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The Dissolution of a Monetary Union: The Case of Malaysia and Singapore 1963–1974

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The abrupt separation of Singapore and Malaysia in 1965 set these two states on separate political trajectories, but the economic ties proved more difficult to untangle. This article explores the nine years of transition required to complete the separation of the monetary systems of the two territories based on new archival evidence. It argues that, while socio-political hostility raged between the two partners, common economic interests prolonged an intimate monetary relationship that extended the interdependence of the two states for many years beyond their formal separation.

The unification of Malaysia and Singapore into the federation of Malaysia in September 1963 has attracted considerable interest among historians because of the complex political relations between these two emergent states and the unusual challenge of unifying two former colonies in the process of British decolonisation.[1] Given limited local resources, researchers have been able to access British documentation to trace the motivations for and obstacles to the unification negotiations since the British Commonwealth Relations Office and Colonial Office acted as brokers. Economic issues were raised during the negotiations preceding the creation of Malaysia in 1963, but they were largely overcome by the political momentum for unification. These negotiations did, however, rehearse the rivalry between the two parties, particularly Singapore's priority of protecting its economic future through a common market and retaining control over fiscal revenues, and the Malaysian government's concerns that Singapore's wealth would drain resources from the rest of the Malaysian peninsula.[2] The economic aspects of the acrimonious separation two years later has been less well examined, partly because of the relative lack of archival evidence from the main participants. A prominent exception is White, who has analysed the impact of the unification and political dissolution on British business in

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Malaysia, but the macroeconomic issues remain undeveloped.[3] Without direct archive evidence from the key participant states, historical accounts tend to rely on contemporary reports or speeches and memoirs of the key protagonists.[4] Thus, while the strategic and political aspects of the separation have been more thoroughly studied, the economic relationship has not been fully explored.[5]

The strategic impact was clearly of most immediate importance at the time, given the confrontation with Indonesia, but the Separation Agreement of 7 August 1965 also committed each state to 'cooperate in economic affairs in their mutual benefit and interest'.[6] Examining the monetary elements of the separation adds a new dimension to our understanding of this difficult time and clarifies relative bargaining positions, the extent of post-separation cooperation and the persistence of transitional arrangements linking the two states despite ongoing political hostility.[7] The economic and political elements in the relationship were clearly related. The Monetary Authority of Singapore later observed that:

> Singapore's path to monetary and currency independence in the 1960s was ... dictated by the sometimes tumultuous political relations with Malaysia. At times, economic criteria alone may have suggested a certain decision on monetary and exchange rate matters, but socio-political factors may intervene in the policy makers' deliberations.[8]

This article argues that, while socio-political hostility raged between the two partners in the mid-1960s, common economic interests prolonged an intimate monetary relationship that reinforced the interdependence of the two states for ten years beyond their formal separation.

The monetary relations between the two states also relate to more recent concerns. Strains in the Eurozone since 2010 have highlighted the difficulties of operating a monetary union across a range of sovereign states, prompting suggestions that even the Eurozone might fracture. The current debacle highlights the difficulties of operating a single currency over a range of fiscal authorities in a region with economies at different stages of development and per capita income. Recent examples of previous currency dis-integration are not very numerous: the collapse of the Soviet Union and the creation of new states in eastern Europe during the 1990s, the division of Yugoslavia into Slovenia and Croatia in 1991, the separation of the Czech and Slovak republics in 1992. Most of these cases of dis-integration followed a political dissolution among states. Historical examples include the Scandinavian currency union of 1901–1905 (which foundered on political dissolution between Norway and Sweden) and the joint colonial currency boards in East Africa, West Africa and the West Indies.[9] Ghana and Nigeria in West Africa launched central banks at independence in the late 1950s and the East African Currency Board fell apart in 1966, soon after constitutional independence of the constituent states.[10]

The case of Malaysia and Singapore offers a different perspective on the link between political and economic integration. This currency union began among the Straits Settlements in 1899 and continued after Singapore became a distinct crown colony in 1946 because of the close economic and commercial links among the territories. Unlike the African cases, in 1963 Malaya and Singapore embarked on political union, and planned to embed the existing monetary union within a single state. The union proved unsustainable and the next stage was political separation alongside extraordinary efforts to retain the monetary union, in line with the perceived economic interest of each state. With hindsight, given the loss of policy sovereignty implicit in a stable currency union, it is more surprising that the *status quo ante* was pursued so rigorously than that, in the end, currency union was not sustainable and monetary dis-integration took place in a staged process.

This paper uses newly discovered archival material from the Bank Negara Malaysia (the Malaysian central bank) as well as archive evidence from International Monetary Fund technical advisers and the UK Treasury, Bank of England and Foreign Office to trace how the process of monetary dis-integration was managed. Given the challenges in accessing primary historical sources in both Singapore and Malaysia, this new evidence makes a substantial contribution to our understanding of the dynamics between the two states during this time of political conflict. The case confirms the benefits of a gradual process of monetary dis-integration and offers fresh insights into how this was achieved between politically hostile but economically interdependent states. It also identifies the basis of their bargaining power and the role of multinational institutions in contributing to the outcome. Although the Malaysian economy and population were much larger than Singapore's, as the international financial and commercial centre for the Malaysian peninsula and with per capita income more than twice that of Malaysia, we might expect *ex ante* that Singapore would be in a strong position to determine the arrangements. But contemporary views were more optimistic about the development of the Malaysian economy than that of Singapore in the late 1960s. In addition, Malaysia had already developed a central bank, which placed it in a more powerful position to lead the discussions on monetary reform. Ultimately, Singapore's distrust of the Malaysian administration led to the abandonment of the efforts at continuing the monetary integration of the two territories.

The economic theory behind monetary dis-integration derives from the optimal currency area literature—in reverse.[11] A monetary union requires the loss of policy sovereignty (since interest rates of partners must be aligned) which is more likely to be palatable if the benefits in terms of reduced transactions costs or imported policy credibility are high. Strobel suggests that a country will choose to leave a monetary union when the inflation preference of the partner is substantially greater than is acceptable.[12] Also, if trade integration is reduced by distorting tariffs or other trade controls, this may reduce the benefits of monetary union. Both of these factors were at work in the Malaysia/Singapore case. Singapore preferred a rules-based system of policy-making to promote sustainable economic growth while the Malaysian government sought a more discretionary policy framework to support expansionary development policies. Dissolving a monetary union, however, is an expensive process due to potential losses of confidence due to uncertainty and the direct costs of replacing existing note issue (although there will be gains from seignorage). As a result, gradual drift away from trade intensity or diverging inflation preferences have not prompted many monetary dissolutions, as the Eurozone crisis of 2011 demonstrates. Instead, political change has usually been the catalyst for dis-integration as new states seek policy independence and the presentational advantages of a separate currency as part of nation-building. After constitutional independence in the late 1950s and early 1960s, a range of former British colonies wanted to introduce separate currencies as emblems of their new status.[13] The staggered pace of constitutional independence postponed Malaysia's adoption of the representational benefits of a national currency. Singapore remained a crown colony for six years after Malaysian independence in 1957, although self-government was achieved in 1959 after the introduction of a local head of state to replace the British governor. Through these constitutional changes, the common currency board continued to operate.

There can be substantial longer-term costs to monetary dis-integration in terms of increasing the barriers to trade and investment, as Schoors has argued was the case for the former Soviet Union.[14] Schoors suggests that these costs could have been minimised by instituting a payments union (analogous to the European Payments Union of 1950–1958) to allow payments systems to continue smoothly even with separate currencies. Šmídková argues that the case of the Czech Republic and Slovakia was successful because the process was gradual and deliberate, moving from a common currency to a currency union and then to a payments union in order to sustain convertibility.[15] Similarly, in the case of Singapore and Malaysia, there was an interim stage of 'interchangeability' of national currencies before final monetary separation, by which time the costs of exit had decreased.

Background to Monetary Union

Singapore and Malaya operated with a single currency issued by the Straits Settlements Currency Commissioners from 1899.[16] From 1953, the Malayan dollar was issued also on behalf of the British Protectorate of Borneo by the Board of Commissioners of Currency of Malaya and British North Borneo. When the Federation of Malaya became independent in 1957, it established a central bank, the Bank Negara Malaya (BNM), which began operations in 1959. The statutes of the bank included a provision to extend its operations to Singapore and Borneo, since the three states were expected soon to merge.[17] Some political parties in Malaysia were impatient for the Bank Negara to begin issuing its own currency, including the Socialist Front and the Pan-Malayan Islamic Party, when a new currency bill was discussed in the Malaysian legislature in mid-1960.[18] In Singapore, Lee Kuan Yew and Tan Siew Sin remarked that they would not oppose participation in a Malaysian currency issue, as long as they were able to ensure that Singapore's interests were safeguarded through continued joint management control of any joint currency.[19] The impetus for quickly winding up the currency board was believed in London to come mainly from political forces resisted by the Bank Negara (headed by W. H. Wilcock until July 1962) and the Malaysian Treasury 'counselling caution'.[20] The British authorities agreed among themselves that they should play no role in this issue, particularly since any intervention on behalf of Singapore's interests was likely to be counterproductive.[21] In July 1961, the Bank Negara prepared a plan for the Malaysian Treasury to transfer note issue powers to the central bank with a 'currency issue advisory board' on which Singapore would be represented. This board would determine the currency backing and exchange rate, essentially giving Singapore their desired veto on these two crucial issues.[22] In the end, these proposals were waylaid by the complex negotiations for political union, but they attest to the flexible attitude in Kuala Lumpur before unification over Singapore's right to control the exchange rate and currency backing of any joint currency.

