

SAFEGUARDING THE FUTURE



By Freddy Orchard

This e-book would not have been possible without the contributions of and oral interviews given by the following individuals:

Herman Hochstadt, Richard Katz, Koh Beng Seng, Lee Kuan Yew, Claus Moser, Ngiam Tong Dow, J Y Pillay, Aje Saigal, Elizabeth Sam, Sim Kee Boon, Wee Cho Yaw, Wong Kok Hoi, Michael Wong Pak Shong and Yong Pung How

PROLOGUE



CHAPTER 1
A Singular Man

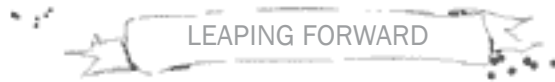
CHAPTER 2
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EPILOGUE

PROLOGUE

Slightly more than 30 years ago – on 22 May 1981 to be exact – erstwhile lawyer and banker Yong Pun How was issued the certificate of incorporation of the Government of Singapore Investment Corporation, or what we now call GIC. To the casual observer, the incorporation of GIC was a non-event. It was not marked by inauguration ceremonies; nor did it receive press coverage. However, the absence of fanfare belied the importance of the event for Singaporeans: the founding of GIC was a watershed, a game-changer in the way the country’s foreign reserves would be managed.

Safeguarding the Future – The Story of How Singapore Has Managed Its Reserves and The Founding of GIC re-creates the vision, creativity and drive that led to the founding of GIC. However, as the title intimates, the story that is told here is also about how GIC is part of the larger tapestry of how Singapore has managed its reserves since it gained its independence in 1965. While the founding of GIC was a landmark development, GIC was not born in a vacuum. It had a pre-history, as it were, for its values and ideals were forged in the crucible of Singapore’s financial experiences in its formative years.

The book is divided into two sections. The first section (“Laying the Foundations”) deals with the pre-GIC period. It discusses three dramatic episodes concerning the reserves, all occurring soon after Independence: the failure of negotiations to continue with a common currency with Malaysia; the decision to maintain the currency board

system rather than establish a central bank; and the diversification of Singapore's reserves from sterling. Then, the section covers the first attempt to institutionalise the practice of reserves management and the subsequent formation of the Monetary Authority of Singapore (MAS).

It might be easy to dismiss events in the pre-GIC period as “ancient history”, so outmoded do communications, technology, financial markets and other facets of life then, look now. But the developments of that period narrated in the book portrayed themes that would anticipate the principles underlying Singapore's reserves management policy today.

One such theme is the close attention given to reserves management by the political leadership at the highest level. The standard was set from the start by Lee Kuan Yew, Singapore's first Prime Minister, and Dr Goh Keng Swee, his deputy. Both were of one mind when it came to reserves management policy. While there were occasional differences between the two, as the chapter on sterling will illustrate, Lee gave Dr Goh the latitude to drive initiatives concerning reserves management and endorsed the outcomes. In turn, Dr Goh initiated and developed the practice of reserves management in Singapore. He also conceived of GIC. Dr Goh can rightly be called the “father” of reserves management in Singapore. It is therefore fitting for the first chapter of the book to be dedicated to Dr Goh and his contributions to reserves management.

The second section (“Leaping Forward”) covers the genesis of GIC. The decision to establish GIC was both original and audacious. Thirty years ago, something like it was not an obvious proposition. Only oil-rich countries had anything resembling a Sovereign Wealth Fund (SWF), and all that Singapore had by way of oil (then and now) was the uncertain sweat of its brow. Other non-oil countries, like China and South Korea, have since established SWFs, but Singapore was the first country deriving its reserves from surpluses generated by its merchandise trade and investment accounts to do so. Why and how did Singapore’s leaders, in particular Dr Goh, come to conceive of GIC? What was the rationale for its formation?

The story of how GIC was brought to life is equally significant here. It had to begin operations from scratch and its founding leaders had to resolve fundamental issues. How should an investment management company be started in the absence of indigenous fund management expertise? Should the funds be managed primarily by external fund managers or by home-grown expertise? If the latter, could such expertise be developed and how fast? What would be the appropriate corporate structure for GIC? What about the composition of its Board?

A number of leitmotifs in the GIC story were set very early. They included the indispensability of a can-do spirit to solve problems which had no precedence; the emphasis on good corporate governance; and the conviction that the task of husbanding the reserves was so important it required the attention of the country’s

top political leadership. At Dr Goh's suggestion, Lee became GIC's first Chairman. Both men recognised that the reserves were of such strategic significance to Singapore that they required the oversight of the Prime Minister. Lee remained GIC's Chairman till 2011. During his tenure as Chairman, Lee shaped the very soul of GIC itself; such was his influence on GIC's culture and investment orientation.

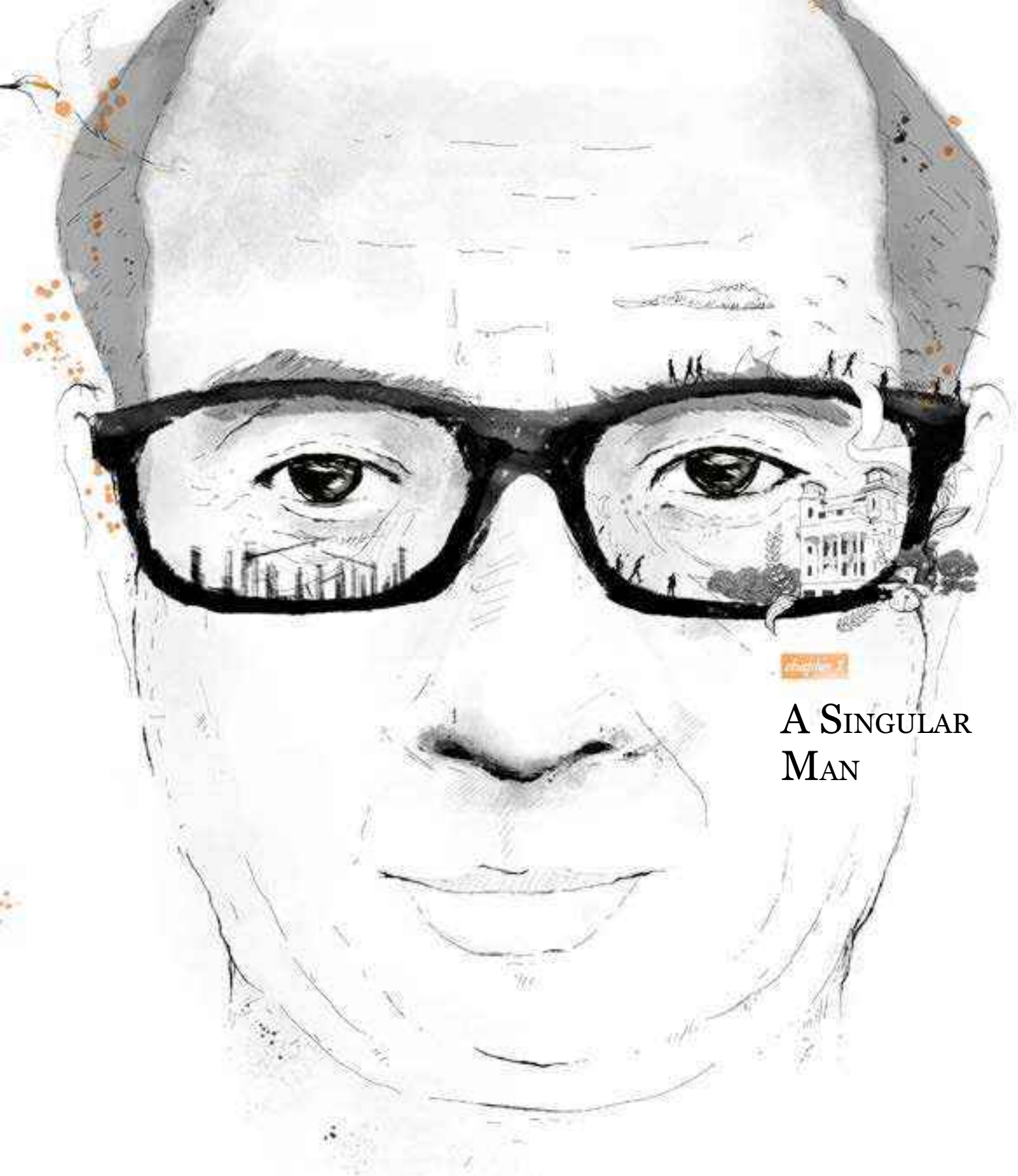
Reserves management is not a subject that normally figures large in the annals of a country's history. The subject seemingly lacks the drama and the heroic deeds that stir the blood.

There are two reasons for this commemorative e-book. The first is the singular importance of reserves to Singapore. This is a theme that resonates through the book. Thus, in the very first episode, on the negotiations over the currency link with Malaysia, the Republic's inaugural Cabinet equated losing control over the reserves to surrendering control of the nation's destiny to a foreign government.

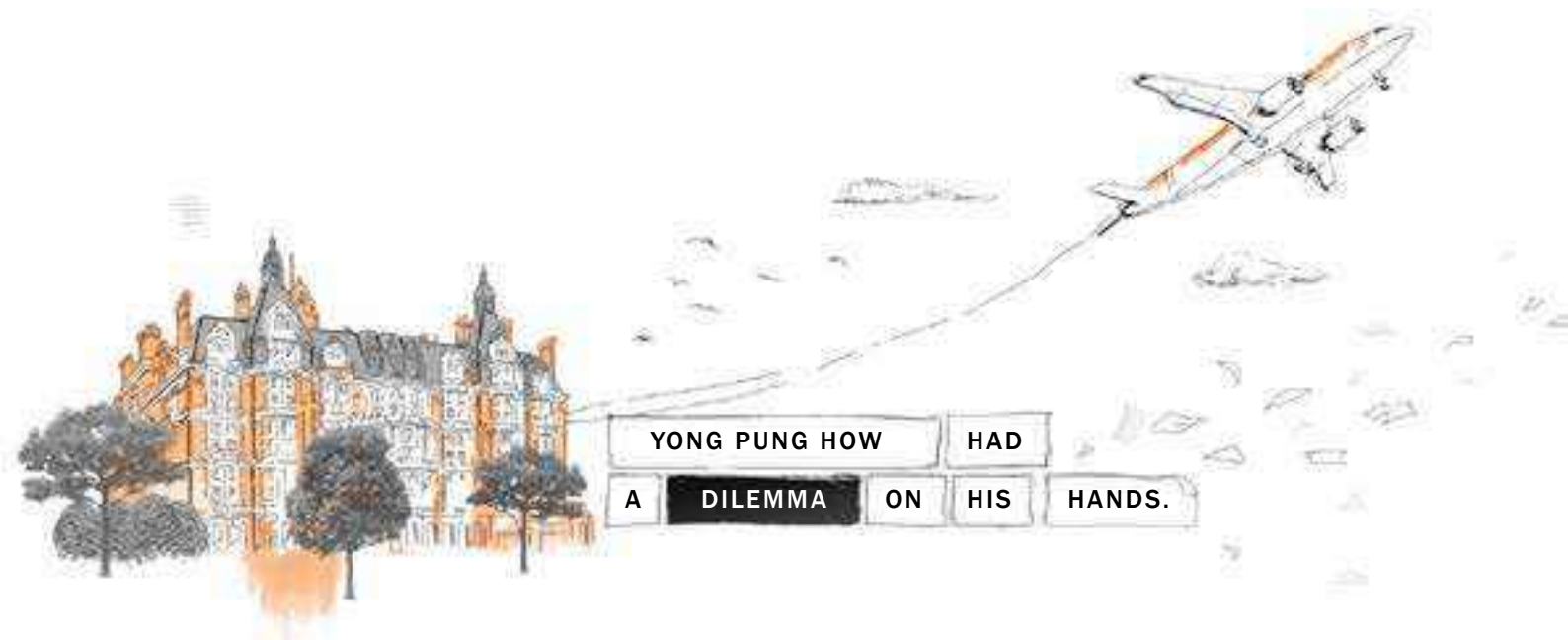
Over the years, the country's reserves have safeguarded the financial security of Singaporeans. These reserves have been the guarantor of the nation's sovereignty; the imprimatur for the country's triple-A credit rating which meant secure savings and investments for Singaporeans and foreign investors; the firewall which shielded Singapore from the numerous external financial crises over the decades, of which the last was the Global Financial Crisis of 2008; the wherewithal which enables Singapore to improve its social services and infrastructure without hefty tax increases. In short, the Singapore

Story – the progress of a small island state since Independence – has been underwritten by the returns from the diligent management of the country’s reserves.

The book has another message: that the advances in reserves management were not due to happenstance but the outcome of an indomitable spirit to do the utmost for the country’s reserves. In a sense, the book therefore is a celebration of the triumph of vision, duty, will, enterprise and energy. These are the ideals and values bequeathed to, and embodied, in GIC. This is our heritage, our inspiration to grow professionally and to do our best so that GIC will fulfil its mission to safeguard the future of Singaporeans.




**A SINGULAR
MAN**



He had checked in at the Hyde Park Hotel in London together with his boss, Dr Goh Keng Swee, then First Deputy Prime Minister and Education Minister. Yong, only recently appointed the Managing Director of a new investment company established to manage Singapore’s external reserves, knew Dr Goh as a man with “a formidable reputation for scolding and firing people” ① .

The hotel gave them adjacent rooms, Dr Goh a large spacious room, the “biggest in the hotel” ② , and Yong a smaller room, a “tiny, tiny room” ③ by comparison. After the porters had brought their bags up and placed them in the respective rooms, Yong took a walk around the hotel to get his bearings.

When he returned, he found Dr Goh’s bag in his room, while his bags were missing. Wondering what had happened, he walked into Dr Goh’s room, and found his own bags there.

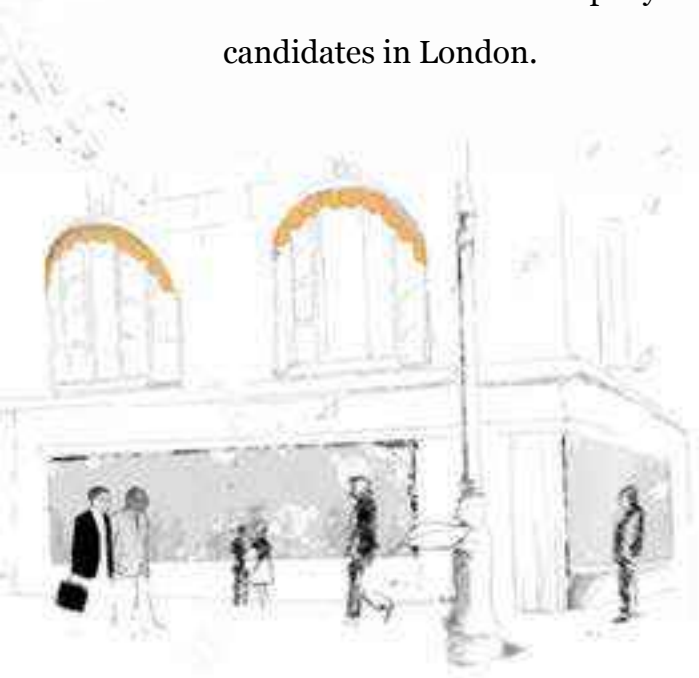


**THE GREAT MAN
WAS AT THE DESK
WORKING ON HIS
PAPERS.**

The great man was at the desk working on his papers. He looked up as Yong came in and announced that he would be taking over Yong's room, and Yong could have his grander quarters. Yong protested but to no avail. The frugal Dr Goh, he famously washed his own undergarments when travelling, said he preferred smaller rooms.

Scrambling to avert an awkward breach in protocol, Yong, a future Chief Justice of Singapore, told Dr Goh that the rooms had been assigned on the advice of the British security service. While Dr Goh's room was positioned such that security officers could keep it under surveillance, Yong's overlooked a park adjoining the hotel and the security service could not vouch for its safety. Yong's explanation was probably apocryphal but it worked. Mumbling under his breath, Dr Goh reluctantly agreed to return to his own room.

The incident over, the two men began discussing the business schedule ahead. They were on the first leg of a mission to recruit experienced fund managers for their new investment company. As it turned out, they did not find any suitable candidates in London.



They were more successful in New York, where they found three American fund managers willing to leave established investment houses to join a company in South East Asia that was then little more than a shell.

Indeed, the shell had come into existence only recently, three months after 27 February 1981, when Dr Goh, then also Chairman of MAS, had issued a statement announcing that the Government would set up an investment corporation. This corporation would invest the foreign reserves that were in excess to what the MAS, the country's de facto central bank, needed to manage the exchange rate, the statement explained. While MAS would keep its own foreign reserves liquid, the new company would be free of liquidity constraints and would thus be able to invest in long-term assets with a view to capital appreciation.

