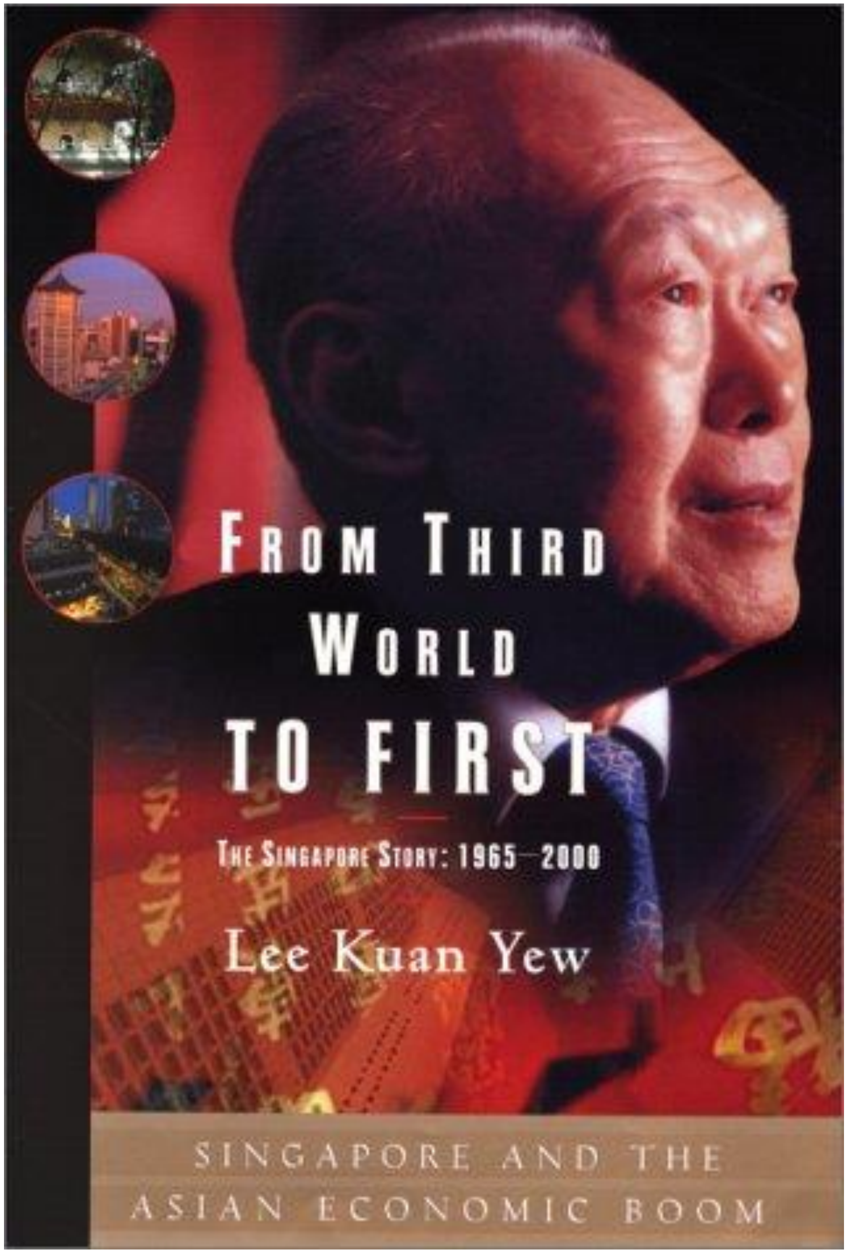


Global Economic Crisis - Impact

- 50,000,000 People fell below the poverty line
- Unemployment quadrupled in six months (Iceland), 210,000,000 (+30M) Global
- Millions lost their life savings

Institute for National Transformation

Singapore from 1965-2000



Singapore – 60s

Institute for National Transformation

Singapore Today

First World Financial Center

Chapter 5, Page 72 2nd Paragraph

In 1968, Singapore was a Third World country. Foreign bankers needed to be assured of stable social conditions, a good working and living environment, efficient infrastructure, and a pool of skilled and adaptable professionals. We also had to convince them that our currency board and the Monetary Authority of Singapore (MAS) were capable of supervising the banking industry.

First World Financial Center

Chapter 5, Page 72 2nd Paragraph

Both Keng Swee and I decided in 1965, soon after independence, that Singapore should not have a central bank that could issue currency and create money. We were determined not to allow our currency to lose its value against the strong currencies of the big nations, especially the United States. So we retained our currency board which issued Singapore dollar only when backed by its equivalent value in foreign exchange. The MAS has the authority of a central bank except the authority to issue currency notes.

First World Financial Center

Chapter 5, Page 72 3rd Paragraph

The MAS has been professional in its financial supervision, working according to laws, rules, and regulations that were periodically reviewed and revised to keep pace with developments in financial services.

We had to fight every inch of the way to establish confidence in our integrity, competence, and judgment.

First World Financial Center

Chapter 5, Page 72 3rd Paragraph

The history of our financial center is the story of how we built up credibility as a place of integrity, and developed the officers with the knowledge and skills to regulate and supervise the banks, security houses, and other financial institutions so that the risk of system failure is minimized.