In the meantime, the BNM had limited powers and the currency continued to be issued by the Commissioner of Currency so that the central bank operated alongside the currency board, described by the Malayan Finance Minister in retrospect as 'having a brandy and water without the brandy'.[23] In September 1963, the constituent members of the currency board merged to create the new state of Malaysia and the powers over currency, central banking and banking became subject to the jurisdiction of the newly expanded Federation of Malaysia, although the currency board continued to operate. By November, the Bank Negara and Malaysian Treasury began negotiations with Brunei (the only member of the currency board not to take part in the new Malaysian state) to transfer the resources of the currency board to the Bank Negara and to replace the currency board notes with Malaysian issue.[24] The Brunei authorities resisted and progress was slow. It was only at the end of 1964 that the federal government was in a position to give the required 18 months' notice that they would terminate the currency board on 12 June 1966 and from that date the BNM would issue a new national currency. The development of the monetary system of the new state seemed on the road to maturity, but political ructions were soon to throw this prospect into confusion.

The merger of Singapore and Malaysia was short-lived due to political conflict between the mainly Chinese population of Singapore and the Malay-dominated government in Kuala Lumpur. The new combined state struggled with racial conflict and distrust among its constituents until Singapore exited in August 1965. From this point the management of the currency board reverted to its pre-unification status with three independent members: Malaysia, Singapore and Brunei. With a deadline for the issue of a national Malaysian currency still set for 12 months thence, the issue of how the monetary system could reflect the new political context had particular urgency for all parties.

Singapore was the key financial centre and main port for the raw material production of the Malayan peninsula, in particular rubber and tin, which dominated economic activity in the region. Conversely, Singapore's economy relied on imports from Malaysia as well as selling financial services. The integration of trade and payments between the two states was intense and the potential costs of disrupting these flows were large for both parties. Measuring trade between the two territories is problematic due to the apparent inclusion of trans-shipment trade in Singapore's trade returns (particularly for the flow of goods through Singapore to Malaysia). Singapore colonial data suggest that trade with the Federation of Malaya amounted to about 20 per cent of total trade from 1958 to 1962 and that these levels were sustained through the political merger and separation of the states. The IMF Direction of Trade data (available only from 1967) are presented in Figures 1 and 2, which show a contrasting trend for the two states. For Malaysia, Singapore continued to account for about 15 per cent of total trade until the late 1970s while there is a pronounced and sustained decline in Malaysia's importance for Singapore's trade. A further characteristic is that Malaysia appears to run a substantial trade surplus with Singapore while the trade was more balanced on Singapore's side. However, Malaysia's recorded imports from Singapore were much smaller than the relevant partner data from the Singapore side, suggesting that the Singapore data include transit trade allocated to other countries of origin by Malaysia. Nevertheless, the basic trends are clear.

By May 1973, when Malaysia unilaterally announced the suspension of the interchangeability of the two separate currencies, Singapore had diversified its trade towards the USA and Japan; these two partners accounted for 18 per cent of Singapore's recorded trade in 1968 and 30 per cent by 1974. Malaysia's trade distribution was more stable during these years; Japan increased from 16 per cent to 19 per cent of total trade due to increased imports, compensating for slight declines in the share of trade with the UK and USA. These trends suggest that Singapore was initially more reliant on its trade links to Malaysia than was the case vice versa, and that, over the course of the separation of the currencies, the trade intensity between

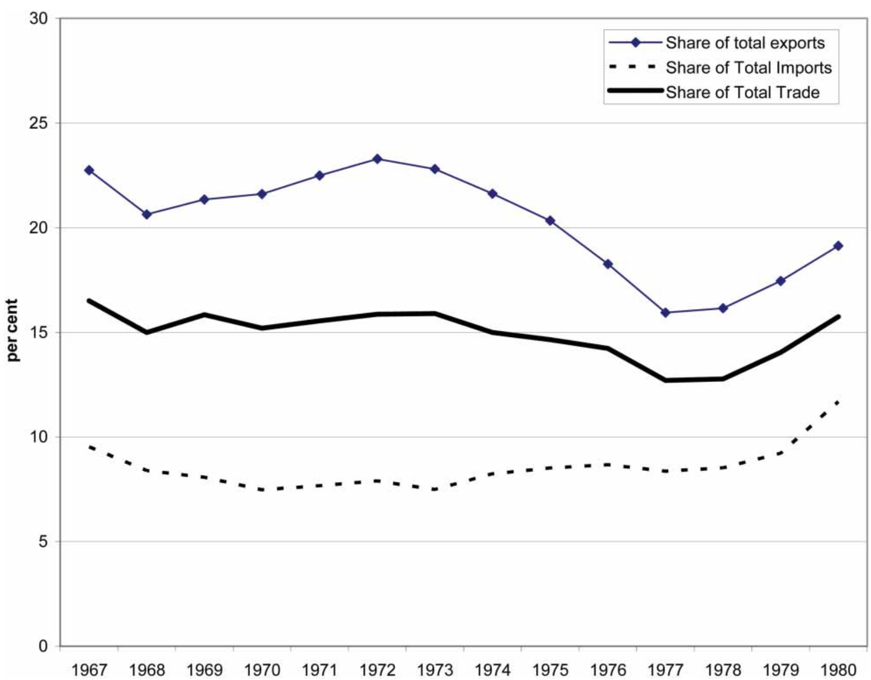

Figure 1 Malaysia's trade with Singapore as a percentage of Malaysia's world trade

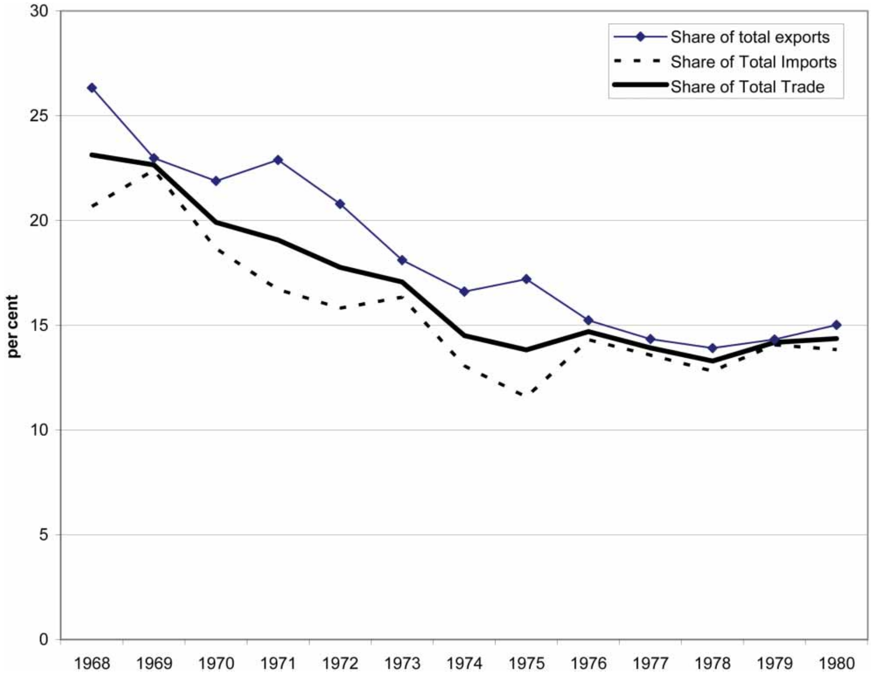

Figure 2 Singapore's trade with Malaysia as a percentage of Singapore's world trade

the two states converged to about 15 per cent of total trade. These levels are rather lower than for many currency areas, for example, in 1992 46 per cent of Slovak exports went to Czech Republic and 31 per cent of Czech exports went to Slovakia.[25] Intra-republican trade in Yugoslavia in 1987 ranged from 40 per cent to 90 per cent of production for individual republics.[26] This changing commercial context reduced the opportunity costs of separate currencies by the time of the formal break between the two monetary systems in 1973.