The statement was matter-of-fact, even prosaic, but the idea it expressed was far-sighted, original and bold: far-sighted, because it foresaw that Singapore would have chronic balance of payments surpluses for years to come; original,

because it broke with the convention of vesting reserves management solely in the central bank; and bold, because it conveyed confidence that Singapore would be able to overcome the lack then of local expertise in global investment management.

The far-sighted, original and bold shell was soon named the Government of Singapore Investment Corporation, or GIC, as everyone soon learned to call it. Nobody could have predicted then, when the very concept of a Sovereign Wealth Fund (SWF) did not exist, that GIC would one day grow into one of the world's largest SWFs.

The genesis and development of GIC, however, is but part of a larger narrative of how Singapore has managed its reserves since it gained its independence in 1965.

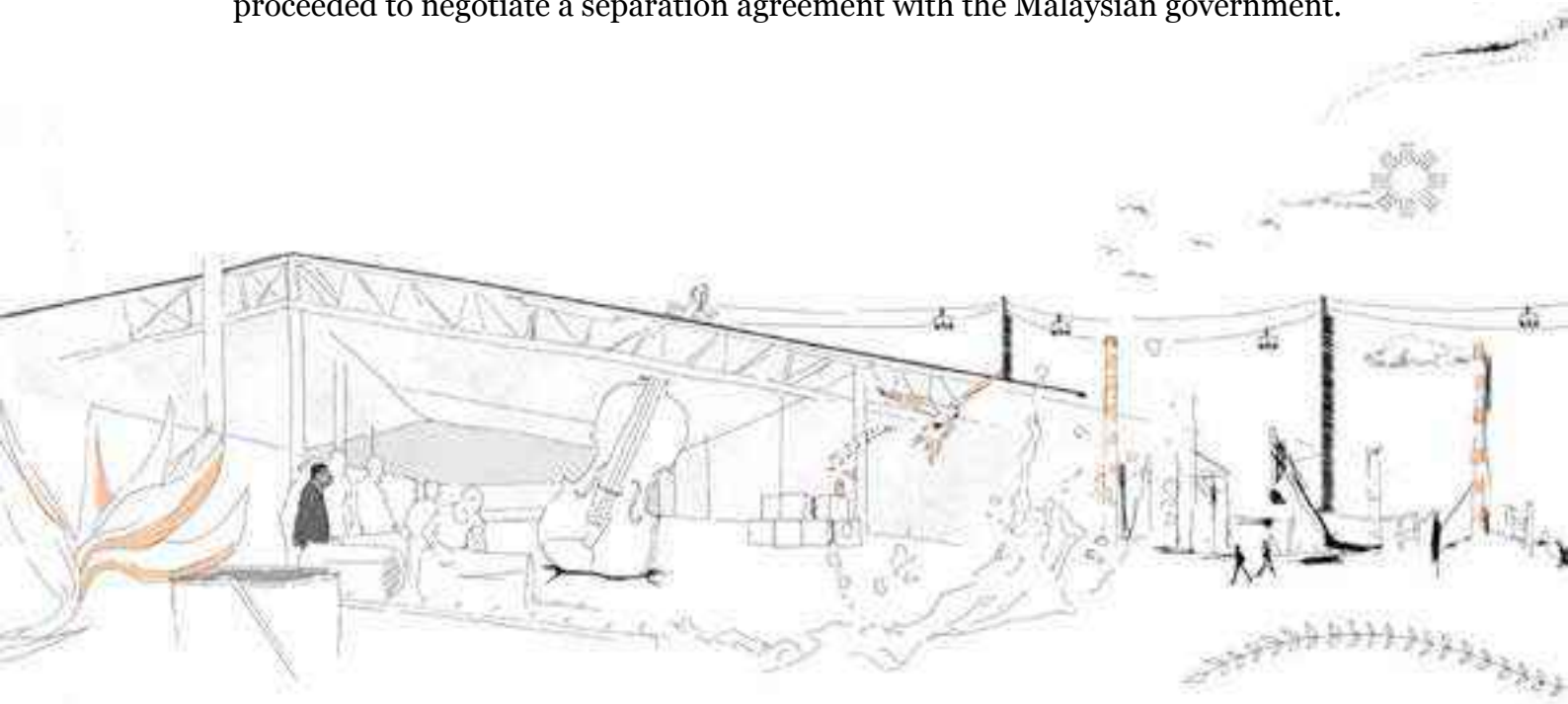
This book is the story of how Singapore's foreign reserves have been managed for the benefit of Singaporeans over the decades. And as with so many other chapters in the Singapore Story, this story too begins with a singular man: Dr Goh Keng Swee.

“A whole generation of Singaporeans takes their present standard of living for granted because you had laid the foundations of the economy of modern Singapore”⁴, wrote Lee Kuan Yew to his closest comrade and “alter ego” Dr Goh, when the latter stepped down from the Cabinet in 1984.



Thirty years later, those foundations are still firm – testimony, if any is needed, that this colossus among Singapore’s founding fathers, built for the ages.

Singaporeans have jobs today in part because Dr Goh laid the foundations for industrial development in the early 1960s. Their savings are secure and the purchasing power of the Singapore dollar has risen over the decades in part because Dr Goh eschewed deficit financing, refused to allow the central bank to issue currency and insisted on a well-regulated financial sector. They enjoy security in part because Dr Goh helped build up the Singapore Armed Forces into the formidable fighting force that it is today. And Singapore is an independent, sovereign state in part because Dr Goh was the first among the founding fathers to realise that merger with Malaysia was a tragic error and proceeded to negotiate a separation agreement with the Malaysian government.



Economic development, finance, defence – and towards the end of his years in public office, education: There was hardly a field in government that Dr Goh did

not touch – and transform. Just a brief list of the alphabet soup of agencies and institutions he either founded or inspired would give one an idea of how much Singaporeans owe to him: SAF, EDB, MAS, Temasek, DBS, JTC, Sembawang Corp, Keppel Corp, Singapore Technologies, NTUC Income – not to mention the SSO, Sentosa, East Asia Institute, ISEAS and of course Jurong Bird Park. He founded the last in part because “birds, unlike predator animals like tigers and leopards, do not eat much and impose no strain on the nation’s food supply”⁵, he explained sardonically.

GIC was another among the institutions Dr Goh founded – the result, like the Bird Park, of his diligent husbandry, only this time of the public purse. In fact, Dr Goh’s management of the reserves began long before the creation of GIC and spanned almost his entire career in public office.

In 1959, when he became self-governing Singapore’s first Finance Minister, he turned a projected budget deficit of \$14 million into a surplus of \$1 million by slashing spending, including the pay of civil servants and ministers. Thus began a regime of fiscal rectitude that has characterised Singapore’s fiscal policy to this day.

In August 1965, when Singapore separated from Malaysia, Dr Goh became the country’s first Minister of the Interior and Defence. But in August 1967, he returned to Finance and again took an active role in reserves management, creating in the Finance Ministry a new unit, the Department of Overseas Investments (DOI) that was in many ways the prototype of GIC.

Before he returned to Defence in August 1970, Dr Goh also laid the foundation for the formation of MAS, which began operations in 1971, when Hon Sui Sen was Finance Minister. The DOI was subsumed into MAS, forming the nucleus of what eventually came to be known as the central bank's International Department.



MAS had the challenging task of managing the reserves in the 1970s, a tumultuous era that witnessed the collapse of the Bretton Woods system of fixed exchange rates, two oil price shocks and global stagflation. Its International Department developed expertise in currency and gold management and the shorter end of the fixed income markets.

But central banking and reserves management make for uncomfortable bedfellows. While central banks seek macroeconomic and financial stability, investment management entities strive to exploit the opportunities arising from economic and financial volatility. Moreover, the international central banking community is a secretive, exclusive club, which tends to frown upon any central bank that makes trading gains in international financial markets. Then, there is the inherent tension between keeping reserves liquid so as to manage the exchange rate, and using the reserves to generate higher returns. For all these reasons, it became apparent by the end of the 1970s that MAS was not the best entity to manage the country's foreign reserves to achieve long-term returns.

And again, it was Dr Goh who was instrumental in arriving at that recognition. Appointed Chairman of MAS in 1980, he was charged by the then-Prime Minister Lee Kuan Yew to assess how the institution he had helped found had developed over the past 10 years. That assignment had two far-reaching consequences:

one, a revamped MAS, more sharply focused on the two essential functions of central banking, monetary policy and bank supervision; the other, the creation of GIC.

Dr Goh persuaded Mr Lee to become GIC's Chairman, while he himself became its Deputy Chairman. In 1985, after he retired from politics and relinquished the chairmanship of MAS, which by law had to be held by a cabinet minister, he was appointed Deputy Chairman of MAS. He relinquished his MAS position in 1992 and his GIC post in 1994.

It has been twenty years since Dr Goh ceased playing a role in reserves management, but his influence on its philosophy and practice in Singapore continues. To begin with, there is the profound impact he had on a number of individuals who played or continue to play critical roles in reserves management: from the pioneer batch of senior civil servants like Chua Kim Yeow, Sim Kee Boon, J Y Pillay and Ngiam Tong Dow, to the next generation of officers like Elizabeth Sam at MAS, and Ng Kok Song and Teh Kok Peng at GIC, to an even younger generation of officers, many of whom now occupy senior management positions at MAS and GIC.

In addition, a number of senior politicians who are still involved in reserves management – from S Dhanabalan, former Cabinet minister, to Lee Hsien Loong, now Prime Minister, and Tharman Shanmugaratnam, now Deputy Prime Minister and Finance Minister – worked with Dr Goh in their formative years in public service. There is in effect a Goh Keng Swee school among officials who served in government from 1959 to the mid-1990s, and they in turn have transmitted his legacy to others.

Finally, Dr Goh's indelible imprint on reserves management in Singapore is encapsulated in GIC itself, the product in many respects of his search through the years for more professional, focused and dedicated ways of managing the reserves.

- 1 Yong Pung How: Interview by Freddy Orchard, 15 October 2003
- 2 Yong Pung How: Interview by Freddy Orchard and Janadas Devan, 29 September 2010
- 3 Yong Pung How: Interview by Freddy Orchard and Janadas Devan, 29 September 2010
- 4 Lee Kuan Yew: Letter to Dr Goh Keng Swee (Reprinted in *The Straits Times*, 29 December 1984)
- 5 Dr Goh Keng Swee: Speech at Opening of Jurong Bird Park, 3 January 1971

Chapter 2

SECOND SEPARATION





WHEN SINGAPORE SEPARATED...

from Malaysia in August 1965, it continued to use a common currency with Malaysia and Brunei, the Malayan dollar. Issued by the Board of Commissioners of Currency of Malaya and British Borneo, the Malayan dollar was a currency that generations on both sides of the Causeway were accustomed to. It served as an umbilical cord linking Singapore to Malaysia, sustaining the close trading and financial ties between the two territories. Political separation, Singapore's leaders hoped, need not necessarily mean monetary separation.

But the Malaysian government had given notice as early as December 1964, well before Separation, that it would issue its own currency, the Malaysian ringgit, by mid-December 1966. Independent Singapore had thus two options: continue with a common currency arrangement with Malaysia on a different basis, or issue its own currency.

Singapore preferred the common currency option, and began negotiations with Kuala Lumpur. But in the end, despite numerous rounds of frantic shuttle diplomacy, the negotiations failed. Significantly, the chief stumbling block turned out to be the foreign reserves: Singapore felt it could not obtain ironclad guarantees over the ownership and control of its reserves. The break was a poignant occasion, with then Prime Minister Lee Kuan Yew in particular regretting that political separation had to entail monetary separation after all.

The common currency arrangement had its beginnings in 1897, when a currency board was established for the Straits Settlements, which comprised Singapore, Penang and Malacca. Since its introduction, the Board had gone through several

restitutions. In 1937, when the Malay States joined the Straits Settlements, it became the Board of Commissioners of Currency, Malaya. In 1950, to recognise the inclusion of Sarawak, Brunei and North Borneo (now Sabah), it was renamed the Board of Commissioners of Currency, Malaya and British Borneo. The 1950 Currency Agreement was amended in 1960 to recognise the change in status of Malaya as an independent country in 1957, and of Singapore as a self-governing state in 1959.

A currency board system operates like the gold standard. In the case of the latter, currencies are pegged to gold at a fixed rate; in the former, currencies are pegged to an international reserve currency at a fixed rate. In both cases, the currencies are backed 100 per cent.

The Malayan dollar was pegged to sterling at the rate of two shillings and four pence, or 0.290299 grammes of gold. The amount of Malayan dollars the Board could issue depended on the amount of sterling it held, with the Malayan dollar being fully convertible to sterling at the stated parity. For these reasons, the currency enjoyed the confidence of traders and investors. There was no possibility of the government printing money to finance deficits.

The 1960 Currency Agreement between the territories continued the common currency, although Malaya had by then its own central bank, Bank Negara Malaya. But the Agreement also allowed any of the national authorities to give an 18-month notice to leave the currency board and issue its own currency.

On 12 December 1964, Malaysia did so, declaring it would issue its own currency, the Malaysian ringgit, to replace the Malayan dollar in two years.



Singapore was then part of Malaysia, so the Malaysian ringgit would automatically have become its currency too. But Separation from Malaysia on 9 August 1965 meant that the proposed Malaysian ringgit would be foreign currency in Singapore.

Despite their strained relations, the two governments agreed to discuss how the common currency arrangement could be preserved. We are able to trace the subsequent twists and turns of the negotiations from two sources. The first is the White Paper that the Singapore government tabled before Parliament to explain what had transpired in the negotiations. Stating that “it is not possible to suppress important Government-to-Government negotiations and the reasons for failure to reach an agreement” ^①, the Singapore government made available in the White Paper a great many documents relating to the currency negotiations.

The other source is internal government files, which reveal the decisive role that Dr Goh played in shaping the thinking of his Cabinet colleagues, though currency issues were no longer part of his portfolio. He had moved from Finance to Defence in 1965 and took no part in the formal negotiations with Malaysia on the currency arrangements.

The White Paper reveals that Singapore’s Finance Minister Lim Kim San, as early as October 1965, just two months after Separation, had raised the matter of a common currency with his Malaysian counterpart Tan Siew Sin, who was also a cousin of Dr Goh. The two ministers, meeting on the sidelines of the IMF/World Bank Annual Meetings in Washington DC, agreed to approach the International Monetary Fund for technical advice on how a common currency arrangement between two sovereign nations might be structured.

The common currency arrangement had its advantages, which was why many, including the Singapore International Chamber of Commerce and the Singapore Chinese Chamber of Commerce, urged its continuance. Arthur Burns, then Chairman of the US Federal Reserve, on a visit to Singapore in May 1966, described the common currency arrangements between the two countries as “one of your great economic assets” ². A common currency would be backed by the combined reserves of two countries; it would facilitate the close economic links between Malaysia and Singapore; and finally – a sentiment held by many on both sides of the Causeway, but unspoken – it would leave the door open for a political reunion of the two territories.

On 8 November 1965, Lim wrote to Tan, recalling that both of them had agreed that “our two Governments should do everything possible to maintain close economic and trade links between Singapore and Malaysia” ³. He suggested one way to do so would be to continue with a currency board issuing a common currency. The other would be to establish a joint central bank that could then issue currency for both countries.

Tan replied on 13 November to say that he had authorised the Governor of Bank Negara, Tun Ismail bin Mohd Ali, to initiate discussions with Singapore. Indeed, Ismail had visited Singapore a day earlier and had submitted a Memorandum on the Proposed Currency and Banking Arrangement to Singapore’s Finance Minister.



Bank Negara's Memorandum concluded that

“economic and financial considerations would suggest that it would be to the mutual advantage of Singapore and Malaysia to continue to have a form of common currency and an integrated banking system”⁴.

But Bank Negara rejected Singapore's first preference – a currency board.

A currency board would be anachronistic, Bank Negara suggested, given the stage of development of the two economies. It was a passive and inflexible mechanism, useful only for the issue and redemption of note issue. A central bank, by contrast, would be able to control bank credit, a more important component of money supply than the note issue in developed economies.

Singapore would continue to press the case for a currency board in the preliminary exchanges, but Kuala Lumpur was adamant that the currency board system was not an option for discussion.

Bank Negara also rejected Singapore's second option, a joint central bank. To Lim's point that “a joint central bank would be the most appropriate institutional framework for two sovereign nations”⁵, Ismail replied that a joint central bank was not acceptable, as it would involve “a passing of new legislation in Malaysia and a reconstitution of Bank Negara Malaysia”⁶.