We can start small

Page 73, 1st and 2nd Paragraph

We made a modest start with an offshore Asian dollar market. It was the counterpart of the Eurodollar market; we called it “the Asian dollar market.” …In the early years from 1968 to 1985, we had the field all to ourselves in the region. We attracted international financial institutions by abolishing withholding tax on interest income earned by non-resident depositors. All Asian dollar deposits were exempted from statutory liquidity and reserve requirements.

International Credibility Established

Chapter 5, Page 73 2nd Paragraph

By the 1990s, Singapore had become one of the largest financial centers of the world, with its foreign exchange market ranking fourth in size after London, New York, and only slightly behind Tokyo….

The foundations for our financial center were the rule of law, an independent judiciary, and a stable, competent, and honest government that pursued sound macroeconomic policies, with budget surpluses almost every year.

Shall we pass the test?

Chapter 5, Page 73 3rd Paragraph

In the 1970's, we had a brush against a big name in the city of London. In March 1972, Jim Slater, a highly regarded British investor who specialized in asset stripping, came to see me in Singapore. When Ted Heath became prime minister, the press reported that he had placed his assets and stockholdings with Jim Slater to manage in a blind trust. Therefore, Slater had strong credentials.

Integrity of Center Tested

Chapter 5, Page 74, 1st Paragraph

Later, in 1975, Sui Sen, then our finance minister, told me that Slater Walker Securities had engaged in manipulating the shares of Haw Par Brothers International, a public-listed company in Singapore.

They had been siphoning off the assets of Haw Par and its subsidiaries illegally for the benefit of certain directors and themselves, conduct which amounted to criminal breach of trust.

Integrity of Center Tested

Chapter 5, Page 74, 1st Paragraph

They were cheating the shareholders of Haw Par and the other companies. Investigation into a big name in the London Stock Exchange, if not justified, would give us a bad reputation. Should he proceed against Jim Slater?

I decided that we had to if we were to maintain our standing as a well-managed stock exchange. The investigation revealed a conspiracy to systematically strip off the Haw Par assets, and this was only the tip of a much larger and wider swindle.

Integrity of Center Tested

Chapter 5, Page 74, 2nd Paragraph

Slater Walker's criminal activities extended from Singapore to Malaysia, Hong Kong, and London, the final repository of the loot….We sought the extradition of Tarling and Slater, but the British establishment did not extradite Slater.

Instead, in 1979, after a three-year struggle through the London courts, the British home secretary ordered Tarling's extradition on only 5 out of 17 charges, the five carrying least penalties.

Tarling was prosecuted and sent to jail for six months on each of the three charges of willful nondisclosure of material facts in Haw Par's 1972 consolidated profit and loss account.

Institute for National Transformation

Bank of Credit and Commerce International

- Founded in 1971, by Agha Hasan Abedi (Pakistani)
- Operated in 73 Counties with over 400 branches
- Assets of **$20bn**
- 7^{th} Largest bank in the world by assets
- 30,000 employees worldwide
- Simultaneous raids by regulators in 7 countries
- Forced to closure in 1991

The BCCI Swindle

Page 74, 3rd Paragraph

The MAS's reputation for being thorough and uncompromising in admitting only financial institutions of repute was put to the test in the 1970s and 1980s when it denied a license to the Bank of Credit and Commerce International (BCCI). The BCCI swindle affected nearly all the big financial centers by the time it finally ended.

The BCCI Swindle

Page 74, 3rd Paragraph

Incorporated in Luxemburg by a Pakistani, the bank's shareholders included members of the royal families of Saudi Arabia, Bahrain, Abu Dhabi, and Dubai. It had about 400 branches or offices in 73 countries in Europe, the Middle East, Africa, and America.

The BCCI Swindle

Page 75, 7th line from top

It applied for an offshore banking license in Singapore in 1973. We rejected the application because the bank **was too new** (it started only in 1972) and low capitalization. It resubmitted its application in 1980. again the MAS would not approve; its international standing was poor. [BCCI tried again through Van Oenen in 1982 and Harold Wilson, **former British PM** and again denied].

The BCCI Swindle

Page 75, 3rd Paragraph

Dishonest operations of the BCCI led to enormous losses for other banks. When it was closed in July 1991, depositors and creditors had claims for **US$11 billion**.

Singapore escaped unscathed because we refused to compromise standards.

The Big Four - Consolidation

Page 76, 2nd Paragraph

Through strict rules and rigorous supervision, the MAS under Koh Beng Seng helped Singapore to develop as a financial center. To meet the competition from international banks, the MAS encouraged the four largest local banks to acquire and merge with smaller local banks to become bigger and stronger. **The Big Four were ranked by Moody's, the U.S. rating agency, as financially among the strongest and best capitalized in the world.**

Singapore International Monetary Exchange

Page 77, 1st and 2nd Paragraph

Another advance for Singapore's financial center was the Singapore International Monetary Exchange (SIMEX). In 1984, the Gold Exchange of Singapore expanded its trade in gold futures to include financial futures and renamed itself SIMEX….In 1984, SIMEX started trading in Eurodollar interest rate futures contracts and soon afterwards, the Euroyen. By 1998, SIMEX had listed a range of regional contracts including stock index futures of Japan, Taiwan, Singapore, Thailand, and Hong Kong.