Political conflict and Malaysia's ambitions to promote national development further weakened the economic ties between the states. Immediately after the separation in 1965, both sides introduced trade controls on a range of goods across the new border to exercise their independence, although there were no restrictions on banking or financial flows. Negotiations for the completion of a free trade area between the states were suspended. It also became clear that Malaysia sought to reduce its dependence on Singapore by improving its own ports and financial infrastructure. Ethnic rioting in Malaysia in 1969 prompted the suspension of the government and the introduction of a New Economic Policy in 1970 that focused on the internal distribution of economic activity as well as a more robust nationalist approach to external economic relations and an ambitious development plan. However, this enhanced nationalism did not affect monetary relations with Singapore until mid-1973 when instability in the global monetary system offered an opportunity to reform relations with Singapore.

Negotiating Away the Currency Board

Some of the correspondence between Malaysia and Singapore over currency issues is available in a White Paper published by the Singapore government when the negotiations broke down in 1966. This account, perhaps naturally, tends to emphasise the Singaporean initiatives rather than Malaysian leadership of the negotiations, which is revealed in newly available archival records in Kuala Lumpur, Washington and London.[27] This new evidence emphasises the dominant position of the BNM well before formal talks began with Singapore in November 1965. Ismail, the governor of the BNM, convened his board of directors on Saturday 21 August 1965, only two weeks after the separation of Singapore from Malaysia. Ismail advised the board that the BNM would continue to operate through its branch in Singapore for the time being and that the Singapore minister of finance 'had indicated that unless the Malaysian Government had other plans, the Singapore Government would like the C.B. to continue to operate in Singapore'.[28] When the board of directors met again two weeks later, Ismail reported that 'the Singapore Minister of Finance had indicated that the Singapore Government was favourably disposed to the Central Bank continuing to operate in Singapore and to administer banking legislation there subject, however, to certain reservations' that were unspecified. This proved to be an overly optimistic impression of Singapore's position.

At a meeting two weeks later, in early September 1965, the board of the BNM discussed various options for cooperation between the two states. The memorandum for discussion set out the recent development of monetary relations, noting that, when the Bank Negara Malaysia was being designed in the 1950s, British advisers had stressed the importance of a continued currency union with Singapore and an eventual joint central bank.[29] This was important for confidence in any new currency and to allow the territories to operate as a single economic and banking unit. Moreover, the commercial integration of the states meant that any monetary policy shift in one would affect the situation in the other so there would need to be 'broad coordination of the general lines of Government fiscal and economic policies. . .a common currency system and a joint central bank would achieve this objective'.

In 1961, when the BNM decided to issue a new Malaysian currency by 1966, the Malaysian government agreed that negotiations should take place to have the new Malaysian currency replace the currency board's issue in all three constituent territories. Preliminary discussions found the Singapore government amenable as long as the exchange rate and the foreign currency backing of the currency could not be changed without agreement from Singapore. This effectively allowed the continuation of *de facto* currency board arrangements as long as Singapore wished. The memorandum before the board of the BNM in September 1965 recalled that, at that time, the Malaysian government was willing to accept Singapore's conditions because of the high cost of introducing new barriers to cross-border payments arrangements and the potential for rivalry between two separate currencies. The proceeds of most Malaysian exports went through banks in Singapore, so it would be difficult to impose effective trade and exchange controls to protect the value of a separate Malaysian currency.

Malaysia would not have complete freedom over their exchange rate in this case since devaluation could lead to capital flight to a stronger Singapore currency. In the same way, reducing the currency cover would threaten a rush out of the Malaysian currency. 'Under such circumstances, the investment policy of Bank Negara Tanah Melayu [Malayan Central Bank] would be almost as circumscribed as under the existing arrangements'. Prior to political unification, therefore, the prospects for a common currency issued by the Malaysian central bank appeared uncontroversial. The unification of Malaysia and Singapore in 1963 temporarily halted these discussions and, by the time they were revived in the new political climate, opinion in Kuala Lumpur had changed.

After rehearsing this history, the memorandum for the BNM board of directors in 1965 set out the advantages and disadvantages of a common currency with Singapore after the new political separation. The only advantage cited was that economic integration between the two states still made a common currency a sensible choice, and that this case was as strong in 1965 as it had been before 1963. The disadvantages of a common currency were more numerous, partly due to the poor state of political relations. Malaysia would lose sovereignty over its exchange rate and monetary policy, particularly 'if the two Governments should have differing political ideologies' as clearly seemed to be the case. The extent of foreign exchange cover could also be a source of dispute if Malaysia wanted to increase the money supply through currency expansion without 100 per cent foreign exchange backing. The memo suggested rather boldly that, if one country went to war and the other did not or engaged on the opposing side, the common currency would make it impossible to impose exchange controls. The Indonesian Confrontation was perhaps in the minds of Malaysian officials on this point. More practically, a free flow of funds would make it difficult to identify separate balance of payments accounts since 'the foreign exchange reserves of the two countries are held in one pocket'. Finally, the paper noted that the choice of governor of a new central bank could be controversial—here Ismail's own position was clearly important. This long list of technical and political obstacles as compared to one economic imperative led to the conclusion that it would be 'extremely difficult, if not impossible' to share a joint currency issued by a central bank with Singapore participation, but that as close a link as possible should be maintained. Ismail's position was clear: 'under no circumstances should Malaysia contemplate the continuation of the Currency Board system in any form. Any such arrangement would deprive the government of freedom of action in monetary matters.' The economic rationale for a common currency was not to be allowed to interfere with Malaysia's policy independence.

The memo proposed three options that all allowed for unfettered interchangeability at par of separate currencies in each territory with a range of governance structures. A new joint central bank could replace the BNM and be jointly owned and operated, although the governance would have to anticipate that 'the eventual creation of two central banks could be regarded as almost inevitable' so this would be an interim solution. Second, and more favourably from Ismail's point of view, the BNM could continue operating and use the provision for extending its operations into other territories (which was in the bank's original statutes) to issue currency for Singapore and Brunei as well as to perform other central banking activities such as banking supervision and regulation. This solution (unsurprisingly) was the one favoured by the BNM board of governors and by the Malaysian cabinet as it would be 'without any need for the surrender of Malaysian control over the Bank's operations'.[30] A third alternative was the creation of two separate central banks with the currencies of the two banks circulating freely in both states. The case of the UK 'where English, Scottish and Irish notes circulate freely' was cited, showing a lack of understanding of the role of the Bank of England as the only central bank in the UK monetary system. Two separate central banks and free circulation of currency would still require close coordination on economic policies and exchange rates because of the economic integration of the two states and therefore a loss of Malaysian policy sovereignty.

After 'some discussion of the memorandum' the board of governors agreed to advise the Malaysian government that negotiations with Singapore on banking and currency matters should be based on a proposal that the BNM would operate in Singapore under the provision in the Central Bank of Malaysia Ordinance 1958 (Section 56) that allowed for the BNM to extend its jurisdiction to other territories.[31] Negotiations should focus on the functions that the BNM would perform for Singapore, arrangements for referring matters of policy to the Singapore finance minister, and payment of any net profit on Singapore's currency issue to the Singapore government. In this respect the BNM board envisaged distinct currency issues for each territory within a common monetary area. Although both sets of notes would be issued by the BNM, the notes circulating in Singapore would embody 'some features to distinguish it from the currency issue for Malaysia' analogous to the national emblems on the Euro today.[32] These proposals were endorsed by the Malaysian government's Advisory Committee on Economic Relations with Singapore and were approved by the Malaysian cabinet in November. Meanwhile, in October Tan Siew Sin, the Malaysian finance minister, invited the IMF to send a special mission to Malaysia for consultations on currency matters.[33]

Like Malaysia, Singapore hoped that the currency union could be prolonged and Lim Kim San, finance minister of Singapore, wrote to Tan Siew Sin on 8 November to propose the continuation of the joint currency board or, failing this preferred option, that the two states should establish a joint central bank.[34] Ismail and Choi quickly met with Lim and presented him with their proposal to extend the BNM's jurisdiction to Singapore to replace the currency board rather than establish a new central bank.[35] Ismail rejected outright the continuation of the currency board, which he claimed was an outdated and inflexible system. Having waited six years for full powers for his central bank, Ismail was not content to let the opportunity to seize these powers escape. More controversially for Singapore's sovereignty, Ismail's proposal would see his bank supervise the Singapore banking system, operate Singapore's exchange control and be banker and financial adviser to the Singapore government.[36] In response, Lim pointed out that the automatic nature of the currency board had ensured the stability of the local dollar through difficult political and economic times, and he questioned whether local money markets were yet developed enough to allow the effective open market operations needed for monetary independence.

Ismail acknowledged this local weakness, but asserted his goal of developing the local money market, as had begun with the establishment of Short Deposits (Malaysia) Limited. This exchange highlights the different attitudes of the two states to monetary policy. Singapore was more preoccupied with monetary stability and international reputation related to its international financial sector while Ismail wanted to take advantage of opportunities for a more expansionary monetary policy in line with Malaysian development aspirations. These different priorities ultimately undermined the prospects for a currency union as the negotiations went forward.