Bank Negara's suggestion was to continue the common currency arrangement, but with it issuing currency for both countries. It said it could issue currency in Singapore through its Singapore branch, which it had established when

Singapore was part of Malaysia. There could be differences in design to differentiate the currency issued in Malaysia from the one issued in Singapore, though either one would be legal tender in the other.

In the event, Bank Negara's proposal formed the basis of negotiations. Kuala Lumpur envisaged a more centralised arrangement than Singapore wished. Singapore would be represented through a Singapore branch of the central bank, headed by a Deputy Governor appointed by, and answerable to, the Singapore government. Much of the ensuing negotiations revolved around the differences between the two sides on the status of the Singapore branch.

The other issue that Singapore raised concerned the control and ownership of the reserves, in the first instance, the pool of reserves transferred from the existing currency board. This, more than the type of monetary system, was a fundamental issue for Singapore: it would only agree to negotiations if there were binding assurances that its reserves would remain under its control and management. Bank Negara understood Singapore's concern and agreed to modify its original proposals concerning the arrangements for the management of reserves. The reserves attributable to each country, it proposed, could be separately controlled and managed by maintaining separate accounts with earmarked depositories.

On 9 May 1966, Lim wrote to Ismail to say that Bank Negara's revised proposals, in particular the revision providing for separate physical control and management of the respective currency reserves, were acceptable in principle to Singapore. Negotiations could begin to settle matters of details such as the exchange rate parity, the design of the new currency, the appointment of the Singaporean Deputy Governor and the Board of Directors, and steps for liquidation in the event of termination.



Formal negotiations began on 10 June. Bank Negara, the convener of the meeting, was represented by a team led by Ismail himself, and included its Deputy Governor Choi Siew Hong and the Manager of its Singapore branch Hooi Kam Sooi.

Singapore's delegation was headed by Sim Kee Boon, then Permanent Secretary at the Ministry of Finance, and included Ngiam Tong Dow and Elizabeth Sam from the Finance Ministry, the Attorney-General, Tan Boon Teik, and the Accountant-General, Chua Kim Yeow. The Malaysian Government delegation was headed by Abu Bakar Samad bin Mohd Noor, then Secretary to the Malaysian Treasury, Tan Sri Chong Hon Nyan and Dato' Malek Ali Merican from the Treasury, and the Solicitor-General, Tan Sri Salleh Abas. Two representatives from the IMF also attended the talks; U Tun Thin and U San Lin.

The delegations met 11 times in all, within a period of slightly less than a month. Each meeting was intense and gruelling. Some meetings would start in the morning and end after midnight. The discussions were wide-ranging and detailed: should the agreement call for “concurrence” or “consultation” between the two parties? Should it be “Bank Negara Malaysia, Singapura Branch” or “Bank Negara Malaysia - Singapura Branch”?

But though intense, the talks were civil. Sim later remembered the negotiations as “difficult but not bitter” ⁷. Ismail, he said, “tried to be fair” ⁸. The personal

ties among the negotiators helped. Tan Boon Teik was from Penang. Choi and Hooi had studied at the University of Malaya in Singapore, which was also the alma mater of Sim, Ngiam and Sam. Sim had known Ismail for some time and had developed a “cordial” ⁹ working relationship with him.

The Singapore Cabinet was kept informed of the progress of the talks, with a small group comprising the Prime Minister, Lim, Dr Goh and EW Barker, then Minister of Law, monitoring events closely and sometimes meeting every day.

Dr Goh was then Defence Minister but was influential in shaping the government’s strategy in the currency talks. He took it upon himself to compose detailed memoranda to explain to his Cabinet colleagues the complexities of monetary policy, the implications of the proposals being tabled and the stand Singapore should take. Sim and Ngiam found themselves reporting not only to Lim Kim San but also to Dr Goh.

Far from viewing Dr Goh’s interventions as intrusions on his turf, Lim welcomed them. Old friends from their days at Raffles College – Lim had been best man at Dr Goh’s wedding – they formed a formidable team: Dr Goh the economic theoretician and practitioner par excellence, and Lim the businessman-turned-politician, a “political entrepreneur...who seized opportunities using powers of analysis, imagination, a sense of reality and character” ¹⁰, as Lee was to describe him later.



We get a glimpse of how Dr Goh and Lim related to each other from Yong Pung How's recollections of his association with both men in the early 1980s, when Dr Goh was Chairman of MAS and Lim had been persuaded to come out of retirement to be the caretaker Managing Director of MAS. Yong recalls the two having heated arguments over policy issues, the staff within hearing distance and cringing at the "unmentionable terms" they flung at each other. Then, wreathed in smiles, they would emerge for lunch, usually Peranakan food. But after lunch, back in the office, they would resume their heated altercations.

It was Dr Goh who had been instrumental in getting Lim appointed Chairman of the Housing and Development Board in 1960, and later in persuading him to run in the 1963 General Elections. They remained lifelong friends and comrades.

Significantly, Dr Goh seems to have been the most sceptical among his senior colleagues about the arrangements for the common currency. He felt that the draft provisions that had been submitted had too many loopholes to prevent the agreement benefiting one party more than the other. The provisions, he noted, had to be unambiguous on how Singapore's interests would be protected: How could Bank Negara's Board be structured to adequately protect Singapore's rights? If Bank Negara was only obliged to "consult" rather than seek the "concurrence" of the Singapore government, wouldn't Singapore's monetary policy be determined ultimately by a foreign government? Shouldn't the provisions on credit creation and deficit financing be tightened? What about the implications of the agreement for the supervision of Singapore banks?

Dr Goh felt Singapore should seek two safeguards: First, each government's reserves should unambiguously be under its own direction. And second, Bank Negara should operate only as an agent of the Singapore government, completely

subject to the direction of the Singapore Finance Minister in matters affecting Singapore.

He forecast that these safeguards, though absolutely necessary for Singapore, would be unacceptable to Kuala Lumpur. Singapore should therefore be prepared for a breakdown in the negotiations, he advised.

Dr Goh had been the first among his colleagues to see in 1965 that Singapore's political separation from Malaysia was inevitable. A year later, he seemed to have been the first to conclude that a monetary separation was inevitable too.

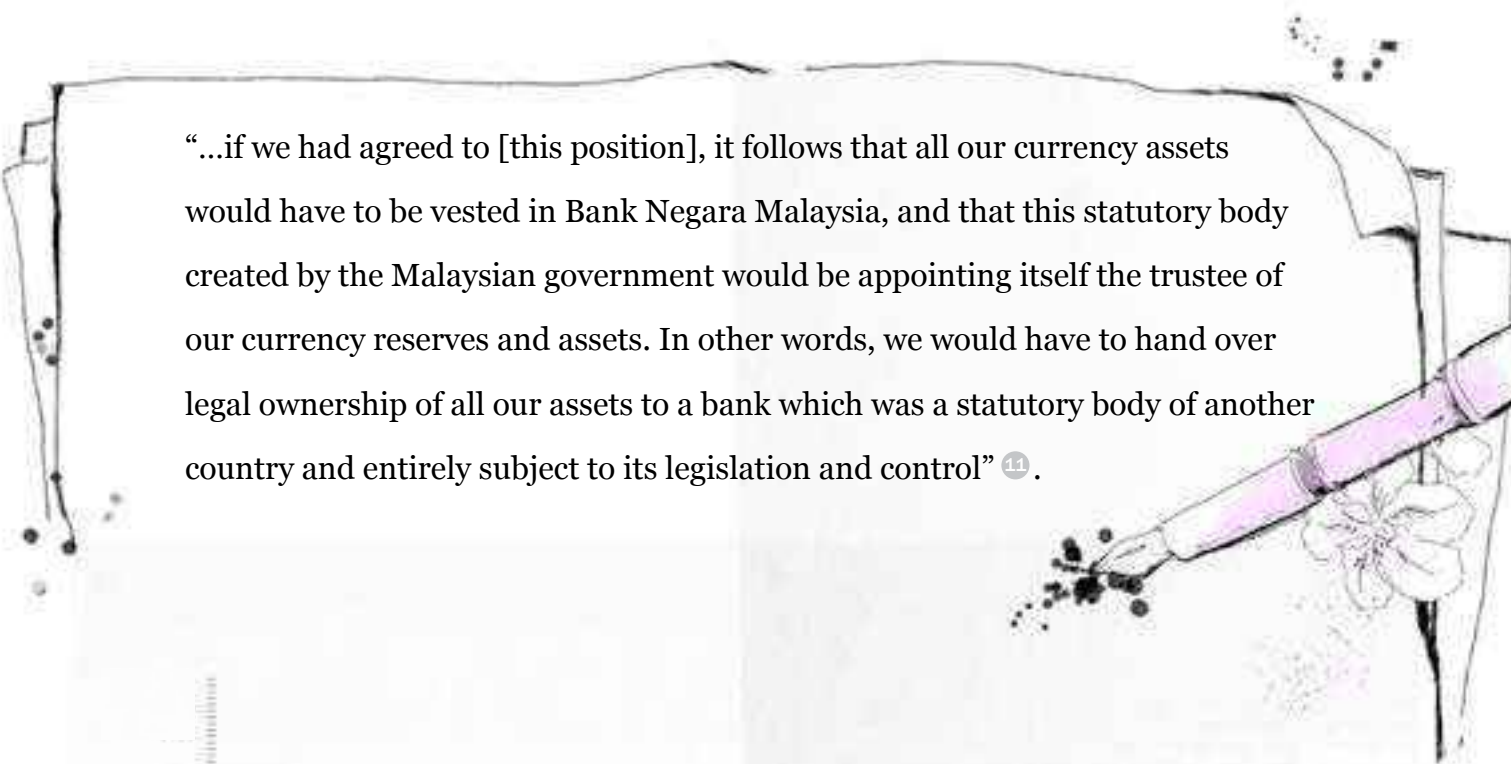
Still, notwithstanding Dr Goh's reservations, and somewhat to his surprise, the talks progressed to the point of producing a Final Draft Agreement. It provided for a common currency with the same design except that the Malaysian issue would be designated the "M" series and the Singapore issue the "S" series. The two issues would be legal tender in either country. Each country would control its own issue and the management of its reserves. The reserves to back the Singapore note issue would be held in a separate and distinct account controlled by the Singapore Government. The Singapore branch of Bank Negara was to be managed by a Singaporean Deputy Governor, appointed by the Singapore Government.

In a meeting with his colleagues on 6 July, Lee commented that Singapore did not get all the safeguards it had hoped for in the Draft Agreement. For example, it had wanted tighter provisions that the Singapore branch would be unambiguously under the direction of Singapore's Finance Minister. He observed that the proposed Agreement was between two unequal parties, for Bank Negara was already an established institution while Singapore had no

equivalent central banking machinery. The Prime Minister, however, viewed that the break-up of the Common Currency arrangement would forestall future wider economic cooperation between the two countries. The best option therefore was to accept the Draft Agreement and work towards modifying it over time.

A few days later, that decision was rendered moot. The trigger was a letter dated 11 July from Ismail to Sim on the status of a piece of land at Robinson Road in Singapore, the site of the proposed Singapore branch. The Malaysian view was that while the value of the land would be credited to the account of the Singapore branch, the title would remain in the name of Bank Negara Malaysia. Kuala Lumpur's position was that the Singapore branch was not a legal entity and could therefore not own assets.

This was a bombshell. If the Singapore branch could not own property, that would mean it could not be the legal owner of its reserves. As Lim later explained to Parliament:



“...if we had agreed to [this position], it follows that all our currency assets would have to be vested in Bank Negara Malaysia, and that this statutory body created by the Malaysian government would be appointing itself the trustee of our currency reserves and assets. In other words, we would have to hand over legal ownership of all our assets to a bank which was a statutory body of another country and entirely subject to its legislation and control”¹¹.

On 15 July, Sim wrote to Ismail, pointing out that his position on the Singapore branch was at odds with the assurance that Singapore's "currency assets shall belong exclusively to Singapore" ¹². On 21 July, Lim informed Ismail that he could not recommend to the Singapore Cabinet that it accept the Draft Agreement. In his reply, Ismail reiterated Bank Negara's position that it could not countenance its Singapore branch being a legal entity separate from itself. The Singapore Cabinet was informed of these developments the same day.

It was an ironic turn of events that while a property became the focal point for controversy, three years ago, a property transaction between the two governments was the occasion for celebrations. This was the purchase by the Singapore Government of a property in Kuala Lumpur. Named Rumah Temasek, the house was to be the official Residence for visiting Singapore Government officials. The opening of Rumah Temasek was marked by a party distinguished by its cheer and bonhomie between the government ministers on both sides.

Lim's letter of 21 July was followed by a response from Tan Siew Sin. Two days later, Tan wrote to his Singaporean counterpart, noting Singapore's reservations about the Draft Agreement but also adding that a decision was needed by the end of July, as the deadline for placing orders with the London printers for the new currency notes was mid-August. On 4 August, Lim flew to Kuala Lumpur to meet Tan at his residence, carrying with him a formal letter of reply.

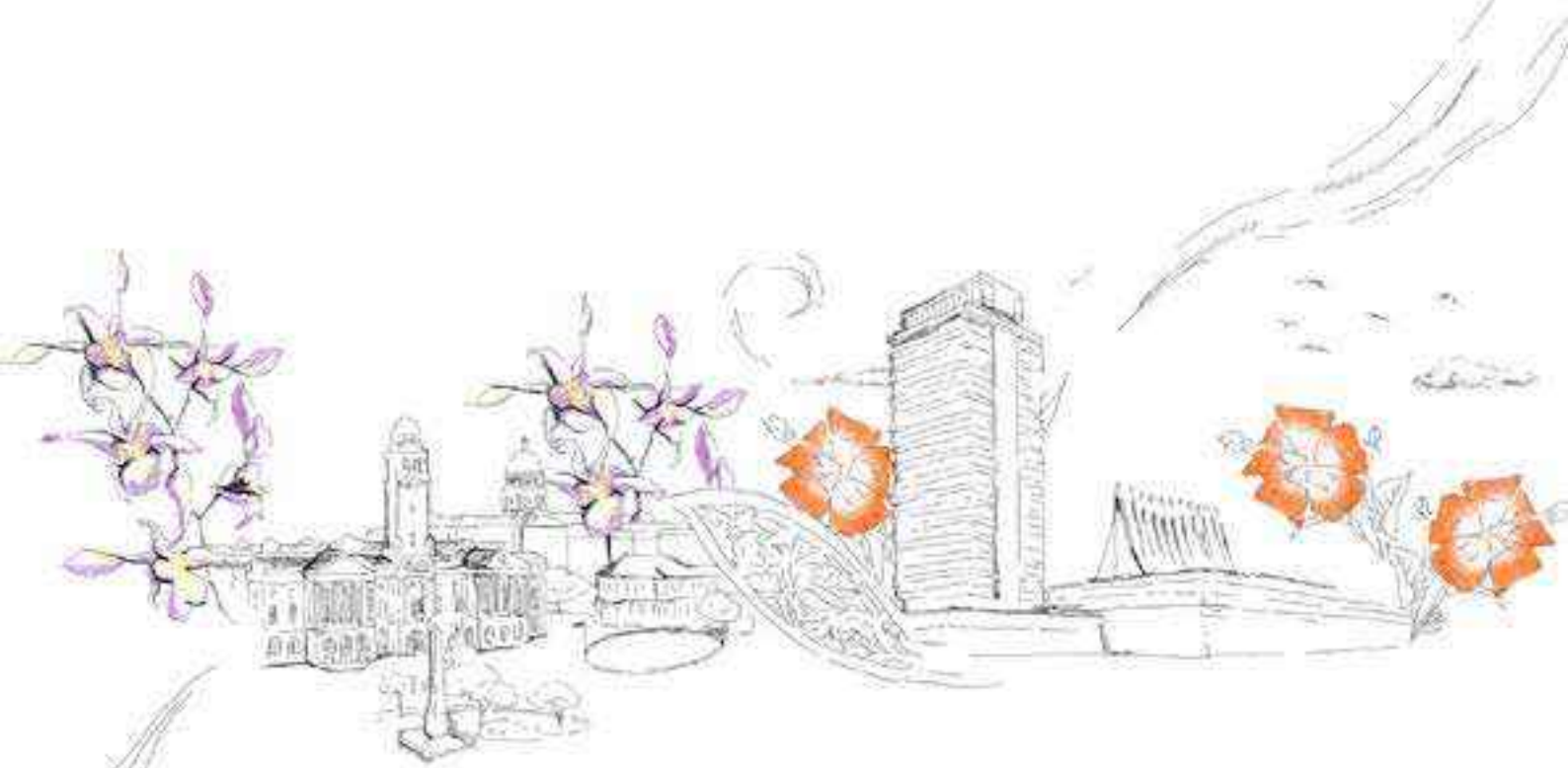
The letter stated clearly that Singapore would never place its reserves

in trust with an agency under the control of a foreign government. It suggested two options that would give Singapore the assurance that it had “immediate access” to its currency reserves. One was to place these reserves with an independent trustee like the IMF or the Bank of England. The other was to incorporate the office of the Deputy Governor overseeing the Singapore branch as a Corporation Sole and for Singapore’s assets to be vested in him and not Bank Negara.