Singapore International Monetary Exchange

Page 77, 2nd Paragraph

The London-based International Financing Review bestowed upon SIMEX the International Exchange of the Year Award in 1998, the only Asian exchange ever to win this title, and the fourth time SIMEX had achieved this award.

In 1999 it merged with the stock exchange to Form the Singapore Exchange (SGX)

Over-Regulated Financial Center

Page 78, 2nd Paragraph

However, Singapore's financial center was considered over-regulated compared to Hong Kong's. Critics wrote, "In Hong Kong, what is not expressly forbidden is permitted; in Singapore what is not expressly allowed is forbidden." They [the critics] forget that Hong Kong enjoyed the backing of the British flag and the Bank of England. Singapore, with no such safety net, could not have recovered from so dramatic a fall as easily. It had first to establish its reputation on it own.

Over-Regulated Financial Center

Page 80, 3rd Paragraph

For over three decades, I had supported Koh Beng Seng on restricting the access of foreign banks to the market. **Now I believed the time had come for the tough international players to force our Big Four to upgrade their services or lose market share**.

Well-Regulated Financial Center

Page 81, 4th Paragraph

The banks believed that a lighter touch in MAS supervision would enable them to be more innovative in introducing new financial products. Perhaps we should have made these changes earlier. But only after the MAS had demonstrated the strength of its system to weather the financial crisis of 1987 and 1997-1998 did I feel confident enough to move closer to a position where what is not expressly forbidden is permitted

Balanced Financial Center

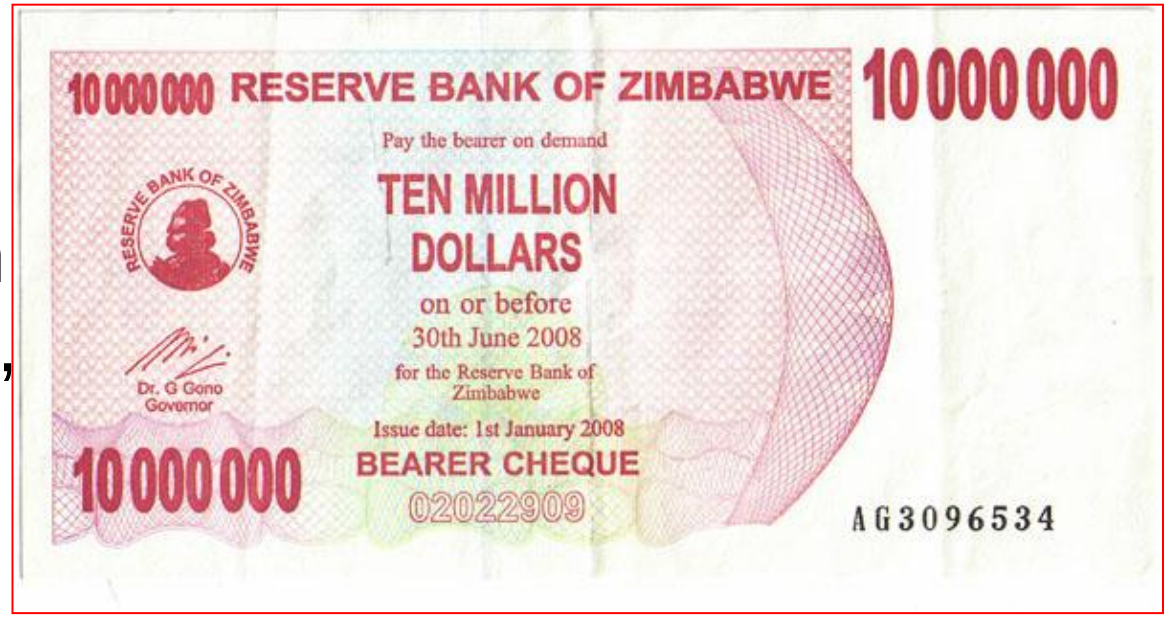
Page 81, 4th Paragraph

Our cautious approach helped us weather the 1997-1998 East Asian financial crisis. Our banks were sound and not overextended. No bubble puffed up our stock market. It has taken us 30 years from the time we first launched the Asian dollar market in 1968 to establish our credentials as a soundly managed international financial center.

Institute for National Transformation

Implication For Africa

- Fiscal Discipline: By adopting a highly conservative approach to Monetary regulation, Singapore set herself on a foundation of discipline.
- Monetary discipline: Singapore resisted the temptation to *"print"* her way into wealth.



Implication

- Monetary in-discipline: Who pays the price?
- How does a country get out of the spiral?

Implication

Where Shall Zimbabwe end?

Institute for National Transformation

Concluding Thoughts

- ***Discipline, discipline, discipline***
- Greatness does not happen by accident, it is largely a matter of ***choice***
- Very interconnected global world Economies are closely interlinked
- Integrity is a pre-condition to confidence (*integer*)
- Consolidation, Nurture and expose

Thank You!