A party of three experts from the IMF visited the area from 25 November to 9 December 1965 led by J. V. Mladek, director of the IMF's Central Banking Service. They met first with Tan and Ismail in Kuala Lumpur on 27 November where Mladek challenged Tan over whether it was reasonable to expect Singapore to give up as much autonomy as was proposed in extending the operation of the BNM into Singapore. Tan responded defensively that Malaysia should clearly lead any institution since Singapore's prosperity depended on its entrepôt services for Malaysian production and trade and threatened that, 'if it became necessary, Malaysia could without much difficulty and in a relatively short period of time, take over this function which would seriously affect Singapore's economic position'. He stressed Malaysia's development ambitions and the goal of handling all Malaysia's own foreign trade directly rather than continuing to rely on Singapore. Mladek responded that this did not accord with Tan's plans for a currency union, which needed to be based on a solid foundation of economic cooperation and coordination. Tan replied that he did want to maintain close economic relations with Singapore but only 'if it could be done without in any way jeopardising the sovereignty of Malaysia in any monetary and financial matters'. The political strains were clearly a major obstacle and Tan's commitment to monetary integration was contingent on Malaysia obtaining control over policy.

Mladek proposed that negotiations proceed on two fronts. First would be to agree the role of each state in managing the currency (e.g. membership of the board and officers) and identify the policies on which agreement had to be achieved (e.g. exchange rate, credit controls, currency cover, discount rate). He urged Tan to delegate as much local currency and banking management as possible to the Singapore branch of the BNM in order to encourage Singapore's participation. Second, since currency union required greater economic cooperation, some machinery for consultation on topics such as fiscal borrowing, wage policy and exchange control would need to be agreed. This list was an ambitious target for politically opposed states. Nevertheless, at the end of the meeting the Malaysian side emphasised their strong preference for a common currency rather than separate currencies that were interchangeable at par, and invited the IMF team to meet with commercial interests in Malaysia to witness how strongly this was also the market's preferred outcome.

The consultation with the IMF revealed the lack of conviction among Malaysian ministers about devolving any of their sovereignty in a way that would be necessary to engage in a currency union with another state, despite the strong commercial pressure to pursue monetary union. This contradiction led the IMF team to be sceptical that a deal could be concluded. On the other hand, the Malaysian government was under pressure from local bankers and producers for a smoothly operating currency union to be sustained. The IMF mission generally approved of Ismail's proposal to extend the BNM, but was more sceptical of the political will to implement it, noting that 'other Malaysian official circles appeared to take too biased a view of the economic importance of Malaysia in relation to Singapore' and that they underestimated the economic damage to Malaysia posed by breaking up the currency union and severing economic cooperation with Singapore.[37]

Members of the Council of the Association of Bankers of Malaysia and Singapore advised the IMF mission that most bank business on both sides of the border was related to the financing of foreign trade.[38] For the local Malaysian banks, commercial credits accounted for close to half of all credits. About 45 banks operated in the two territories, including foreign banks. Only 12 banks were registered in Malaysia, and half of these operated only in the Borneo states. Of the six Malayan banks, only three had branches in Singapore. Conversely, four Singapore banks had branches in Malaysia. The total volume of deposits of the 12 Malaysian banks was about M$1.7b as against M$1.1b for Singapore banks. Since Malaysia's economy was about three times the size of Singapore, Malaysia was clearly less well endowed with banking facilities relative to the size of the economy. The bankers worried about the extra costs of managing two currencies among branches on either side of the border, including separate reserves and exchange rate risk. They warned that 'the general public, as well as the banks in both Malaysia and Singapore would be appalled if there were to be two currencies for the two countries. Such currency separation would lead to utter confusion, cause considerable business uncertainty, and affect adversely the flow of investments from one country to another.' Even after initial uncertainty had abated, the restoration of the flow of funds 'would be contingent upon the stability of the exchange rate between the two currencies, the general state of the economy of each country, and the degree of economic cooperation between the two countries'.[39] Commercial concerns were clearly paramount, although the bankers also believed that the introduction of two currencies would make the political separation of the states even more irrevocable.

In Singapore, the IMF mission found Prime Minister Lee Kuan Yew keen to retain the currency union in order the preserve economic ties between the countries and to leave the door open for political reunion. However, he was not willing to forgo Singapore's interests to achieve this end. In particular, Lee insisted on retaining control of Singapore's share of the external assets of any common currency authority.[40] The Singapore side had three possible alternatives for the IMF to suggest to the Malaysians. First, given the difficulties of creating a new common currency, the Singapore government preferred to retain the currency board for a further two years to resolve the outstanding political and economic issues. If Malaysia insisted on changing the current system, Singapore preferred to establish a new joint currency and joint central banking authority. If even this compromise was not acceptable, they would agree to the Malaysian proposal to extend the BNM 'subject of course to certain basic conditions and safeguards'.[41] What Singapore considered 'basic' was to become a source of dispute.

By this time, the Singapore Treasury had developed a series of conditions for retaining the currency union with particular emphasis on the right of Singapore to veto changes in the exchange rate or foreign exchange backing, the two elements that would ensure confidence in the stability of the currency and contain inflationary expansion. By maintaining a fixed exchange rate to sterling and holding 100 per cent currency reserves they could continue a *de facto* currency board under the guise of a central bank. They also insisted that Singapore's share of the external assets be held physically in Singapore and recognised as legally owned by the Singapore government. None of the central bank's reserves was to be loaned to the Malaysian government. In terms of governance, the deputy governor of the central bank would be from Singapore and both governments would have to consent to the appointment of the governor. Staff of the Singapore branch would be Singapore citizens and Singapore's representatives on the board would be able to reserve their positions on various issues such as liquidity ratio requirements, which would not apply in Singapore until the government agreed. Finally, Singapore insisted that arrangements be put in place to distribute the foreign exchange reserves in the event that the common currency was dissolved. In particular, they wanted the allocation to be on the basis of the 12-month average of the distribution of currency balances between the two territories rather than the distribution on the date of the separation alone.[42] This requirement echoed the bitter and prolonged dispute over the distribution of the existing currency board assets.

Over the following six months, negotiations proceeded on the basis of the BNM proposals. IMF staff visited Kuala Lumpur again in June 1966 at the request of both parties to assist in drafting the proposals. San Lin, the IMF representative, noted that the approaching end of the confrontation with Indonesia as well as the passage of time had 'helped to cool tempers on both sides' and the mood had improved since December.[43] The negotiations were gruelling, twice extending from 10 am to midnight, and 11 meetings were held alternately in Kuala Lumpur and Singapore, all chaired by Governor Ismail.[44] The IMF team provided technical advice and compromise solutions as well as advising the Singapore side on central banking since they had less expertise in this area than Malaysia. The negotiating group finally arrived, on 5 July 1966, at agreed statutes for the extension of the BNM to Singapore which met most of Singapore's requirements. The ministers of finance of each state had to be consulted before any change was made to the exchange rate of the common currency or the type or ratio of the reserve backing. Any alteration in the parity without the consent of both governments would constitute a termination of the agreement. In effect, this gave Singapore a veto over any inflationary departure from a *de facto* currency board system. Also, both finance ministers had a veto over monetary and banking policy in their territory.

The statute established two institutions: the Bank of Malaysia as under the Central Bank of Malaysia Ordinance (with three out of ten board members from Singapore) and its office in Singapore, to be named either Central Bank of Malaysia-Singapore (the hyphen was ultimately not acceptable to Malaysia) or Central Bank of Malaysia, Singapore. The Singapore branch was to form a separate accounting and operational unit of the Bank of Malaysia, run by the Singaporean deputy governor with separate external reserves and balance sheet and performing the duties of banker and adviser to the Singapore government, with powers to influence the credit environment and promote financial and monetary stability in Singapore. All the central bank's notes would be common legal tender, but there would be two issues with slightly different seals and prefixes. Currency issued by one office and withdrawn from circulation by the other office would be repatriated and become a claim payable in foreign funds. Settlement between Kuala Lumpur and Singapore would take place through inter-branch accounts with net balances settled periodically by transfers of external reserves. There was no formal apparatus for coordinating fiscal or general economic policy between the two states and in many respects this compromise solution was very close to the interchangeability agreement that was finally agreed between the BNM and the Singapore currency board. At the time, the IMF representative was optimistic that approval could be concluded between the two governments within a month, but the compromise quickly unravelled.[45]

The difficult issue of control of Singapore's assets within the common central banking structure combined with distrust on Singapore's side proved the ultimate stumbling block. When, on 11 July, Ismail requested that title of the land of the Singapore branch of BNM should be retained by the BNM but the value transferred to the Singapore branch, the Singapore government confronted the legal difficulties of retaining absolute and immediate access to what it considered its owned assets when they were formally vested in the Bank Negara Malaysia.[46] Worrying that a future and more hostile Malaysian state might not deliver the assets after termination of the agreement in accordance with the legal statute, Lim proposed bringing in a third party as a trustee to hold the central bank's assets (perhaps the Bank of England or the IMF) or vesting the assets of the Singapore branch with the deputy governor personally rather than the BNM. On the trustee proposal, Tan responded that 'no self-respecting central bank can accept such a position' since all operations would have to go through the foreign trustee. The second suggestion was rejected as tantamount to having two central banking organisations. Lim sought further delay in finalising the legal arrangements to the satisfaction of both sides, but, with the deadline approaching for the Malaysian side to order its new note issue in time for the launch in mid-1967, Ismail abruptly announced on 17 August that a separate Malaysian currency would be issued from June the following year.