Ismail replied that the Corporation Sole suggestion was unacceptable as it meant a separate legal entity, in effect a separate central bank. In a reply on 8 August, Tan also stated that Singapore’s proposals were not acceptable. He subsequently visited Singapore on 13 August. At a meeting at Rumah Persekutuan he was given a letter by Lim, which reiterated Singapore’s stand that it could not be placed in a position where its reserves might be jeopardised. But Lim expressed a willingness to explore “any alternative proposal” ¹³ to resolve the impasse.

In a reply dated 17 August, Tan said the Draft Agreement did ensure that Singapore would have “the whole of the assets and liabilities shown in the books of Bank Negara Malaysia” ¹⁴ in the event that the Agreement was terminated. He added: “Your real fear is that we may not honour that Agreement. The only answer to this is clearly to have no agreement at all” ¹⁵ .

And so it came to pass that at 1.30pm on 17 August 1966, both governments announced to their peoples that Singapore and Malaysia would have separate currencies from 12 June 1967.



Earlier, Dr Goh seemed to have been in the minority in thinking that a common currency arrangement was unworkable. In the end, the Cabinet was unanimous in deciding a complete currency break was preferable to risking Singapore's reserves. Ultimately, the talks failed because Singapore did not receive ironclad guarantees that it had indisputable rights over its reserves.

Lim later explained in Parliament that he saw the issue of the ownership of reserves as a matter of national survival. Financial security was the cornerstone of a country's sovereignty, of a nation being the "master of its own fate" ¹⁶, as he put it. He had lived through two periods when Singapore was under foreign rule – the British, and then the Japanese. Losing control over the reserves would be akin to exposing Singapore to the risk of being subjugated again, he felt.

Not for the first time, it should be noted, the Prime Minister had been prepared to be more conciliatory towards Kuala Lumpur than many of his colleagues, including Dr Goh, had been thus inclined. But, in this instance as in others, he was driven to conclude that there were limits to being conciliatory. He decided he would have been negligent if he had not insisted on the most watertight and

stringent legal measures to ensure the safety of Singapore's assets. "Singapore's reserves", he wrote later in succinctly framing the issue on which the currency negotiations broke, "could not be protected simply by relying on trust" ¹⁷ .

Ultimately, despite the inevitable strain placed on the relationship between the two governments as a result of the failure of the currency negotiations, cooler heads did prevail. Tan himself noted in the Malaysian Parliament that he could "appreciate Singapore's reluctance to enter into an agreement of this kind. Consequently, I suggest that this is not the time for mutual recrimination" ¹⁸ .

Subsequently, Malaysia and Singapore, together with Brunei, agreed to a Currency Interchangeability Agreement. The agreement allowed for the new Bruneian, Malaysian and Singapore currencies to be used as customary tender, fully interchangeable at par value, in all three countries. The agreement lasted till 8 May 1973, when the Malaysian government opted out of it. Brunei and Singapore, however, have maintained the interchangeability of their currencies till this day.

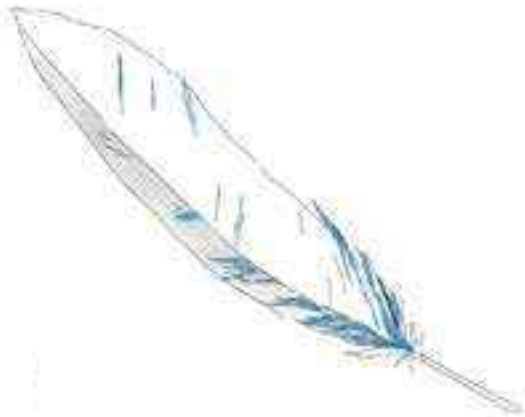
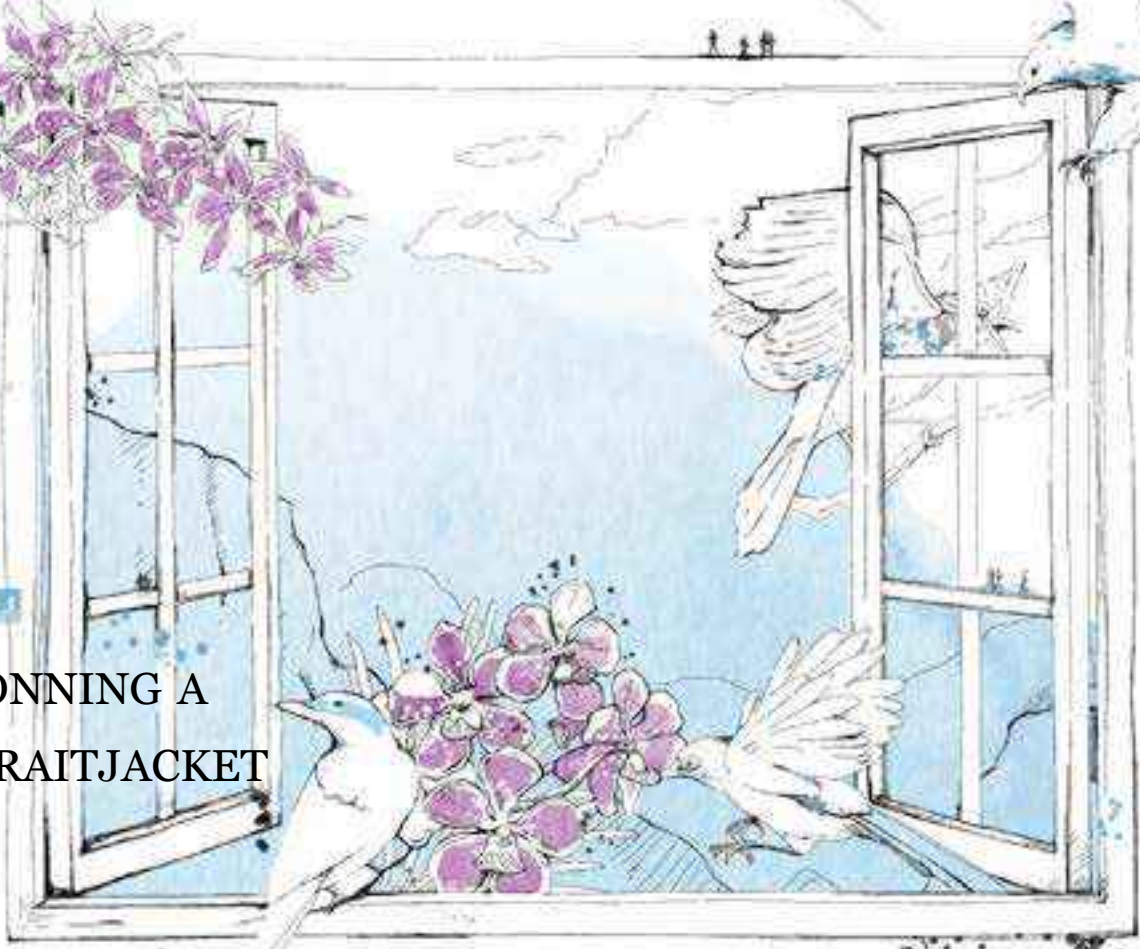
In retrospect, it was clear that the currency interchangeability agreement was but a stopgap measure to ensure that the traditional ties of banking, commerce and social intercourse between Malaysia and Singapore would not be abruptly disrupted by the currency split. Thus, despite the agreement, Singapore was confronted with stark economic realities even as it issued its own currency. The writing was on the wall: the destinies of the two economies would follow different paths. Singaporeans would have to find new ways of earning a living. The first separation had to be followed by a second.

It says much of the importance that Singapore's founding leaders accorded the country's reserves that they chose to face the existential uncertainties of a currency split rather than risk Singapore losing control of its reserves.

- 1 Lim Kim San: Statement in Parliament - Common Currency and Banking System, Parliamentary Debates, Vol 25, Col 268, 26 August 1966
- 2 *The Straits Times*, 5 May 1966
- 3 White Paper on Currency (1966): Annex A 1
- 4 White Paper on Currency (1966): Annex A 3
- 5 White Paper on Currency (1966): Annex A 6
- 6 White Paper on Currency (1966): Annex A 6
- 7 Sim Kee Boon: Interview by Freddy Orchard, 21 October 2003
- 8 Sim Kee Boon: Interview by Freddy Orchard, 21 October 2003
- 9 Sim Kee Boon: Interview by Freddy Orchard, 21 October 2003
- 10 Singapore Press Holdings, 11 December 2002
- 11 Lim Kim San: Statement in Parliament - Common Currency and Banking System, Parliamentary Debates, Vol 25, Col 268, 26 August 1966
- 12 White Paper on Currency (1966): Annex C 2
- 13 White Paper on Currency (1966): Annex C 6
- 14 White Paper on Currency (1966): Annex C 7
- 15 White Paper on Currency (1966): Annex C 7
- 16 Lim Kim San: Interview by Freddy Orchard, 28 October 2003
- 17 Lee Kuan Yew, *From Third World To First*. (Singapore: Singapore Press Holdings and Times Editions, 2000), Pg 261 - 62
- 18 Tun Tan Siew Sin: Reply to question from Dr Tan Chee Khoo, Parliamentary Debates, Dewan Ra'ayat, Vol III No 6, 22 August 1966

Chapter 1

DONNING A STRAITJACKET





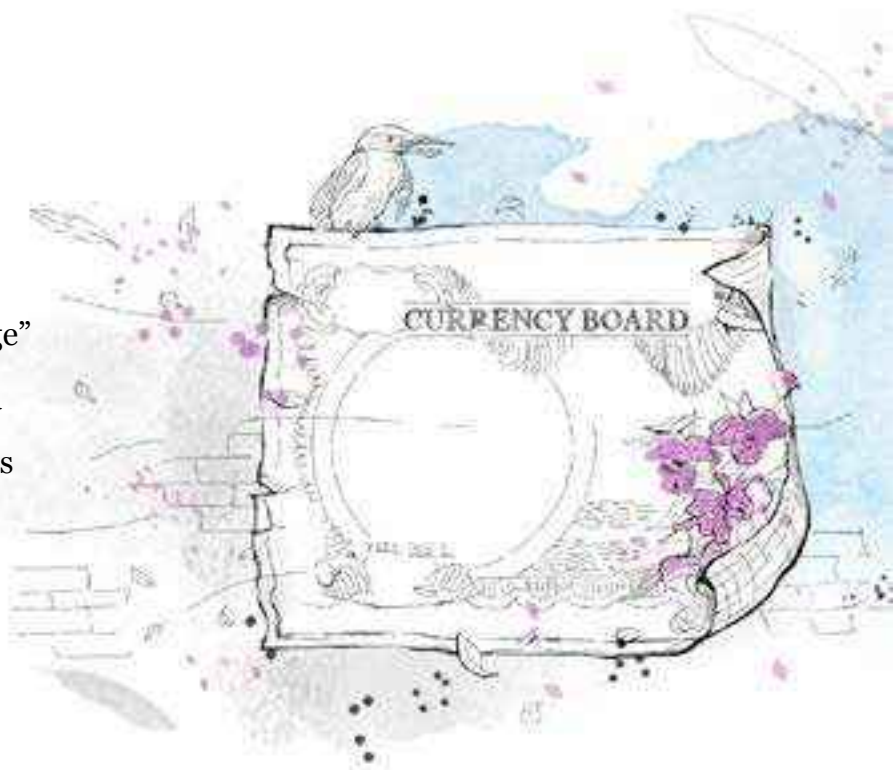
SINGAPORE	ISSUED	ITS	
OWN	CURRENCY	ON	12 JUNE 1967

The conventional wisdom then was that it should have established a central bank simultaneously. Instead, the government chose to maintain what was even then considered an archaic symbol of colonialism – the currency board system.

Far from being quixotic, this decision underlined the young nation's commitment to the values of thrift and industry. And though the Board of Commissioners of Currency has since merged with the Monetary Authority of Singapore, which then assumed the function of currency issuance, its establishment in the early years of independent Singapore was to have far-reaching consequences. It laid the foundations for the country's rapid accumulation of reserves in the 1970s; and that in turn led to the creation of GIC in 1981.

The currency board system was an invention of the British Raj, and was designed to ensure that the currencies issued by its colonies were fully backed by sterling reserves held in London. The system was beneficial to both sides: to Britain, because the capital inflows into London helped the City become the world's leading financial centre; and to the colonies, because it resulted in stable and convertible currencies. Paradoxically, having invented a system for the colonies that would be synonymous with currency stability, the British Raj would subsequently be haunted by sterling crises because Britain eschewed a similar system for itself.

The currency board system was almost wholly abandoned by the late 1960s, as the “winds of change” that blew through Asia and Africa saw almost all of Britain’s colonies attain independence. These countries decided that a central bank would better suit their new status. After all, a currency board

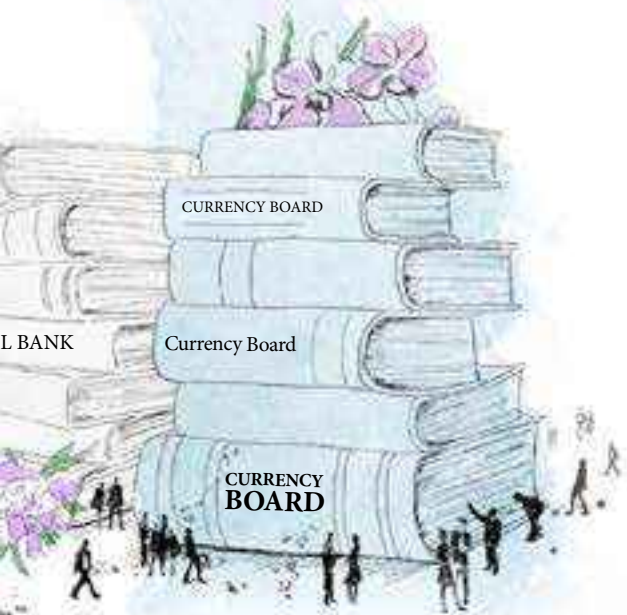


system would only have given the governments of these newly independent countries control of the note issue. A central bank, in contrast, would give them the power to vary the money supply by manipulating bank credit and thus influence economic conditions.

A central bank can ease credit conditions during an economic downturn and tighten them when the economy overheats. It can also create money without it being fully backed by reserves. Of course, most of the newly independent countries did not have money markets of a size and depth to enable monetary policy to work as textbook theory prescribed. But a central bank – like a standing army or a diplomatic service – was deemed to be something independent countries just had to have. And so they did.

Singapore was advised to follow suit. International Monetary Fund missions to Singapore during this period recommended the adoption of a central bank system. Apart from creating bank credit, a more important component of the money supply than the note issue in advanced economies, a central bank would

also be able to be the lender of last resort, the IMF teams advised. Even the individual retained by the Singapore Government to be its currency advisor, an RW Goenman, recommended a central bank.



But the Government was unmoved and opted for a currency board. Indeed, it never wavered in believing that it was the only viable option for Singapore. As Dr Goh was to recall in a speech two years later in 1969: “The test Cabinet decided to apply...was which type of institution would inspire more confidence in the new currency?”¹ The Cabinet concluded that there was “little doubt that the currency board would fulfil this requirement better than a monetary authority of the central bank type”².