The genuine expectation that the Bank Negara would be extended to Singapore is evidenced in preliminary expenditure on a Singapore branch of the BNM in 1967, which had to be written off in 1968. The details of the expenditure are presented in Table 1. The total amount of $564,230 was only roughly equivalent to the interest earned on the BNM's deposits in Singapore ($596,822) or 2 per cent of net profit for 1968.[47] Nevertheless, they indicate some forward planning for BNM's extension into Singapore as late as 1967.

Table 1 Expenditure on proposed permanent building for Singapore branch of Bank Negara Malaysia: 1967 (Malaysian dollars)

Architects	312,698
Structural engineers	142,344
Quantity surveyor	53,275
Drilling and penetration test	11,143
Preliminary designs and reports for air conditioning and lifts	44,270
Professional fees	500
TOTAL	564,230

Source: Bank Negara Malaysia – 1968 Final Accounts, 7 March 1969, 19850005811, ANM.

The reason for the failure of the currency union was lack of trust between Singapore and Malaysia over the disposition of foreign exchange assets related to the currency issue. For Singapore, the prospect that a future Malaysian government might seize these assets even if they were earmarked through the formal statutes proved insurmountable. This attitude was no doubt influenced by the inability of the two sides to agree a formula to distribute the remaining assets of their joint currency board. Malaysia insisted on a formula based on the distribution of profits in 1963 (which favoured Malaysia) rather than the distribution of currency issue and redemption (which favoured Singapore).[48] The Singapore side also feared that future governments in Kuala Lumpur would promote a more inflationary expansionist policy that would be unwelcome in Singapore's burgeoning international financial and commercial centre. These opposing policy trajectories meant that the two states did not form an optimum currency area. The British high commissioner in Singapore also suggested that race played a role and that 'in matters of finance, bankers, businessmen and politicians of Chinese origin in Singapore have no confidence in their Malay brethren either in Singapore or elsewhere'.[49]

Issuing Separate Currencies: Interchangeability

After the failure of the negotiations for a common currency, Singapore requested support from the IMF to issue its own notes and coin. The mission visited from 20 November to 6 December 1966. Although, when the talks collapsed in August, the Singapore government had announced its intention to continue with a currency board system in order to retain confidence, the IMF recommended that Singapore establish its own central bank which would be more commensurate with the sophistication of the country's banking and credit structure.[50] The finance minister was receptive to the idea for a monetary authority with credit control powers and endorsed the proposals to the Cabinet, but they rejected a central bank in favour of a currency board with banking supervision undertaken by a banking commissioner—similar to the arrangement introduced in Hong Kong in 1965. Given the precarious position of Singapore as a new republic and the announced withdrawal of British forces from the territory, the Cabinet opted for a conservative approach in order to minimise disruption and to help retain confidence in the local economy.[51] In 1971 the Monetary Authority of Singapore took over the monetary and supervisory functions of a central bank but the Board of Commissioners of Currency, Singapore continued to manage the currency separately until 2002.[52]

The IMF staff also recommended that Singapore pursue an agreement with Malaysia to have the notes of each country accepted as 'customary tender' among commercial banks. To underpin this arrangement, the two central banks would accept the notes of the other country against local currency at par without commission. The two central banks could then settle balances periodically through accounts in London. The Singapore government authorised the IMF staff to approach Malaysia informally, where the idea was met with enthusiasm. The IMF staff agreed to draft an exchange of letters between the two states to begin negotiations once the legislation for the new Singapore currency was ready in about February 1967 and advised both sides to avoid further public discussion until the negotiations had taken place. Within a week, however, the Malaysian side announced publicly that they had 'offered' interchangeability to Singapore and were waiting for a response. This brinkmanship irritated the Singapore side and, in the view of the IMF, reduced the likelihood of gaining any agreement.[53] Nevertheless, by 7 January both sides had agreed in principle to adopt some form of interchangeability.[54]

The primary concern for Singapore was retaining a fixed exchange rate between the two currencies and Lim worried that inter-bank transactions might introduce rate fluctuations.[55] The BNM could counter these fluctuations but the Singapore currency board did not have the resources to intervene in the foreign exchange market. Concerns arose over whether the transfers would be primarily between the central monetary authorities (i.e. they would store up balances and take the exchange risk) or between commercial banks on either side of the border (i.e. the banks would take on the risk). The response from Singapore was that they preferred the transfers to take place through the commercial banking system since their currency board could not bear risk.[56] Ismail insisted that discussions not be at government level, but rather between him and his counterpart, the chairman of the new Singapore currency board. The Bank of England recommended the example of the East African Currency Board, which held accounts in the name of several central banks and cleared balances through them, settling the accounts at the end of each week.[57] However, both the Bank of England and the Commonwealth Office were reluctant to get involved in advising on this issue, as they might be accused of taking sides in any subsequent dispute between the two states; they preferred to leave it to the supposedly more neutral IMF adviser Familton, who passed through London on his way to Kuala Lumpur in early 1967 and received the views of the Bank of England.

The IMF draft letters on interchangeability of notes were finally concluded on 9 March 1967 and provided for the collection of notes and coins by each monetary authority and then periodic repatriation against settlement in 'sterling or other agreed currency'.[58] Interchangeability through bank transfers proved more intractable than the physical exchange of notes. Malaysia tried to urge Singapore to adopt an account system at their respective monetary authorities similar to the East African Currency Board, but they refused, probably because it was not deemed appropriate for the currency board to accept a holding account for the BNM, since this went beyond the scope of their currency board's activities.[59] Instead, it was left to commercial banks to set up clearing accounts across the border. The Association of Banks in Singapore and Malaysia continued to operate as a single entity and agreed on rates of 0.125 per cent on transfers up to $20,000 and 0.0625 per cent on larger sums. A final hitch appeared when Brunei balked at the 'other agreed currency' phrase for settlement but the exchange of letters finally took place on 5 June 1967. It was clear at this early stage that the operation of the interchangeability would face challenges.

In June 1967 separate currencies were finally introduced. To retain the advantages of integration, each currency was to circulate at par in the other territory with periodic clearing back to the country of issue. The external exchange rates were also fixed at parity against sterling. The new Singapore dollar issued by the Board of Commissioners of Currency was backed by 100 per cent gold and foreign exchange and was freely convertible to sterling on demand. The currency board statutes allowed for the diversification of reserves away from sterling to other foreign exchange but no reduction in currency cover.

The management at the Singapore branch of the HSBC was initially critical of the process, alleging that:

> neither government appear to have considered the implications of the change-over sufficiently before it took place. One of the most disturbing aspects so far is that at the present time no arrangements exist whereby banks can exchange the respective currencies with the currency boards in the two financial centres—the only medium of settling differences being through sterling (or other foreign currencies).[60]

In order to ease the operations, in October the Singapore currency board began to sell spot sterling to commercial banks on request. After the devaluation of sterling against the US dollar in November 1967, there was considerable market pressure against both local currencies due to expectations that they would follow sterling and devalue. This created a heavy demand for forward cover and on 2 December commercial banks in Singapore urged the accountant general as head of the Currency Board to meet the demand in order to retain confidence in the Singapore dollar.[61] From 6 December the Currency Board began selling sterling forward. The BNM on the other hand did not provide sterling either spot or forward on request so there was a strong demand for sterling through Singapore to meet the needs of both territories. The Currency Board did not charge any margin between sales and purchases, although bankers recommended a charge of 1/32d either way to put some grit in the market. The reason given by the Singapore authorities was the BNM's insistence on a strict parity for the exchange rate.[62] By the first week of January 1968, Singapore's willingness to supply sterling on demand appeared to have steadied confidence and, after about £8m of forward cover had been bought, demand eased off.[63] The episode exposed the strains likely from different operating practices on either side of the border.

The separation required the switch of the accounts of the West Malaysian branch of HSBC from Singapore to Kuala Lumpur. Higher interest rates in Singapore (0.5 per cent prime) encouraged the bank's clients to shift their overdrafts to Malaysian branches, while lower tax rates in Singapore on deposit interest for non-residents (10 per cent rather than 40 per cent) attracted depositors to Singapore. The HSBC also reported that 'firms in Kuala Lumpur who previously paid for their imports in Singapore are jibbing at the increased rate of so-called inland exchange and are also transferring their facilities'. The separate currencies thus encouraged more banking activity in Malaysia (a goal of the BNM) although HSBC continued to complain about the increase in regulations and requests for statistics by the Bank Negara Malaysia.[64]

The initial acceptance of the new Malaysian currency was greatly aided by the 14.3 per cent devaluation of sterling in November 1967. At this time there was still M$600m of old currency in circulation and it was gradually being redeemed at par for new currency. Since the old currency was statutorily pegged to the pound but the new currency did not follow the devaluation of sterling, the old currency was effectively depreciated against the new currency by 14.3 per cent. This provoked a series of riots and social unrest by those who felt betrayed by the government which had promised a 1:1 exchange of old to new currency. In January 1967 Tan had assured the public that 'no loss whatsoever will be incurred in this exchange—every Malayan dollar will be exchange for exactly one Malaysian dollar'.[65] Poorer and rural inhabitants tended to hold more of the old currency and were thus most disadvantaged. In the end, as a compromise, the BNM agreed to exchange old coins at par to help the poorest who tended to hold more coin.

Nevertheless, confidence in the new Malaysian currency tended to be weaker than that in the Singapore currency. The interchangeability did not extend to bank balances so transfers either had to be through sterling or by mutual offsetting of balances by banks across the border. The first method of transfer to Singapore was restricted because the BNM would not sell sterling on demand against Malaysian dollars.[66] Christopher Fogarty of the British High Commission in Kuala Lumpur learned from Ismail that he was informally rationing sales of sterling by requiring detailed evidence of the use for which each bank's requested sterling would be put. Although warned that this could undermine confidence in the convertibility of the Malaysian dollar, Ismail asserted that all 'legitimate' requests for sterling had been met.[67] By March 1968 the demand for sterling receded in the context of the global gold crisis which weakened confidence in the dollar and the pound, although Fogarty reported continuing delay and difficulties experienced by banks in Kuala Lumpur.[68] Finally, in mid- March 1968 interchangeability was extended to bank balances and to facilitate this process the BNM opened an account in Singapore currency with the accountant-general in Singapore. The accountant-general opened a mirror account in Malaysian dollars with BNM.

Figure 3 shows the pattern of repatriation of the two currency issues in the years leading up to the announcement by the Malaysian government on 8 May 1973 that they would suspend interchangeability by 7 August. The data show that there was a substantial flow of notes between the two states and that a consistently larger amount was repatriated from Singapore to Malaysia. The exception was when the suspension of interchangeability was unilaterally announced on 8 May by authorities in

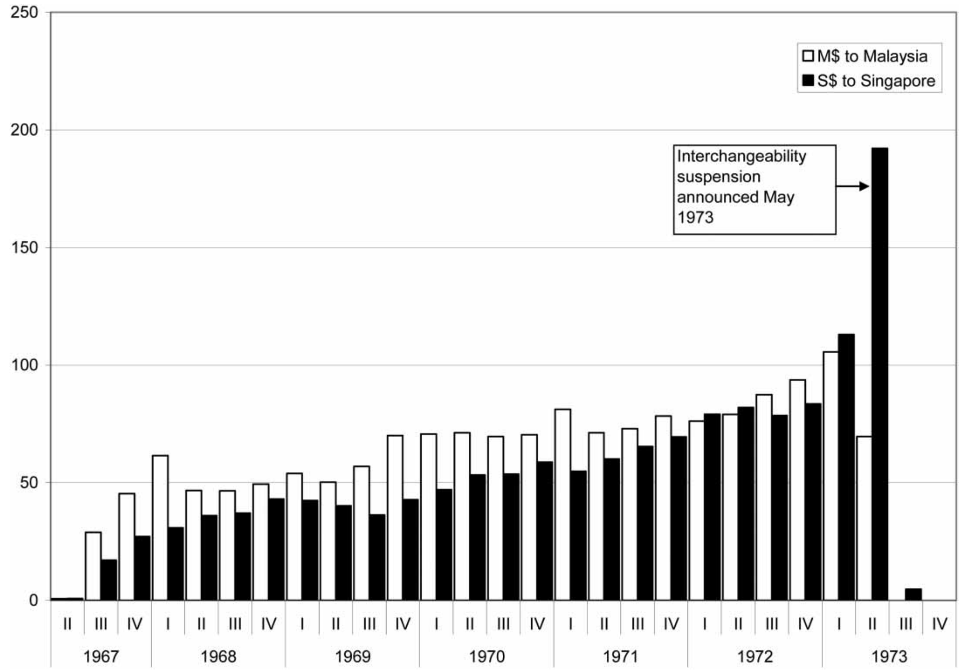

Figure 3 Repatriation of Singapore and Malaysian currency (S$ million).
Source: Board of Commissioners of the Currency, Singapore, Annual Report and Accounts 1973.

Kuala Lumpur. This prompted a rush of Singapore dollars circulating in Malaysia back to Singapore in advance of the August deadline. Conversely the flow of currency out of Singapore fell in this quarter. The quarterly repatriation of Singapore currency from Malaysia comprised a remarkably stable share of the total Singapore currency in active circulation—between 7 and 9 per cent. The surge on the eve of suspension of interchangeability amounted to 20 per cent of the Singapore's currency. This suggests that perhaps 20 per cent of Singapore's currency issue was held in Malaysia prior to May 1973.

It is clear from this evidence that the system was not without strains and that it did not comprise a full payments union. In June 1968 Malaysia introduced controls to insist on payment in foreign currency (not S$) direct to bank accounts in Malaysia for exports even when they were routed through Singapore. In addition, administrative costs were increased by requiring exchange control forms to be completed for all exports via Singapore and the UK over M$5000 (a decrease from the previous M$20,000 threshold). Tan Siew Sin also claimed that the interchangeability inhibited the development of Malaysian financial and commercial institutions since Singapore had the advantage of incumbent marketing institutions, for example for rubber.[69]

Between the issue of the new currencies in June 1967 and the monetary break with Singapore in May 1973 the Malaysian political system underwent considerable upheaval. Riots in 1969 led to the suspension of the government and the launch of a much more aggressive development policy based on ethnic and racial identity. Meanwhile, Singapore began to promote its offshore market, eliminating withholding tax on deposit interest earned by non-residents in August 1968 and launching the Asiadollar market through the First National City Bank in March 1969. At the same time, Lee Kuan Yew solicited FDI to enhance Singapore's manufacturing base and absorb labour. These developments pulled the two economies further apart while the global context of the pegged exchange rate regime crumbled and the benefits of greater exchange rate flexibility for monetary independence gained credence among policy-makers.

Suspension of Interchangeability

Malaysian Finance Minister Tan Siew Sin unilaterally gave three months' notice of the end of the automatic transfer of the two currencies on 8 May 1973.[70] The decision accompanied several other amendments to exchange controls to eliminate the discrimination in favour of members of the sterling area. While the rhetoric of the change was couched in terms of liberalisation of payments, in fact it tightened up controls on the requirement to surrender to banks all export proceeds (over $5000) in convertible currencies. Exporters were required to fill in appropriate forms before exporting, although efforts were made to minimise the disruption of trade across the Johore Bahru Causeway to Singapore. Formerly, exporters to sterling area countries had been exempt from this bureaucratic process, which the prime minister estimated had cost the central reserves $700–800m p.a. in foreign exchange.[71] In addition, foreign companies were also required to get approval for borrowing more than $500,000 from local banks. Furthermore, Malaysians were required to seek approval for transferring amounts more than $1000 out of the country.

At the same time as the end of interchangeability, the Malaysian government also announced plans for a separate Malaysian stock exchange to serve local companies instead of the joint exchange with Singapore. This appears to have been a last-minute decision since only three days earlier the prime minister had replied to a question in the house that the time was not yet ripe for establishing a new exchange since 'there may not be enough shares to go round'. The prime minister asserted on 8 May, however, that a separate exchange would enhance the ability of the government to plan and promote Malaysia's national interests. The market was closed temporarily and the Kuala Lumpur and Singapore offices opened as independent units on 13 May.

The termination of the currency arrangements with Singapore was clearly linked with the new exchange controls imposed on trade and investment flows with all countries. Interchangeability was clearly unsustainable under the new system unless Singapore was exempted. Tan noted in his explanation that the agreement was only ever meant to be temporary and characterised it as an aberration, noting that even the EEC 'are finding it difficult to achieve monetary union in spite of the fact that they have attained comparable levels of development and their economies are basically similar'. The economies of Malaysia and Singapore were so different that 'monetary union between our two countries can, therefore, be likened, in so far as finance is concerned, to a pair of Siamese twins trying to grow together normally. It is universally agreed that this is just not possible and such a situation in fact hinders normal development…this is therefore an unnatural arrangement and cannot be expected to endure indefinitely'.[72] Surgery to separate the interdependent economies was Malaysia's solution to promoting its own sustained economic growth.