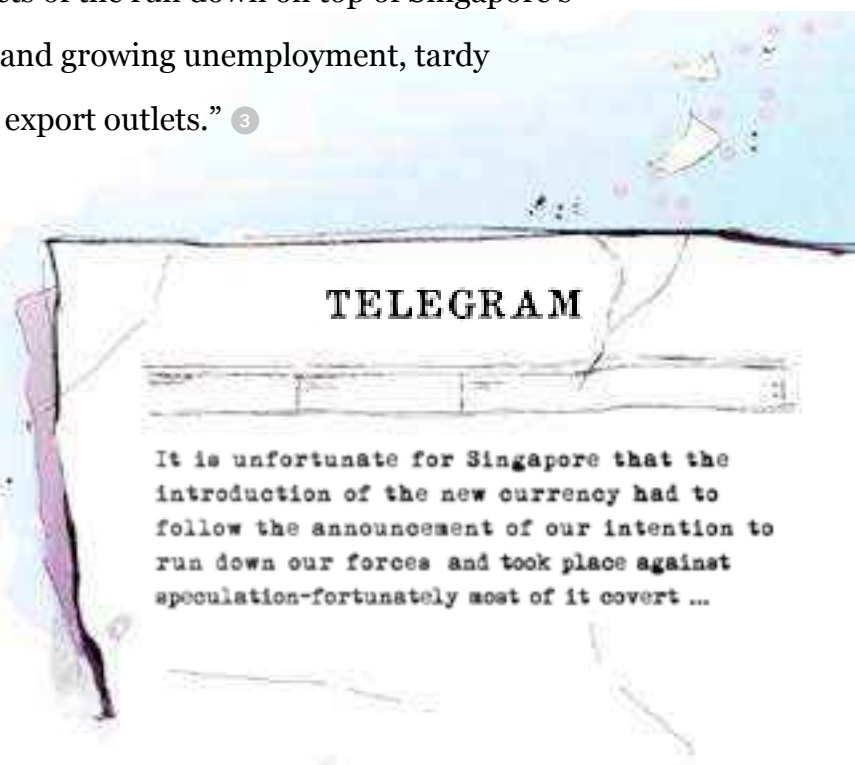
Singapore’s leaders felt they could not take chances with the new currency. The country had to have a stable and strong currency. That was the precondition of its existence as a financial and commercial centre in the region. With a currency board, traders and investors would know that every Singapore dollar was backed by its equivalent in reserves, and was fully convertible to an internationally acceptable currency at a fixed rate.

Young Singaporeans today might find it difficult to imagine a situation when it was possible to doubt the Singapore dollar. After all, the Singapore dollar has steadily appreciated against all major currencies since its inception. But the circumstances for the Singapore economy and currency were far from propitious in 1967.

First, there was uncertainty as to how the new currency would be received. Second, the country faced an uncertain economic future. And third, as it had separated from Malaysia just two years earlier, there was still a question mark over its viability as an independent state. Moreover, the currency split with Malaysia had dashed whatever remaining hope there was of a common market with Malaysia.

To make things worse, the British government announced in 1967 that it would withdraw its military forces “East of Suez”. About 15 per cent of Singapore’s workforce had jobs linked to British military bases on the island. As the then-British High Commissioner to Singapore telegraphed London; “It is unfortunate for Singapore that the introduction of the new currency had to follow the announcement of our intention to run down our forces and took place against speculation – fortunately most of it covert as to how the infant Republic would be able to contain the economic effects of the run down on top of Singapore’s general economic problems of large and growing unemployment, tardy industrialisation and general lack of export outlets.” ③

Of course, those who counselled Singapore against a currency board system argued that it was not the system that produced currency confidence. Ultimately, it was policy credibility that secured system credibility. The system cannot substitute for credible policies.



Singapore's political leadership too subscribed to the importance of policy credibility. But they felt that form and substance were equally important. There should be no doubt about how the Singapore dollar was issued, or about its backing and convertibility. And neither should there be any question about the Singapore Government's determination to do whatever it took to live within its means. System credibility, they felt, would reinforce policy credibility: the straitjacket of a currency board system was the price the new country had to pay for confidence in the currency.

The currency board system works according to mechanical rules. The discipline it imposes on a country is clear but stark. There is no room for policy improvisation. It operates as the gold standard did. Under the gold standard, trade imbalances led to changes in the stocks of gold countries held and thus their money supply, which then caused changes in the levels of employment, incomes and prices. These variations in turn led to changes in domestic demand for imports and foreign demand for the country's exports, eventually reducing the trade imbalances and restoring equilibrium.


Similarly, under the currency board system, an adjustment process would be triggered if the country incurred trade deficits repeatedly. Persistent trade deficits would mean that foreign traders would be holding increasingly large stocks of the deficit country's currency. As these traders redeemed it for the reserve currency, the country's stock of reserves would diminish.

A falling stock of reserves would in turn mean that the note issue would have to be correspondingly curtailed. Though the note issue is but one component of money supply, it nevertheless is the fulcrum on which the banks create credit. A shrinking note issue would thus ultimately lead to a contraction in credit. A

deflationary situation would be set in motion, leading to higher unemployment and lower wages – and ultimately to a reversal of the trade deficit.

The penalty for loss of competitiveness under a currency board system can thus be severe. Countries that adopt the system have to cope with deflationary situations by working harder and not by creating credit. But this was precisely the message the Government wished Singaporeans and foreign investors to note. Only if the country accumulated more reserves by exporting more than it consumed could monetary conditions be more accommodating. Singapore's leaders wished their people to realise there were no shortcuts to prosperity.

Aside from choosing a currency board system for these reasons, the Singapore Government also had an economic rationale for rejecting a central bank system. Given the openness of the Singapore economy and the high import content of what Singaporeans consumed, Dr Goh concluded that monetary stimulus would have limited impact in lifting the economy during a downturn: Most of the stimulus would simply leak abroad through increased imports. As a consequence of this, he observed in 1969:



“The way to stabilise the economy would lie less in monetary than in fiscal measures. During a downturn, it would be possible to mitigate the harsher effects of a recession if the Government were to run budget deficits financed not by central bank credit creation but by spending accumulated overseas assets or proceeds of foreign loans raised on the collateral of these assets. But this would imply the accumulation of such funds during good times... And for this we don't need a central bank, as the instrument for such measures of stabilisation would be the normal government budget.”⁴

The other reason why the Cabinet eschewed a central bank was that the central bank's power to create credit had been frequently abused. Singapore's leaders had witnessed how the replacement of currency boards with central banks in many newly independent countries had led to inflation and currency debasement. They had also seen how monetary policy in developed countries, in Lyndon Johnson's America as well as Harold Wilson's Britain, had an inflationary bias. "Lead us not into temptation..." – Singapore's founding leaders did not think they should tempt themselves or their successors with seemingly easy options.

History offers support for their instincts about the value of a currency board system in instilling confidence in the currency. In 1982, the Hong Kong dollar faced a crisis of confidence following the announcement of the colony's transfer to China in 1997. A currency board system was installed, with the Hong Kong dollar pegged at HK\$7.2 to one US dollar. That squashed speculative attacks against the currency. Almost 30 years later, Hong Kong still abides by the system, which has kept its currency steady through various crises, including the 1997-98 Asian Financial Crisis, when so many other currencies fell like ninepins.

On 25 August 1966, the Prime Minister explained to Singaporeans why the country was adopting a currency board system. A week had passed since the announcement that the common currency talks with Malaysia had fallen through. Singaporeans had yet to be told about what would replace the Malayan dollar and there was some unease about how the new Singapore dollar would fare. There had been speculation in some quarters, Lee Kuan Yew told his audience, the Singapore General Printing Workers' Union, that "Singapore is finished, because we have no natural resources" ⁵, and so its currency would be weak. But the strength of a currency did not depend on whether a country had vast or slender natural resources. "It is a matter of whether you issue notes as

and when you like or whether you issue notes against backing” ⑥, he told the printing workers.

“For every Dollar we issue, there will be a currency board which guarantees that there is that amount in gold or foreign exchange in London or New York or some other place to back it. So the money won’t go down” ⑦. Then he added characteristically: “But I will tell you what will go down – employment will go down if you don’t work hard.” ⑧



The next day, on 26 August, Finance Minister Lim Kim San announced in Parliament the formation of the Board of Commissioners of Currency, Singapore (BCCS). It began operations on 7 April 1967 and issued its first notes and coins in June.

The Finance Minister himself chaired the board, with Accountant-General Chua Kim Yeow serving as his deputy. The other directors included people from the private sectors, including from foreign banks. Their inclusion was to signal to the outside world that the currency board was subject to scrutiny by independent and credible people from outside the government. As Lee put it: “It wouldn’t be

just our word. It was also the word of the foreign bankers... that the reserves were there for every dollar issued.” ⁹

Within two years of its independence, Singapore made decisions that had far-reaching consequences for its reserves. It seceded from the common currency with Malaysia over the issue of the ownership of the reserves. Then it insisted on retaining the currency board system so Singaporeans understood there was no route to a good life other than through thrift and hard work. These were the values that produced the budgetary and external surpluses that enabled the country to accumulate substantial reserves.

- 1 Dr Goh Keng Swee: Singapore's Monetary System, 1969 (Reprinted in *The Economics of Modernisation*, Asia Pacific Press, 1972)
- 2 Dr Goh Keng Swee: Singapore's Monetary System, 1969 (Reprinted in *The Economics of Modernisation*, Asia Pacific Press, 1972)
- 3 Dr Goh Keng Swee: Singapore's Monetary System, 1969 (Reprinted in *The Economics of Modernisation*, Asia Pacific Press, 1972)
- 4 Dr Goh Keng Swee: Singapore's Monetary System, 1969 (Reprinted in *The Economics of Modernisation*, Asia Pacific Press, 1972)
- 5 Lee Kuan Yew: Speech at 54th Anniversary of the Singapore General Printing Workers' Union, NTUC Conference Hall, 25 August 1966
- 6 Lee Kuan Yew: Speech at 54th Anniversary of the Singapore General Printing Workers' Union, NTUC Conference Hall, 25 August 1966
- 7 Lee Kuan Yew: Speech at 54th Anniversary of the Singapore General Printing Workers' Union, NTUC Conference Hall, 25 August 1966
- 8 Lee Kuan Yew: Speech at 54th Anniversary of the Singapore General Printing Workers' Union, NTUC Conference Hall, 25 August 1966
- 9 Lee Kuan Yew: Interview by Teh Kok Peng, Freddy Orchard and Janadas Devan, 4 June 2010



THE
STERLING
RAJ



Even before the common currency talks with Malaysia had come to an end, another crisis loomed on the horizon. This time it was sterling.

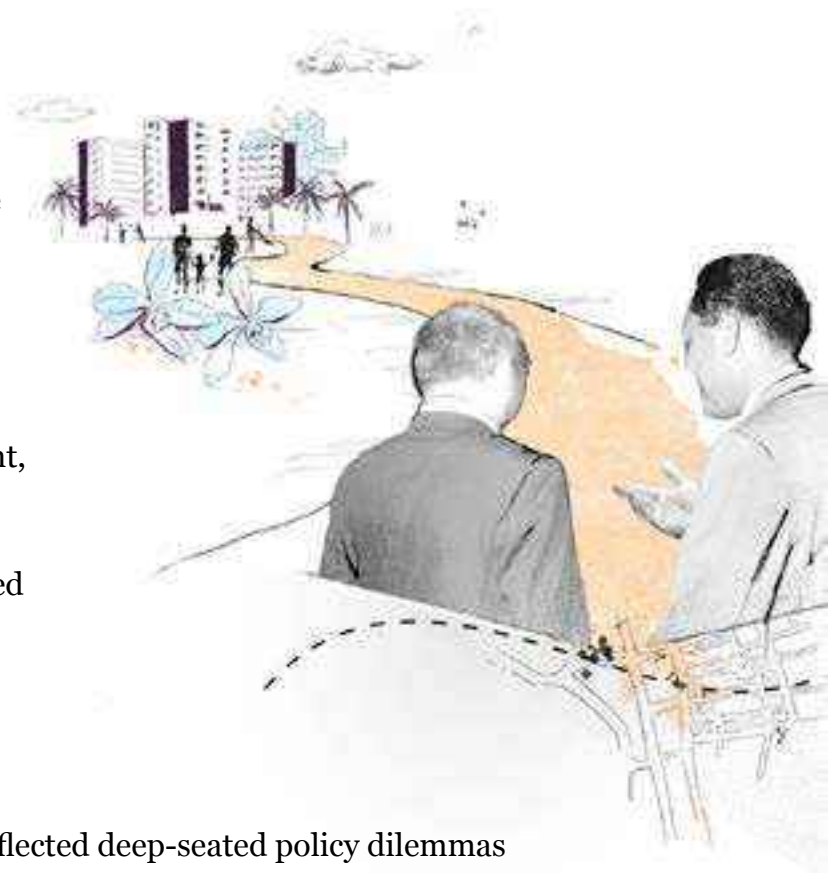
Currency markets had long been uneasy about sterling. Britain, unlike its ally the United States, had emerged from World War II exhausted – its resources depleted, its people deprived, its prestige battered. The British economy did recover in the 1950s – they “have never had it so good”, then-Prime Minister Harold Macmillan told British voters in 1957. But by the time “the swinging 60s” arrived, there was a palpable sense that Britain was living beyond its means and that it would soon be forced to devalue sterling from its fixed rate of US\$2.80.

Singapore had a lot riding on sterling’s fate. It was part of the Sterling Area, and so was obliged to hold its reserves in sterling. A devaluation of the pound would mean substantial foreign exchange losses for the country.

What could it do to protect the value of its reserves? Should it accept the British government’s assurance that it would not devalue the pound? Or should it diversify out of sterling? And if it were to diversify, how could it do so without antagonising the British government to such an extent as to jeopardise promised British aid in compensation for the withdrawal of British troops from Singapore?

In the event, the sterling episode saw a number of dramatic developments: The Singapore Government surprised London with the size of its reserves; an exchange of letters between then-British Chancellor of the Exchequer Roy Jenkins and Dr Goh Keng Swee was marked by an asperity that Lee Kuan Yew

characterised as “injudicious”; a display of what one British Treasury official described as the “fertility of the Singaporean financial mind” ¹ in proposing inventive ways of diversifying out of sterling; reports of a “breach” between Lee and Dr Goh; and Singapore got a glimpse of the potency of reserves as a bargaining chip in bilateral negotiations. But the essence of the tale, though, beyond the drama of high-level jousting between Singapore and Britain, were certain themes that became increasingly prominent as the story of Singapore’s reserves management unfolded: It was foresight, determination and resourcefulness – not dumb luck or chance – that enabled Singapore to amass its reserves and manage them well.



The travails of sterling in the 1960s reflected deep-seated policy dilemmas that successive British governments in the post-war period had to grapple with. Britain emerged from World War II victorious, but as “the most indebted country in the world” ². What was required in those circumstances was a restriction of consumption and an increase in savings to pare down the debt.

However, it would have been difficult for any British government to urge the electorate to tighten their belts yet again after six grim years of war. Having sacrificed so much during the war – “I’ve nothing to offer but blood, toil, tears and sweat”, Winston Churchill had told them in 1940 – the British expected a

better life after. And so in 1945, they voted out of office Churchill's Conservative Party and voted in Clement Atlee's Labour.

Atlee's government initiated a cradle-to-grave welfare system. As a result, savings were diverted to consumption; the rising debt had to be serviced through capital inflows; there were endemic balance of payments deficits; and sterling came under repeated attack.

The pressure intensified in 1964 when Labour returned to power but with a tiny majority of just four. On their first day in office, Prime Minister Harold Wilson, First Secretary and Secretary of State for Economic Affairs George Brown, and Chancellor of the Exchequer James Callaghan, were informed by Treasury officials that Britain was facing a balance of payments deficit of £800 million for 1964 – twice what Wilson had estimated during the campaign, only to be accused then of “scaremongering” by Tory leaders. The prospect for 1965 was scarcely less alarming.

Wilson, Brown and Callaghan decided against devaluation; not least because the previous decision to devalue in 1949 had been taken by a Labour government. “There would have been many who would conclude that a Labour government facing difficulties always took the easy way out by devaluing the pound”, Wilson later explained in his memoir, *The Labour Government 1964-1970: A Personal Record*. “Speculation would be aroused every time that Britain ran into even minor economic difficulties – or even without them.”

As events unfolded, that was precisely what happened, with speculators concluding that Wilson's government was not prepared to bite the bullet and

reduce expenditure. Labour's first budget disappointed the market. Old age pension, for instance, was raised from 12s 6d to £4 for singles, and 21s to £6 10s for married couples. Expectations were confirmed that the Wilson government would not back its tough words with tough action. Sterling came under renewed attack – by “the gnomes of Zurich” as Brown colourfully, though mistakenly, called the speculators.


To defend the pound, the Bank of England began drawing on its bilateral credit lines with other central banks. But these proved insufficient and a bigger rescue effort was mounted. In November 1964, the US Federal Reserve assembled a joint credit facility, amounting to US\$3 billion, with 11 other major central banks and the Bank of International Settlement. The announcement of the facility eased market concerns, only for a while. The facility had to be renewed the following year.

In 1966, sterling came under pressure again. Wilson had called for general elections in March that year, and this time won a decisive majority. Perhaps lulled by electoral success, Callaghan announced a budget that the markets judged insufficiently austere. Furthermore, a mid-year seamen's strike undermined sentiment, and the announcement of a large drop in the reserves created more pessimism. In July, the government had to announce an austerity package. But it was only after the US Federal Reserve announced an expanded swap line that sentiment towards the pound stabilised.

It was short-lived. A series of events in 1967 forced Wilson and Callaghan to renege on their assurances that sterling would not be devalued: Charles de Gaulle's veto of Britain's application to join the European Common Market;

the Six-Day War in the Middle East which led to the closure of the Suez Canal and in turn a rise in the costs of British imports. There were rumours of Middle Eastern countries withdrawing their funds from London.

In October, at the annual Labour Party Conference in Scarborough, the government activated a prices and incomes policy to dampen inflation. Lee Kuan Yew, who was a guest speaker at the conference, was assured by Wilson that the British government was determined to avoid devaluation. But matters came to a head the same month with the outbreak of strikes in the dockyards of Liverpool and London, which caused a delay in the shipment of British exports. The trade deficit for October spiked upward.

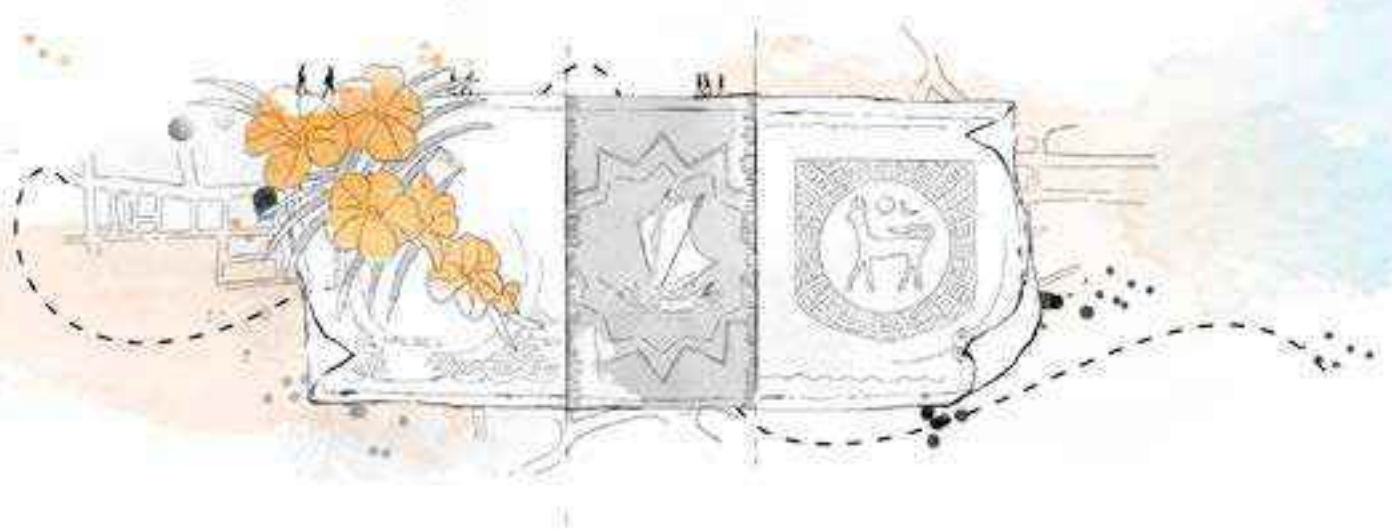


In November, Wilson and Callaghan decided that the parity of US\$2.80 to the pound could no longer be defended. On 16 November, the British cabinet approved their proposal to devalue the pound by 14.3 per cent to a new parity of US\$2.40. Callaghan announced the move on 18 November – and promptly resigned as Chancellor of the Exchequer. He was succeeded by Roy Jenkins.

Both Singapore and Malaysia were informed of the devaluation in the late evening of 18 November (local time), a few hours before the BBC announced it in London. The news was unexpected, and came at an awkward time as there were two currencies circulating in Singapore, the new Singapore dollar as well as the old Malayan dollar.

Though the currency board had begun issuing the new Singapore dollar in June, the public had been given time to exchange the Malayan dollar (which remained legal tender) for the new currency. Now the Government had to decide whether to devalue the Singapore dollar in line with sterling and what to do about the Malayan dollar in consultation with Kuala Lumpur.

The Malaysians decided that they would not devalue the ringgit, and informed the Singapore Government of their decision at 7.45 pm that evening. The Singapore Cabinet held an emergency meeting at midnight to discuss its response. A devaluation of the Singapore dollar in line with sterling would improve the competitiveness of the country's exports. However, the prices of its imports would rise. Ministers were also conscious that a devaluation of the new currency barely four months after its introduction would dent investor confidence. Singapore decided to follow Malaysia's decision in not devaluing its currency. Both the Singapore dollar and the ringgit remained at 0.290299 grammes, or the sterling equivalent of 2s 8.67d, as compared to the pre-devaluation value of 2s 4d.



The old Malayan dollar, however, was treated differently. Both countries agreed that its sterling parity should remain at 2s 4d. This meant that it would be at a discount of 14.3 per cent to the new Malaysian and Singaporean currencies. Those who had not redeemed the old currency for the new issue would be worse off. The divergence in values between the note issues created confusion in the market place, with some vendors refusing to accept the old notes and coins.

On 23 November, the Singapore government issued a statement ³ that would become the subject of close scrutiny by the British government. The first part of the statement was unexceptional. It explained the government's position and reassured the public that ample time would be given to redeem the old Malayan notes and coins. It was the second part of the statement that caused eyebrows to be raised in London.

The statement disclosed that the combined external reserves of the Singapore government and the Board of Commissioners of Currency Singapore (BCCS) amounted to \$1,251.6 million, twice what London had estimated. More startling still to London, the statement also revealed that since July 1966 the Singapore government had been gradually diversifying its reserves from sterling into other currencies, mainly the US dollar. Indeed, half of the reserves was now in currencies other than sterling. About 82 per cent of the non-sterling portion was in US dollars.

The statement added that diversification had been undertaken with two considerations in mind. First, since Singapore was part of the Sterling Area, its government had refrained from any action that could have precipitated sterling weakness. Second, given the British government's promise of aid to mitigate

the effects of Britain's military withdrawal on the Singapore economy, the diversification was conducted so as not to "prejudice a fair settlement" regarding the aid. Because of these considerations, the Singapore government had left its sterling reserves in London intact, and had moved only the additional revenues it had accumulated over time into non-sterling currencies.

The British Treasury and the Bank of England began an intensive probe into how Singapore had managed to increase its reserves and diversify them without London knowing about it. The Bank of England found that its figures on Singapore's reserves tallied with the Singapore Government's figures of its sterling reserves. What was missing was Singapore's non-sterling reserves, the source of which the Bank was "completely at a loss" to explain. Likewise, the Treasury, after meticulously tabulating the monthly statements on Singapore's reserves, still came up short of the figures released by Singapore. It was only later that the puzzle was solved: Singapore's budget surpluses over the years had been consistently underestimated.

What alarmed the British authorities most was the extent to which Singapore had diversified its reserves from sterling. The British had believed that Singapore had about 90 per cent of its reserves in sterling at the end of 1966. However, the Singapore government's press statement showed that in November 1967, the sterling proportion was only 50 per cent. Whitehall was piqued, if not furious, that Singapore had reduced its sterling proportion without informing or consulting London. It had been unaware of the true extent of Singapore's reserves, or of its policy of retaining non-sterling earnings.

The Singapore Government's statement nonetheless confirmed British suspicion that Singapore was an important Sterling Area country. It had the fourth largest holdings of reserves in the Sterling Area, after Australia, Kuwait and India. And though it held only half of its reserves in sterling, it was still, among Sterling Area members, the fifth largest holder of the currency. The four largest holders of sterling were Australia, Hong Kong, Kuwait and Malaysia. For these reasons, Singapore's diversification out of sterling was worrisome to London. What if its actions tempted other Sterling Area countries to follow suit?

Whitehall made attempts to ferret out how and in what amounts Singapore had switched out of sterling into other currencies. A possible lead was the Crown Agents, which acted for the Singapore government in London. Though the Crown Agents would be unwilling to divulge details of a client's account, Whitehall felt that a probe "at a fairly high level" of the organization could be worthwhile ⁴. This was subsequently undertaken by Sir Arthur Snelling, a senior Treasury official who then reported: "I have found out from the Crown Agents and told the Bank of England and the Treasury the amounts Singapore had switched out of sterling in recent months." ⁵

Whitehall came to two conclusions as a result of this probe. One, for a country of less than two million people, Singapore had "enormous" reserves. Judged solely on the basis of its reserves position, Singapore should be considered a "rich country". Two, the evidence suggested that Singapore had not been a loyal

and cooperative member of the Sterling Area. The British government should therefore rethink the amount of aid it should offer Singapore to mitigate the effects of Britain's military's withdrawal.

Some in Whitehall, albeit a minority, were sympathetic to Singapore's viewpoint. They pointed out that while Singapore had indeed chosen self-interest over its obligations to the Sterling Area, Britain itself had "not been over-zealous in protecting the interests of holders of sterling" ⁶. As to Singapore being "richer" than London had assumed, this was because of the policies Singapore had pursued. It was ultimately in Britain's interest to have a Singapore that was financially independent. It was also noted that, like Hong Kong, Singapore's position as a financial and trading centre required it to maintain a high level of reserves.

There followed an exchange of letters between Roy Jenkins, who had just become Chancellor of the Exchequer, and Dr Goh, who had just returned to the Ministry of Finance in August 1967. It was a barbed exchange, one that Lee Kuan Yew was reported to have commented to the British High Commissioner in Singapore, had "raised each other's hackles" ⁷.



Jenkins, a formidable intellect who later became Chancellor of the University of Oxford and a celebrated biographer, fired the first salvo. In a letter dated 6 December, he wrote to Dr Goh to express his concern at the extent to which Singapore had diversified out of sterling and his “regret that your government did not take us into their confidence in making the moves which have now been announced, indeed, in taking the decision to announce them” ⁸. He asked that the British government be informed of future diversifications.

Dr Goh, an equally formidable intellect, was just as combative in his reply of 12 December. First, he made a distinction between “monetary reserves”, to be used to back the note issue, and “non-monetary reserves”, which consisted mainly of the government’s fiscal surpluses. He argued that while the monetary reserves came under Sterling Area rules – and thus would be kept largely in sterling – the non-monetary reserves did not. Dr Goh added that he was not aware he was obliged “to discuss with anyone where I bank (the non-monetary reserves)” ⁹.

The monetary reserves, he added, were not insubstantial – about \$352 million to back the new Singapore dollar, plus \$150 million to back the old Malayan currency still circulating in Singapore. There were other deposits in sterling as well. Consequently, Singapore had sustained losses of about \$157 million as a result of the pound’s devaluation, a substantial amount for a “small under-developed country to sustain”. Still, despite the loss, “you may be

pleased to know that neither I nor any of my colleagues has uttered a single word of recrimination against your Government” ¹⁰ , Dr Goh noted with a touch of tartness. He concluded by referring to the reaction in Malaysia, “where consultations with your government (about sterling diversification) did take place” ¹¹ , and enclosed newspaper cuttings reporting on the protests in Malaysia against the devaluation.

The British, of course, regarded Dr Goh’s distinction between monetary and non-monetary reserves as disingenuous. Jenkins wrote to Dr Goh to say that the diversification rule in the Sterling Area applied to the totality of reserves, regardless of how components of the aggregate might be classified.

Jenkins had a point, but he missed the larger implications of Dr Goh’s distinction. In retrospect, it is clear that the distinction reflected an original insight into the nature of Singapore’s reserves: The term “non-monetary” reserves was a somewhat inelegant formulation to be sure, but it was accurate insofar as it underlined the difference between the reserves that the BCCS needed to hold in order to meet its obligation to redeem the note issue for sterling, and the rest, the non-monetary reserves, the currency composition of which the Singapore government should arguably have greater latitude in deciding. The distinction foresaw the differentiation that later led to the creation of the GIC a full 14 years in the future, namely, that Singapore’s reserves can be thought of as two pools – one, what would be required to manage the Singapore dollar exchange rate (“monetary reserves”), and the other, what could be invested long term (“non-monetary reserves”).

The next turn in the saga came at the end of December 1967. As Lee put it in a letter to Wilson, Singapore would face a “third blow”¹² if news agency reports that Britain would withdraw its forces “East of Suez” by 1971, and not 1975, as promised as recently as July 1967, were true. The two earlier “blows” that Lee was referring to were the initial announcement that Britain would withdraw its military forces within five years and the devaluation of the pound. And indeed the third blow did fall when, in January 1968, London confirmed the rumours of an expedited withdrawal schedule. Even Washington was taken aback by the sudden announcement. George Brown, then-Britain’s Secretary of State for Foreign Affairs recalled the “bloody unpleasant meeting in Washington”¹³ he had had with then-US Secretary of State Dean Rusk whose memorable response to Brown’s message was: “For God’s sake, act like Britain.”¹⁴

Singapore’s response to the withdrawal announcement was, in the words of one observer, “angry and militant”¹⁵. George Thompson, the emissary sent by Wilson to meet the Australian, New Zealand, Malaysian and Singapore governments on the defence cuts, noted that the general response to the news was “deep feelings of being let down”. He also reported that in the case of Singapore, Lee had threatened retaliatory measures if Britain went ahead with the earlier withdrawal, a warning that Dr Goh later repeated. Singapore, Dr Goh cautioned, could “feel obliged”¹⁶ to withdraw its sterling balances in London by one-third each year up to 1971. Singapore’s sterling holdings had become a potent bargaining chip.

Knowing about the planned announcement on withdrawal, Jenkins had refrained from engaging further with Dr Goh, and had left it to Wilson to raise London’s concerns directly with Lee. The Wilson government’s strategy was to tie the promise of aid to Singapore’s actions on sterling. Accordingly, Wilson

wrote to Lee to inform him that Britain would offer Singapore £50 million in aid to be phased over five years, but conditional on Singapore acting satisfactorily on sterling. Lee's response, as noted by British Treasury officers, was to give "satisfactory oral assurances to our High Commissioner, although only in general terms"¹⁷.

But three months later, another squabble arose. This time it was triggered by developments in the gold market. Beginning in late 1967, there had been heavy buying of gold from the so-called "Gold Pool". Established in 1961 by eight major central banks, the Pool was essentially a stockpile from which gold could be bought or sold in London to keep its price at US\$35 an ounce.

The sterling devaluation had stoked fears of further exchange rate instability among the major currencies. There was also uncertainty about how long the fixed exchange rate system would last. As a result, in March 1968, there was a burst of panic buying of gold. On 14 March, the Pool members caved in to the outflow of gold from their stocks and dissolved the Pool. The London gold market closed for two weeks. When it reopened, gold traded at US\$38 an ounce and soon climbed to US\$42.

Singapore, on the instructions of Dr Goh, it transpired, had been in the market selling sterling just before the gold market closed. The amounts were not large. Singapore had sold £3.2 million for a US\$-denominated bond issued by the World Bank and £7 million for gold. But the British were enraged when they found out about these transactions and dispatched several queries about them. Singapore's response, communicated through Sim Kee Boon, then Permanent Secretary at the Ministry of Finance, was that the transactions should not be viewed as attempts to diversify out of sterling. The World Bank bond was bought in support of its fundraising exercise, while the gold would be held in London

and would be sold for sterling if it was disposed of.

London did not accept Sim's reply and instructed Sir Arthur de la Mare, then the British High Commissioner to Singapore, to convey to Lee that the £10 million sold should be "reconstituted". De la Mare saw Lee on 27 March. The next day he sent a dispatch to the Commonwealth Secretary summarising his conversation with Lee. It was a dramatic and astounding document ¹⁸ .

De la Mare reported Lee as saying that the transactions would not have occurred if he had had his way; that the Cabinet was split into a pro-Japanese camp, led by Dr Goh, and a pro-British camp; and that if he, Lee, were to force the issue on Britain's behalf, there might be a "Cabinet break-up" and he would be committing "political suicide", as it would give Dr Goh a chance to capture the party leadership.

De la Mare went on to quote Lee as saying that the effort and risk of doing what the British were asking him to do would serve "no purpose whatever" ¹⁹ . What would affect confidence in sterling was not Singapore's £10 million but whether Britain's Labour government could deal with the trade unions. Lee ended the conversation, according to de la Mare, by assuring the High Commissioner that while he could not undo the transactions, he could try to reverse them partially when he reshuffled the Cabinet following the Singapore General Elections in April that year.

De la Mare, always sympathetic to Singapore, cautioned Whitehall that Britain's relations with Singapore were at risk if they pursued a hard line against

Singapore on sterling. One consequence of the estrangement could be that British interests would lose out to the Japanese. De la Mare ended his dispatch with a reference to the British surrender to the Japanese in February 1942, saying he hoped “we are not on our way to another tragic rendezvous with history on the Bukit Timah Road” ²⁰ .