Singapore's response to Malaysia's unilateral decision to suspend interchangeability on 8 May 1973 was hostile. Privately, officials in the Malaysian prime minister's office suspected that '[i]t is evident that the Singapore Government, as part of its psychological warfare, wants to discredit the Malaysian currency and to create doubts in the minds of Malaysians regarding the basic strength of the Malaysian currency'.[73] This apparent campaign included referring to the Malaysian dollar by its Bahasa Malaysia (local language) name as the 'ringgit'. This contrasted with the Singapore 'dollar' and was interpreted in Kuala Lumpur as part of Singapore's 'deliberate campaign to denigrate the Malaysian currency'. Rather than combat this nomenclature, the Malaysian government decided to embrace it and adopt the term ringgit as 'evidence on the part of the nation to evolve its own identity and as part of a symbolic gesture of breaking with the past'. This departure was to be pursued alongside a campaign to reinforce confidence in the strength of the ringgit in terms of its gold parity, relatively modest inflation compared with Singapore and the strong foreign exchange earning capacity of the Malaysian economy in an environment of commodity price rises.

Tan's stated goal of promoting a Malaysian rubber market by suspending interchangeability was immediately taken up by the Malaysian Rubber Exchange (MRE). Four days after his speech in parliament, Tan announced 'it should be easier for us now to build up an effective money and commodities market, the latter specialising in products like rubber, tin, palm oil, timber and pepper'.[74] A special meeting of the board of the Malaysian Rubber Exchange was held on Saturday 12 May to determine the future relations with the Rubber Authority of Singapore (RAS). The chairman, Gan Teck Yeow (an appointed member of the Malaysian Senate), 'remind[ed] those present that Malaysia was a Sovereign Country and that it was the duty of all concerned to support wholeheartedly the aims of the Government, particularly in respect of the recent decision relating to the currency position vis-à-vis Malaysia and Singapore' but that 'it would be to our advantage to enlist the cooperation of Singapore'. The board agreed that in future arrangements, Malaysian rubber exports to or through Singapore would be settled only by payment of Malaysian dollars in Malaysia. All official prices quoted by either the MRE or the RAS should be quoted in Malaysian dollars. This would allow interchangeability of contracts across the border since the Malaysian market was still too small to support hedging. If the RAS refused, then the board of the MRE agreed to set its own prices through a 'Price Advisory Committee' and joint price setting between the two institutions would be abandoned. This outcome was endorsed by ministers and Tan was advised that 'special effort is to be made to attract brokers and dealers to expand their activities in Kuala Lumpur and for new ones to establish themselves in Kuala Lumpur' in line with 'Malaysia's wish to establish Kuala Lumpur as the dominant international rubber market'.[75]

However, Gan urged the government to allow joint price fixing across the border to continue if the RAS could be persuaded to quote in Malaysian dollars. At their joint meeting on 16 May the RAS noted that any decision on quoting rubber in Singapore using Malaysian dollars would have to be referred to the Monetary Authority of Singapore. In principal, the MRE and RAS agreed to participate in joint price quotations in Malaysian dollars for RSS1 Settlement Guarantee contracts but not for physical rubber *in situ* in Singapore, which could come from a range of sources and must be quoted in Singapore dollars. The separation of the currencies did, therefore, introduce complications into the operation of cross-border markets, although these arose from Malaysia's political desire to isolate the Singapore market from the Malaysian market in order to build up the latter. In this sense, the monetary separation was a symptom of a broader economic policy strategy that aimed to replace Singapore's financial and commercial services to the Malaysian economy with local institutions.

Conclusions

The colonial monetary system developed at the end of the nineteenth century economised on currency issue by grouping together (mainly) contiguous colonial jurisdictions into regional monetary unions. These joint currency boards were most prevalent in Africa where resource-based economies became progressively monetised through the early twentieth century. Unlike the case of Malaysia and Singapore, the African monetary unions did not long survive political independence and the establishment of central banks. The West African and East African currency boards operated between colonies that were less closely linked in terms of trade and financial services and more focussed on external relations with the UK. In contrast, the states of Malaysia and Singapore in the early 1960s were much more economically interdependent, operating as the hinterland and commercial hub for what many considered to be a single economy. The case of Malaysia and Singapore is also distinctive since political union was an ultimate goal that was achieved, although it failed to be sustainable. However, the prospect of political union encouraged the cross-border monetary system to be prolonged after Malaysian independence in 1957. The dissolution of the monetary union of these two states emphasises the importance of institutions to the impact and outcome of dissolution. Even in the highly contested political environment after the constitutional break between the two states, the economic imperatives of economic cooperation led to a prolonged period of disengagement. Although more financially developed, Singapore ended up with less bargaining power than the larger resource-rich territory of Malaysia. This case has also highlighted the importance of the global context to the process of disengagement. The dissolution of the currency board and separation of currencies occurred during a period of transition and uncertainty in the international monetary system, which made the optimal path to monetary independence more opaque.

In many ways, Malaysia and Singapore present as an ideal opportunity for a currency union given the complementarity of their economic functions in an essentially unified resource-based and trade-dependent economy and because of the long-standing success of an existing common monetary framework that operated effectively between separate states. Political factors were clearly dominant in the dis-integration, particularly exhibited through hostility and growing distrust between the two capitals and diverging development priorities. Malaysia proved to be in a stronger economic position than Singapore and also was more institutionally mature (and with a strong advocate in Ismail) and this out-weighed Singapore's specialism in financial services and being physical host to the currency board. The costs of a separate currency were anticipated by Malaysia, which had planned in any case to replace the currency board note issue. Singapore, however, had to replace its note issue unexpectedly, although it found ready funds from the distribution of assets of the old currency board and merely renamed the old Malayan currency board premises. Nevertheless, the solution of interchangeable currencies circulating at par implied a commitment to common economic goals in terms of interest rates and inflation despite the political hostility and different policy outlooks in the two states.

As a result, the subsequent interchangeability stage proved unsustainable as the flows of currency were sticky, trust between the two states eroded and the international monetary environment deteriorated with the depreciation of the US$, prompting Malaysia to embark on a more independent regime. The end of interchangeability has been explained as part of a suite of Malaysian policies to disengage economically from Singapore as well as a way to increase flexibility in exchange rate policy. In practice, however, the tight link between the Singapore and Malaysian currencies continued for a further two years and it was only from 1982 that a marked divergence in exchange rate was visible.[76] Strategically, the separation was achieved without substantial economic disruption because of the staged process of disengagement and because of favourable environmental factors which eased the transition: namely the commodity boom (for Malaysia) and the opportunity to expand international financial services and diversify trade (for Singapore). Additional support was provided by the IMF which acted as a broker between the two states. The existence of established cross-border banking through branches of international banks as well as the continuation of a *de facto* pegged exchange rate were clearly also instrumental in the gradual and strategic monetary disengagement. This case stresses the importance of political and environmental factors in the dissolution of monetary unions, including the role of trust and common policy goals. Nevertheless, the process of monetary dis-integration lasted for almost a decade after the bitter political separation of the two states, prolonging their shared economic interests.

Notes

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[1] Jones, 'Creating Malaysia' and *Britain, the United States and the Creation of Malaysia;* Stockwell, 'British Policy across the Causeway'; Lee, *Singapore*.