What is one to make of this dispatch? It seems difficult to credit the story of a breach between Lee and Dr Goh, a breach so serious as to threaten the government. All the Singaporean eyewitnesses to those times say this was “wayang” (play-acting), just the two top Singaporean leaders divvying up the good cop/bad cop routine between them. Furthermore, they point to the facts: there was no Cabinet split, nor was there any hint of one. Dr Goh continued as Finance Minister till August 1970, when he returned to Defence and was promoted to the additional post of Deputy Prime Minister. And in the 1980s, Dr Goh, by then First Deputy Prime Minister, was placed in charge of the Monetary Authority of Singapore, and again took frontline charge of Singapore’s monetary policy. What sort of breach could have occurred in 1967 if the succeeding years witnessed the continued close collaboration of these two giants among Singapore’s founding fathers?

Still, there is no doubt that the two disagreed on what Singapore should do in response to the sterling crisis. Sim Kee Boon and Ngiam Tong Dow, both officials in the Finance Ministry then, recalled the two disagreeing vigorously. Lee himself, when interviewed for this book, said plainly that he would have preferred if Singapore had not disappointed the British by selling sterling just then. He had an “obligation to Harold Wilson”, he recalled, a “friendship” ²¹ . Wilson had “promised to slow down (British military) withdrawal and give us aid” ²² , he recounted.

Wilson, it should also be remembered, had sent a stern message to Malaysian Prime Minister Tunku Abdul Rahman in June 1965 not to take action against Lee and his colleagues when Singapore was part of Malaysia. “I felt it necessary to go so far as to let the Tunku know that if he were to (arrest Lee), it would be unwise for him to show his face at the Commonwealth (Prime Ministers’) conference”²³, Wilson wrote in his memoir.

It is altogether possible that if it had not been for Wilson, there might well have been a “coup”²⁴ against Singapore’s political leadership in 1965. Instead, in part because of Wilson’s unambiguous signal, the Malaysian leadership decided it was best to hive off Singapore as a separate, sovereign state. It was understandable if in these circumstances, Lee felt an “obligation” to Wilson. His “sympathies were with the British”²⁵ during the sterling crisis, he said, and he “didn’t want to do them harm”²⁶.

Lee was also concerned about the aid the British had promised. “Supposing we hadn’t sold (sterling)”, he said.

“How much would we have lost as against the assets they’ll leave behind and the aid that they’ll give us? They knew we were in a jam – that it was 20,000 jobs lost when the troops withdraw and they felt sorry for us. So they left all the workshops, the shipyards, everything was in place – they gave us everything that they had here. So if I were the Finance Minister I would not have done it.”²⁷

The British government for its part did not fully believe there was a breach between Lee and Dr Goh. But they recognised, for good reason, that the two had different views on sterling and that “in financial matters... Dr Goh can and does act on his own in matters of the first import to us”²⁸.

The British, accordingly, tried another tack. They informed Singapore that the aid package to Malaysia would be announced while that for Singapore would be delayed until Singapore “reconstituted” the sterling that it had sold.

Dr Goh responded by suggesting two ways of reconstitution. One was for the gold in question to be deposited with the Bank of England for two years. This was ingenious: the British would be assured the gold would not be switched into US dollars while Singapore would retain the gold. The other suggestion was to convert the US dollar-denominated bonds into sterling, which would then be deposited in the offshore sterling market. This again was shrewd. Deposits in the offshore market attracted higher interest rates than deposits in Britain and the Bank of England could not monitor offshore market transactions as closely as it did onshore transactions.

Dr Goh’s suggestions were met with exasperation. The British Treasury proposed that Jenkins write a formal reply to Dr Goh, but de la Mare advised against this, observing that the letters between the two tended to be abrasive rather than conciliatory. He added that he had just spoken with Lee, who was also of the view that Jenkins and Goh “each raised the hackles of the other”²⁹, and that “there had been occasions when if he had seen Goh’s reply before dispatch he would have stopped it, and he thought that if ‘someone’ in London had seen the Chancellor’s letters to Goh before dispatch they might have thought it well to stop them too”³⁰.

De la Mare suggested that British ministers raise the issue when Lee was in London in May. The Treasury sent representatives to discuss Singapore’s proposals but there were no solutions as to how they could be implemented to

both parties' satisfaction. De la Mare also observed that Lee himself was at that juncture expressing doubts about the Wilson government's ability to pull Britain through its economic problems. In a telegram earmarked for only a select few because of the "stark" ³¹ message it contained, de la Mare noted that Lee was with "increasing frequency" ³² pursuing the line among his close confidants that "if the Cabinet changes (in Britain) are the mark of (the Wilson government's) resolve to deal with the labour unions then another early devaluation is inevitable" ³³. According to de la Mare, Lee would only be prepared to give assurances to London that Singapore would not diversify further out of sterling if London was prepared to put its "own house in order" ³⁴. The outcome of all these doubts was that efforts to "reconstitute" the sterling that Singapore had sold in March stalled.

In May 1968, Britain began negotiations with Sterling Area countries, including Singapore, on an extension of the Sterling Agreement. The British first proposed that Singapore agree to maintain 50 per cent of its reserves in sterling for seven years. This was unacceptable to Dr Goh and his team, especially since there was every possibility of another sterling devaluation. The negotiations were "difficult and protracted" ³⁵. There were disputes over Singapore's reserves figures, the proportion of sterling that should be guaranteed by Britain, and the Minimum Sterling Proportion (MSP) that Singapore should be required to maintain. It was not till Singapore learnt that Australia had agreed to a draft Agreement that it too agreed, "with considerable reluctance" ³⁶, to an MSP of 40 per cent, the same as for Australia.

In September 1968, Singapore renewed the Sterling Agreement with Britain for three years. In return for Singapore's commitment to an MSP, London agreed

to guarantee the US dollar value of an agreed proportion of the MSP. Later, in September 1971, the Sterling Agreement was renewed for another two years and the MSP for Singapore was reset to 36 per cent, but again not without protracted negotiations. But by then the US dollar guarantee for part of the MSP had become of dubious value, for the US dollar too had weakened. Indeed, in August 1971, President Richard Nixon had unilaterally devalued the US dollar, an action that effectively ended the Bretton Woods international monetary system of fixed exchange rates.

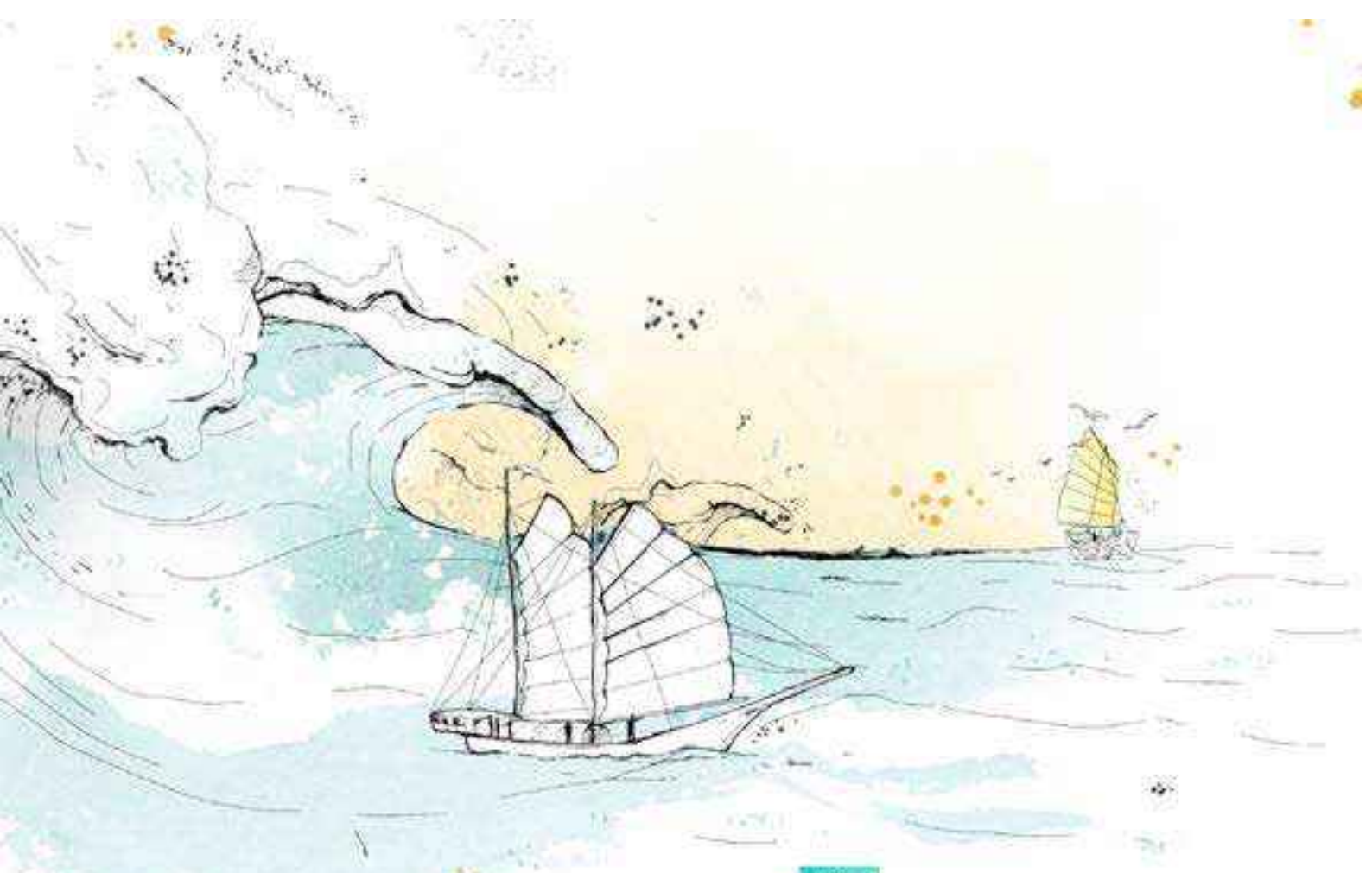
In June 1972, when sterling again came under renewed selling pressure, London too floated the pound and the currency weakened. On 26 June 1972, *The Straits Times* carried an article with the heading: “Singapore has broken her ties with sterling”³⁷. The article reported that the Singapore Government had decided to use the US dollar as intervention currency in place of sterling. Other Commonwealth countries, including Malaysia, made similar announcements around that time. The British had been earlier putting out feelers for a renewal of the Sterling Agreement in 1973 when the current agreement was due to come to an end but the floating of sterling effectively meant the dismantling of the Sterling Area.

The sun had finally set on the Sterling Raj.



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- 2** Edmund Dell, *The Chancellors*, Pg 20. (HarperCollins Publishers, 1996)
- 3** Statement by Singapore Government, 23 November 1967
- 4** Note from P Scanlon: How “rich” is Singapore?, 6 December 1967. TNA 00038 FCO 24/315
- 5** Note from A Snelling: How “rich” is Singapore?, 14 December 1967. TNA 00029 FCO 24/315
- 6** Note from D G Holland: How “rich” is Singapore?, 6 December 1967. TNA00036-37 FCO 24/315
- 7** Telegram: Arthur de la Mare, 13 May 1968. TNA 00010-11 FCO 24/316
- 8** Letter to Dr Goh: Roy Jenkins, 6 December 1967. TNA 00046 FCO 24/315
- 9** Letter to Roy Jenkins: Dr Goh, 12 December 1967. TNA 00138-139 FCO 24/316
- 10** Letter to Roy Jenkins: Dr Goh, 12 December 1967. TNA 00138-139 FCO 24/316
- 11** Letter to Roy Jenkins: Dr Goh, 12 December 1967. TNA 00138-139 FCO 24/316
- 12** Letter to Harold Wilson: Lee Kuan Yew, 18 December 1967. TNA 00019-22 FCO 24/315
- 13** Telegram: George Brown, 11 November 1968. TNA 0022 CAB 129/135
- 14** Telegram: George Brown, 11 November 1968. TNA 0022 CAB 129/135
- 15** Memorandum: Michael Stewart, 11 January 1968. TNA 0015 CAB129/135
- 16** Memorandum: George Thompson, 15 January 1968. TNA 0023 CAB 129/135
- 17** Background Note: Singapore Sterling, UK Treasury, 22 May 1968. TNA 00054 FCO 24/316
- 18** Telegram: Singapore Sterling, Arthur de la Mare, 28 March 1968. TNA 00081-85 FCO 24/316
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- 20** Telegram: Singapore Sterling, Arthur de la Mare, 28 March 1968. TNA 00081-85 FCO 24/316
- 21** Lee Kuan Yew: Interview by Teh Kok Peng, Freddy Orchard and Janadas Devan, 4 June 2010
- 22** Lee Kuan Yew: Interview by Teh Kok Peng, Freddy Orchard and Janadas Devan, 4 June 2010
- 23** Harold Wilson, *The Labour Government 1964-1970: A Personal Record*. (London: Weidenfield and Nicolson and Michael Joseph, 1971) Pg 130-31
- 24** Harold Wilson, *The Labour Government 1964-1970: A Personal Record*. (London: Weidenfield and Nicolson and Michael Joseph, 1971) Pg 131
- 25** Lee Kuan Yew: Interview by Teh Kok Peng, Freddy Orchard and Janadas Devan, 4 June 2010

- 26 Lee Kuan Yew: Interview by Teh Kok Peng, Freddy Orchard and Janadas Devan, 4 June 2010
- 27 Lee Kuan Yew: Interview by Teh Kok Peng, Freddy Orchard and Janadas Devan, 4 June 2010
- 28 Background Note: Singapore and Sterling - Visit of Mr Lee Kuan Yew on 16 January 1969. TNA T 312/2649
- 29 Telegram: Arthur de la Mare, 13 May 1968. TNA 00010-11 FCO 24/316
- 30 Telegram: Arthur de la Mare, 13 May 1968. TNA 00010-11 FCO 24/316
- 31 Telegram: Sterling and Singapore, Arthur de la Mare, 22 April 1968. TNA 00049-52
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Chapter 1

THE BUCCANEERS





THE DEVALUATION OF STERLING IN NOVEMBER 1967

was a harbinger of more turmoil in the international monetary system. The next four years or so were marked by incessant international currency crises, culminating in 1971 of the abandonment of the Bretton Woods system of fixed exchange rates that had been created after the end of World War II. The period overlapped with Dr Goh's second stint as Finance Minister from August 1967 to August 1970. The upheavals in global financial markets led him to conclude that the reserves should not be managed on an ad hoc basis. Accordingly, he initiated steps to develop reserves management as a dedicated activity of government.

Up to 1971, when the Monetary Authority of Singapore (MAS) was established, there was no central monetary authority in Singapore. Instead, a number of agencies, including the Board of Commissioners of Currency Singapore, the Commissioner of Banking, the Exchange Control, and the Accountant-General's Office (AGO), had performed various monetary and banking functions.


One of the quirks of the situation, as Dr Goh was to note in an address in 1970, was the wide ambit of the AGO. Apart from its normal accounting functions, it also undertook some central banking functions, like issuing Treasury bills and acting as the government's banker. In addition, the AGO had oversight of the country's reserves and dealt with brokers like the Crown Agents in London.

Coordinating this assortment of agencies was the job of the Ministry of Finance. It was an untidy system, one that placed a heavy burden on the Finance Minister and his officers. Dr Goh eventually concluded that the arrangement was not equal to the challenges involved in watching financial markets and investing the reserves.



Sometime in 1968, he began convening weekly meetings on reserves management. Apart from himself, the regular attendees at the gatherings included the Accountant-General, Chua Kim Yeow, and the two Finance Ministry officials, Sim Kee Boon and Ngiam Tong Dow. The meetings were held on Monday mornings at Dr Goh's office in Fullerton Building (since then converted into a hotel). Sim Kee Boon, in an interview ^①, recalled Dr Goh's "Monday morning prayers" as tutorials on the conduct of central bank functions. Dr Goh, he felt, was teaching himself as well as his officials how they might function when Singapore finally did establish a central bank or monetary authority. In retrospect, because the meetings often involved discussions of how the reserves might be invested, the Monday morning group might also be described as Singapore's first Investment Committee.

The group did not have as easy an access to market information as we do now. This was a time of telexes, not faxes, let alone e-mail. Foreign newspapers arrived in Singapore some three or four days late. Television was available in Singapore, but coverage of international financial developments was spotty and cursory. There was no CNN or CNBC or Channel NewsAsia.



The “Monday morning prayers” were simple, unceremonious affairs. There were no support staff or observers in attendance. Dr Goh would direct the agenda and call for reports to be prepared or research to be conducted as and when he felt they were necessary.

Elizabeth Sam, a young finance officer then, took the minutes, which had to be completed within the same day for Dr Goh’s vetting. Chua would be responsible for implementing the investment decisions made at the meeting. He would usually forward Dr Goh’s instructions to the Crown Agents in London for execution. The entire process was typical of Dr Goh’s “hands-on, direct style” ² of working, Sam recalled later.