[2] Tai Yong Tan, *Creating 'Greater Malaysia'*, 125–50.
[3] White, *British Business in Post-Colonial Malaysia*.
[4] Lee Kuan Yew, *The Singapore Story*; Rahman, *Looking Back*.
[5] The most comprehensive account based on interviews and foreign archives is Lau, *A Moment of Anguish*. For the strategic context, see Chin Kin Wah, *The Defence of Malaysia and Singapore*; Abu Bakar 'Seeds of Separation'.
[6] The Separation Agreement, 7 Aug. 1965, Article VI.
[7] Abu Bakar 'Seeds of Separation'.
[8] Monetary Authority of Singapore, 'Survey of Singapore's Monetary History'.
[9] The Scandinavian currency union operated through clearing of national currencies at par from 1885 and then circulation of banknotes from 1901, but Sweden drew out in 1905. Henrikson and Kaergard, 'Scandinavian Currency Union'.
[10] Schwartz, 'Currency Boards'; Kratz, 'East African Currency Board'; Guillaume and Stasavage, 'Improving Policy Credibility'.
[11] The classic account of an optimal currency area is Mundell, 'A Theory of Optimum Currency Areas'.
[12] Strobel, 'When to Leave a Monetary Union?'.
[13] Schenk, 'Monetary Institutions in Newly Independent Countries'.
[14] Schoors, 'The Effect of Soviet Monetary Disintegration'.
[15] Šmídková, 'Costs and Benefits of Monetary Disintegration'.
[16] For the classic account of the monetary history of the two states, see Lee, *Monetary and Banking Development of Singapore and Malaysia*.
[17] Schenk, 'Origins of a Central Bank in Malaya'.
[18] Telegram from Kuala Lumpur to Commonwealth Relations Office, 1 July 1960, OV 65/17, Bank of England Archives (hereafter BoE).
[19] Telegram from Lord Perth in Singapore, personal to Secretary of State for Commonwealth, 17 Oct. 1960. OV65/17. BoE.
[20] Memo by J. L. Rampton, Financial Adviser to British High Commission in Kuala Lumpur to P. S. Milner-Berry, UK Treasury, 21 Oct. 1960. Telegram from Kuala Lumpur British High Commission, 12 Nov. 1960. OV65/17, BoE.
[21] Minute of a meeting of Commonwealth Relations Office, Bank of England and Treasury officials, 28 April 1961. OV/65/17, BoE.
[22] Letter from J. L. Rampton to Alastair McKay, UK Treasury, 21 July 1961. OV65/17, BoE.
[23] Quoted in Singh, *Bank Negara Malaysia*, 123.
[24] Record of a meeting between the governments of Malaysia and Brunei, 23 Nov. 1963. OV65/17, BoE.
[25] Šmídková, 'Costs and Benefits of Monetary Disintegration'.
[26] Uvalic, 'The Disintegration of Yugoslavia', 278.
[27] The details in the White Paper are also described in Lee, *Monetary and Banking Development of Singapore and Malaysia*.
[28] Extract from Minutes of 80th Meeting of the Board of Governors, BNM, 21 Aug. 1965, 1985/0005803, Arkib Negara Malaysia (hereafter ANM).
[29] 'Currency and Banking Implications of Separation of Singapore', Central Files, Economic Subject Files, S874 (M-P) Box 313, IMF Archives (hereafter IMFA). Malaysia and Singapore Mladek, Ballmann and Pandit, Nov.–Dec. 1965. This copy is dated 16 Sept. 1965 but it is clear through cross-referencing paragraphs cited in the minutes of the Board of Governors that it is substantially the same document as that considered at the BNM on 4 Sept. 1965.
[30] Brunei had been offered a sterling value guarantee for the new Malaysian currency in return for allowing it to circulate freely as the Brunei currency. However, the much larger cash circulation in Singapore made a similar solution prohibitively costly in the event of a devaluation.

[31] Extract from Minutes of 80th Meeting of the Board of Governors, BNM, 21 Aug. 1965, 1985/0005803, ANM

[32] Extract from Minutes of 81st Meeting of the Board of Governors, BNM, 4 Sept. 1965, 1985/0005803, ANM.

[33] Extract from Minutes of the 82nd Meeting of the Board of Governors, BNM, 28 Oct. 1965, ANM 1985/0005803.

[34] Letter from Lim to Tan, 8 Nov. 1965. Reproduced in Republic of Singapore, *White Paper on Currency*, Cmd 20, 1966. For reminiscences about the negotiations, see Singh, *Bank Negara Malaysia*, 128–138.

[35] Extract from BNM Board of Governors meeting 25 Nov. 1965, 198/0005803, ANM.

[36] 'Memorandum on proposed currency and banking arrangements between Singapore and Malaysia', 12 Nov. 1965. Singapore, *White Paper*.

[37] Memo by J. V. Mladek for P. P. Schweitzer (IMF Director) and F. A .Southard, 4 Jan. 1966, Economic Subject Files S874(M-P) Box 313, IMFA.

[38] Minutes of Meeting with Members of the Council of the Association of Bankers of Malaysia and Singapore, 2 Dec.1965, Economic Subject Files S874(M-P) Box 313, IMFA. The following banks were represented: OCBC, HSBC, Lee Wah, Chartered, Kwong Yik, Chung Khiaw, Malayan Banking, Indian Overseas Bank. Representatives from the BNM were also present.

[39] Ibid.

[40] Minutes of meeting with Minister of Finance, Singapore, 7 Dec. 1965, Economic Subject Files S874(M-P) Box 313, IMFA.

[41] Minutes of meeting with Minister of Finance, Singapore, 7 Dec. 1965, Economic Subject Files S874(M-P) Box 313, IMFA.

[42] Singapore's conditions for accepting the Malaysian Proposal for Common Currency and Banking Arrangements between Malaysia and Singapore, Dec.1965, Economic Subject Files S874(M-P) Box 313, IMFA.

[43] Memo from San Lin to Managing Director Schweitzer, 12 July 1966, Economic Subject Files S874(M-P) Box 313, IMFA.

[44] For an anecdotal account of the mood of the negotiations, see Singh, *Bank Negara Malaysia*, 128–37.

[45] Lee notes merely that 'the Draft Agreement did not materialise, as it was not signed' without further explanation. *Singapore Story*, 228.

[46] Letter from Lim Kim San (Singapore Finance Minister) to Tan Siew Sin (Malaysian Finance Minister), 4 Aug, 1966. Singapore, *White Paper*.

[47] Bank Negara Malaysia—1968 Final Accounts, 7 March 1969, 1985/0005811, ANM. Singapore had hired a consultant, Dr Groenin, who also advocated a central bank rather than a currency board.

[48] The distribution of surplus funds in 1963 was 75 per cent Malaysia, 18.3 per cent Singapore, 7.7 per cent Brunei.

[49] J. V. Rob, British High Commissioner, Singapore, to Secretary of State for Commonwealth Affairs, 11 July 1967, FCO11/64, The National Archives, Kew (hereafter TNA)

[50] Memo from San Lin to Managing Director Schweitzer, 20 Dec. 1966. Economic Subject Files S874(M-P) Box 313, IMFA.

[51] Telegram from R. V. Rob, High Commissioner Singapore, 11 July 1967. FCO11/64, TNA. The Currency Board was chaired by the Finance Minister with the Singapore accountant general as deputy (he also took on the role of banking commissioner). In addition, three bankers (from Chartered, OUB and Bank of America) and the president of the Indian Chamber of Commerce were selected to sit on the board for one year.

[52] Telegram, British High Commission, Singapore, 19 May 1967, FCO11/64, TNA.

[53] Memo from San Lin to Managing Director Schweitzer, 20 Dec. 1966, Economic Subject Files S874(M-P) Box 313, IMFA. This is also reported in M. Walker (British High Commission, Kuala Lumpur) to Commonwealth Office, London, 4 Jan. 1967. FCO11/64, TNA.
[54] Reported in *Financial Times*, 3 Jan. 1967. Press Statement of Board of Commissioners of Currency 7 Jan. 1967, FCO11/64, TNA.
[55] British High Commission, Singapore to Commonwealth Office, 12 Jan.1967. FCO11/64, TNA.
[56] British High Commission, Singapore to Commonwealth Office, 24 Jan. 1967, FCO11/64, TNA.
[57] Bank of England memo to Scanlon, 30 Jan. 1967, FCO11/64, TNA.
[58] Draft Exchange of Letters, March 1967, FCO11/64, TNA.
[59] Memo by C. E. Macdonald, Australia High Commission, Kuala Lumpur, 26 May 1967, FCO11/65, TNA.
[60] Half-Yearly Report of Singapore Branch, June 1967, GHO238 Singapore Half yearly Reports 1956–67, HSBC Group Archive.
[61] Telegram from L. F. Hope British High Commission Singapore, 11 Dec.1967, T317/1540, TNA.
[62] Telegram from L. F. Hope British High Commission Singapore, 11 Dec. 1967, T317/1540, TNA.
[63] L. F. Hope to P. Scanlon, Commonwealth Office, 9 Jan. 1968, T317/1540, TNA.
[64] GHO238 Kuala Lumpur Office Half Year ending 31 Dec. 1967, HSBC Group Archive.
[65] Press release, 27 Jan. 1967, FCO11/64, TNA.
[66] L. F. Hope to P. Scanlon, Commonwealth Office, 9 Jan. 1968, T317/1540, TNA.
[67] C. W. Fogarty, British High Commission Kuala Lumpur, to A. Mackay HMT, 25 Jan. 1968, T317/1540, TNA.
[68] C. W. Fogarty, British High Commission Kuala Lumpur, to A. Mackay HMT, 13 March 1968, T317/1540, TNA.
[69] Tan Siew Sin speech in the Dewan Rakyat, 8 May 1973, 1987/00207500, ANM.
[70] Singapore and Brunei continued their interchangeability agreement with each other.
[71] Tan Siew Sin's speech in the Dewan Rakyat (People's Hall), 8 May 1973, 1987/00207500, ANM.
[72] Tan Siew Sin's speech in the Dewan Rakyat (People's Hall), 8 May 1973, 1987/00207500, ANM.
[73] 'The case for using the term "ringgit"' over our mass media', 8 June 1973, Bahagian Perancang (Planning Dept), Prime Minister's Office, 1987/0020750-0, ANM.
[74] Tan Siew Sin's speech at the opening of the Bank of Nova Scotia, 'Events of this week a watershed in our economic history', 12 May 1973, 1987/00207500, ANM.
[75] Memo by TKSPI to YABM (Tan Siew Sin), 'Termination of currency interchangeability and marketing of rubber', 15 May 1973, 2004/0022738-0, ANM.
[76] Claasen, 'Financial Liberalisation'.

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