The weekly meetings began at a time of extreme stress in the international monetary system. The Bretton Woods system, in existence for close to a quarter century then, was in crisis. Essentially a modified version of the gold standard, the system had countries fixing their exchange rates against a common peg or “numeraire” – in this case, the US dollar. In turn, the US government guaranteed the conversion of US dollars to gold at a fixed price of US\$35 per ounce. As long as that convertibility was not in doubt, holding US dollars was as good as holding gold.

The creation in the main of John Maynard Keynes, the famous British economist, and Harry Dexter White, a senior American treasury official, the Bretton Woods system of fixed exchange rates functioned well initially and helped sustain the post-War global economic boom. But by the late 1960s, it had come under severe strain because major global economies had chronic balance of payments surpluses or deficits. For various reasons, they resisted

altering their exchange rates, as they were supposed to, which meant the system lacked an effective mechanism for correcting what economists called “balance of payments disequilibria”.

The world’s major economies fell into two camps: on the one hand, there were the chronic trade surplus countries like West Germany, Japan and Switzerland; and on the other, chronic trade deficit countries like the United States, Britain and France.

These were conditions that fed contagion in the currency markets. Thus, the devaluation of sterling in November 1967 led to selling pressure on the French franc, which was eventually forced to devalue in August 1969. The franc devaluation renewed speculation of another sterling devaluation. With time, the speculative attacks became self-reinforcing, with each success in bringing down a currency encouraging speculators to search for a new victim.

Ultimately, Bretton Woods was undermined because of rising doubts about the status of the US dollar as a secure store of value. These doubts were kindled by US economic developments as the 1960s progressed. President Lyndon Johnson then had instituted his “Great Society” welfare programmes even as he presided over an expensive war in Vietnam. The result was chronic fiscal deficits and expansionary monetary policy, a combination that resulted in US trade deficits and a rapid accumulation of US dollars in surplus countries. As the overhang of US dollars increased and more US dollars were presented to the US Treasury in exchange for gold, there was increasing worry that the US would run out of gold

and would suspend its pledge to convert US dollars to gold at US\$35 per oz. This indeed occurred in 1971, when President Richard Nixon unilaterally suspended the convertibility of dollars to gold. With that peremptory stroke, he cut the Bretton Woods system from under its feet.

Before the inevitable occurred, the gold market had become the barometer of the market's uneasiness over currency instability. Gold was viewed as the ultimate safe haven, the asset investors turned to when there was mistrust in any paper currency. The sterling devaluation of November 1967 triggered speculation against the US dollar and a consequent "gold rush" in March 1968. This led to the dissolution of the so-called "Gold Pool", a mechanism created by eight major central banks, including the US Federal Reserve, to help keep the price of gold at US\$35 per oz. The gold market was also closed for some time.

During the closure of the gold market, the US orchestrated an agreement among most of the world's major central banks that they would neither buy gold from the market nor sell it to other monetary authorities. The communiqué announcing the agreement was sent to central banks and the relevant monetary authorities around the world – including Singapore – accompanied with the request that they comply with the agreement. One of the consequences of the agreement was an embargo on gold purchases from South Africa, a major producer of gold then.



Meanwhile in Singapore, Dr Goh’s weekly meetings focused inevitably on developments in the currency and gold markets. He and his staff, Dr Goh later said, devoted “an inordinate amount of time and effort to the study of current monetary developments” ³.

Their overriding concern was how Singapore’s reserves should be safeguarded amidst the global financial turmoil. Dr Goh was sceptical of the assurances emanating from Washington and London that the Bretton Woods system would hold and that the US dollar and sterling, the world’s two major reserve currencies then, would maintain their parities against the currencies of countries with balance of payments surpluses, in particular the Deutsche mark, Swiss franc and Japanese yen. He also concluded that the price of gold would have to rise.

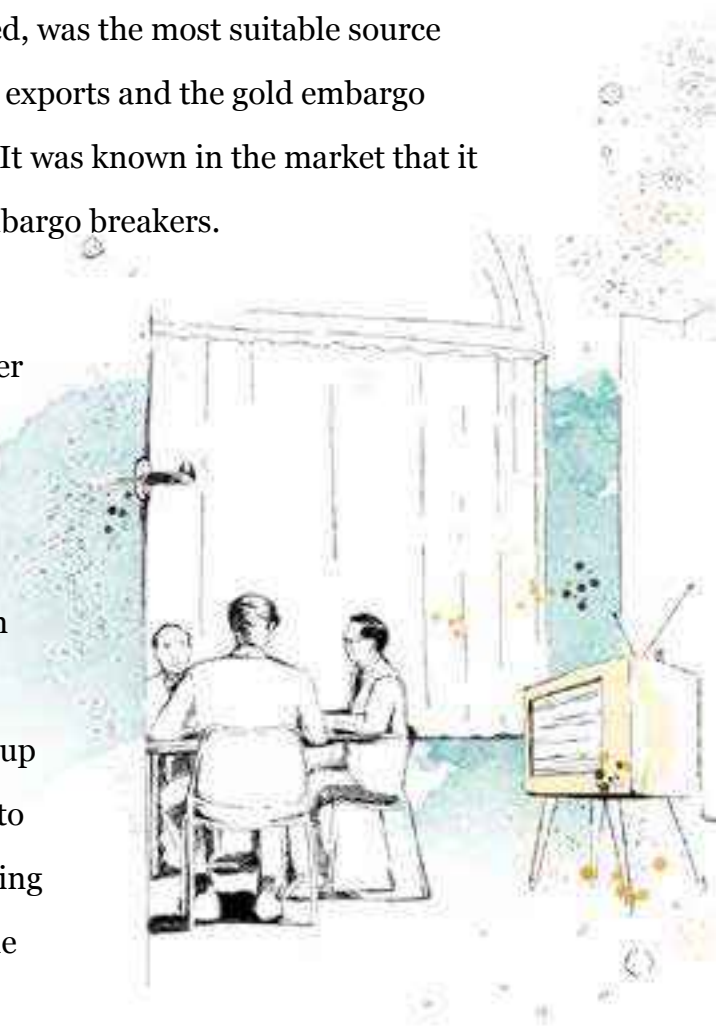
Consequently, his first decisive “move was really (to change the) currency composition” ⁴ of the reserves, Sam recalled. He directed that the proportion of sterling and US dollars held by Singapore be reduced in favour of the Deutsche mark, the Japanese yen and the Swiss franc. In doing so, he initiated a policy of currency diversification that would later become a cornerstone of reserves management everywhere. But at that time, it was an “unusual course because most central banks just adhered to holding their reserves in the reserve currencies” ⁵, Sam noted.

Dr Goh also decided to buy gold. But given the US-led embargo on gold

purchases from the market or from official stocks, the purchases would have to be covertly made. South Africa, Dr Goh decided, was the most suitable source of gold to approach. Gold was one of its major exports and the gold embargo was depriving it of a major source of revenue. It was known in the market that it would welcome approaches from potential embargo breakers.

The first connection was made in September 1968 in Washington, at the annual meeting of the IMF-IBRD (International Bank for Reconstruction and Development). Dr Goh, accompanied by Ngiam, met the South African Minister for Finance, Dr Nicolaas Diederichs. Dr Diederichs was a cautious man. He turned up the volume of the television in his hotel room to prevent his conversation with Dr Goh from being eavesdropped by some intelligence agency. The meeting was kept brief and to the point. Both parties came to a preliminary agreement that

Singapore would buy 100 tonnes of gold at the indicative price of US\$40 per oz. Dr Diederichs proposed a meeting between emissaries from the two countries in Zurich to confirm the quantity and price, and to settle various details such as the method of payment and how the gold was to be transferred to Singapore's account.





Dr Goh told Dr Diederichs that Ngiam would be one of Singapore's emissaries. Dr Diederichs then fished out a US dollar note from his wallet, tore it in two and gave one half to Ngiam. The other half, he told his Singaporean visitors, would be held by his representative at the Zurich meeting. The two emissaries would verify each other's identity by matching the two pieces.

Dr Diederichs would probably have torn the note with a practiced hand: A number of countries, including European ones, were known to have broken the US-led embargo by buying gold from South Africa. The arrangements to do so would probably have been made in the same clandestine manner. Dr Goh, who had the "soul of a buccaneer" ⁶, as J Y Pillay, another high-level mandarin from that era, put it, must have relished the cloak-and-dagger atmosphere.

When he returned to Singapore from Washington, Dr Goh asked the banker Wee Cho Yaw to accompany Ngiam to Zurich. It was an astute move. Ngiam, being a civil servant, was unfamiliar with financial transactions of such magnitude. Wee, by contrast, had banking in his blood and was well-versed in the protocols of such transactions. He was also familiar with the hurly-burly world of commercial negotiations, a familiarity that would come in handy if the South Africans sought to drive a hard bargain. In addition, Dr Goh probably

thought it wise to ensure “transparency” ⑦, as Wee put it decades later, for a transaction of this size, involving more than US\$100 million, was best concluded before an independent witness, particularly a banker. A year later, on another mission to purchase gold, Dr Goh asked another local banker, Lien Ying Chow, to accompany Ngiam.

The meeting with the South Africans took place as scheduled in Zurich.

There was no need for further negotiations as the South Africans indicated their assent to the terms agreed to at Washington. Wee called Dr Goh on the telephone to seek his confirmation that 100 tonnes of gold be bought at US\$40 per oz. Dr Goh agreed and the deal was sealed.



In 1969, Dr Goh created a new unit within the Ministry of Finance, the Department of Overseas Investments (DOI). Singapore’s external assets had risen at “an exceptionally fast rate” ⑧ and Dr Goh saw the need for them to be managed by a unit dedicated to the task. Hence, the creation of the DOI. The DOI in effect was a rudimentary investment management unit, the embryo from which GIC developed.

A clue to its orientation was the appointment of Lim Chee Poh, a stockbroker, as its first head. He left after a short tenure and was succeeded by Francis De Costa, a deputy secretary at the finance ministry. De Costa, however, soon

became involved in the negotiations to renew the Sterling Agreement and the consequent effort to reduce Singapore's sterling holdings. He was succeeded by Elizabeth Sam. She would oversee reserves management over the next 12 or so years, heading DOI until its absorption into the Monetary Authority of Singapore on 1 January 1971, and later helming MAS' International Department, DOI's successor, until 1981.

Dr Goh was clear about DOI's direction. It should invest Singapore's reserves so as to maximise returns, not merely take the conventional route of investing in cash and short-term paper. This meant investing in international equities and bonds. This was a revolutionary, unheard-of step in those days, particularly for a finance ministry.

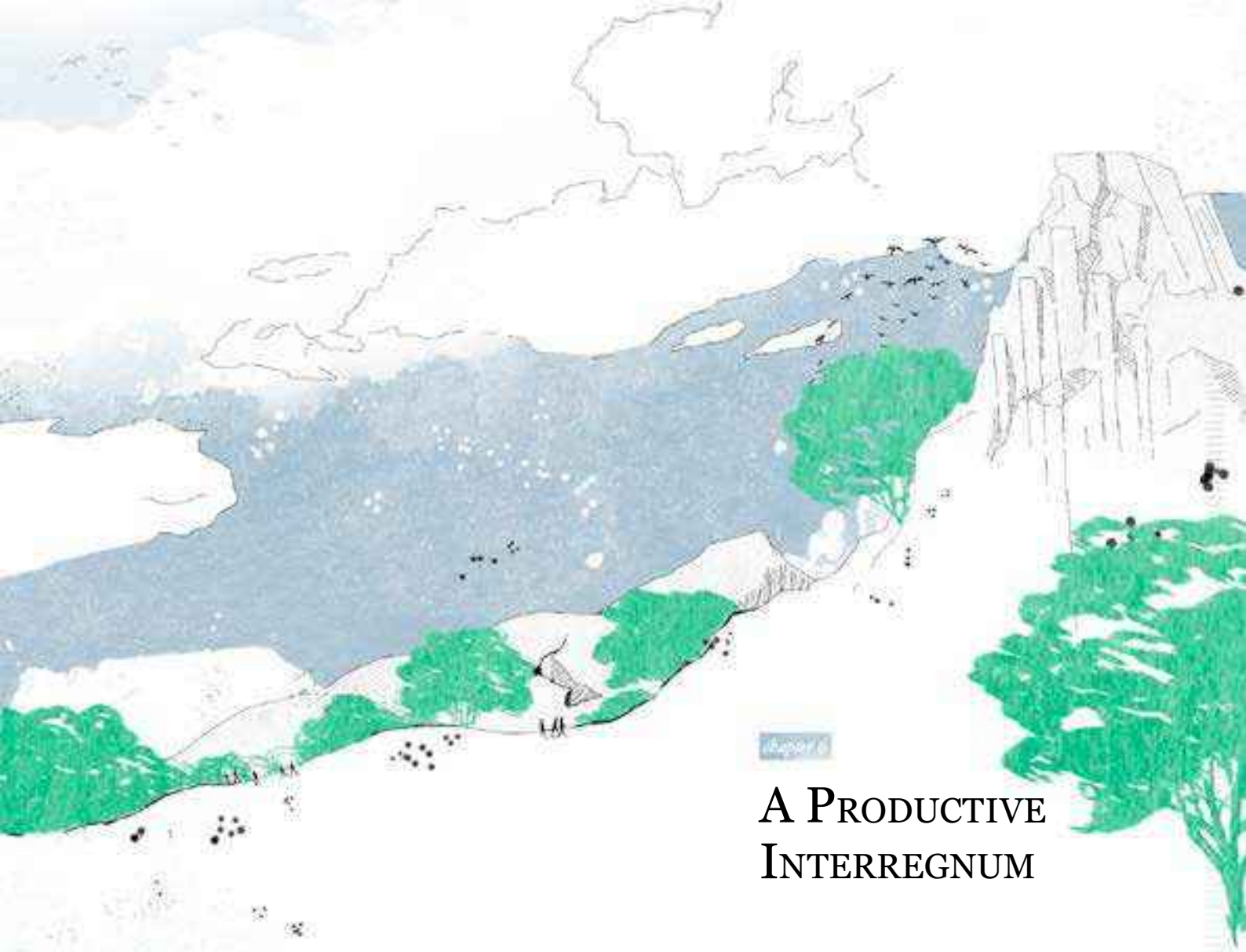
The first Japanese brokers Sam invited to present a sales pitch to DOI for Japanese equities did not believe that any business would come their way. They were incredulous that a finance ministry was considering investing in Japanese stocks.

But that was precisely what the Singapore officers were considering and word soon spread through the brokerage community that business was indeed available from the DOI. Sam received approval from Dr Goh to invest in the US, Britain, West Germany and Japan. Eventually, specific brokers were chosen for each of these countries: James Capel and the Crown Agents for Britain; Lehman Brothers and Lazard Freres for the US; Dresdner Bank and MM Warburg-Brinckman Wirtz for West Germany; Nomura Securities and Daiwa Securities for Japan; and the Swiss Bank Corporation and Union Bank of Switzerland for Switzerland.

Sam had two officers assisting her, an accountant and an investment officer. The latter was Ng Kok Song who would remain with Sam at MAS and then move to GIC after its formation to take charge of its equity and bonds departments and eventually to be Group Chief Investment Officer.

The DOI was short-lived, for it was subsumed as a department in MAS when the latter began operations in 1971. However, its influence transcended its life and the ethos it symbolised was more than ephemeral. The returns-oriented culture that Dr Goh inspired was transplanted to MAS, and later to GIC. The “buccaneers” who faithfully attended Dr Goh’s “Monday morning prayers” would go on to shape the future course of reserves management in Singapore.


- 1 Sim Kee Boon: Interview by Janadas Devan
- 2 Elizabeth Sam: Interview by Freddy Orchard and Janadas Devan, 22 April 2010
- 3 Dr Goh Keng Swee: Singapore’s Monetary System, 1969 (Reprinted in *The Economics of Modernisation*, Asia Pacific Press, 1972)
- 4 Sim Kee Boon: Interview by Janadas Devan
- 5 Sim Kee Boon: Interview by Janadas Devan
- 6 J Y Pillay: Interview by Freddy Orchard and Janadas Devan, 23 April 2010
- 7 Wee Cho Yaw: Interview by Freddy Orchard and Janadas Devan, 16 July 2010
- 8 Dr Goh Keng Swee: Singapore’s Monetary System, 1969 (Reprinted in *The Economics of Modernisation*, Asia Pacific Press, 1972)



A PRODUCTIVE
INTERREGNUM

began operations on 1 January 1971. Except for the note issue, which remained the province of the Board of Commissioners of Currency, MAS assumed all other central bank functions, including the management of the country's reserves. Thus began another stage in the history of reserves management in Singapore – a stage that coincided with the 1970s, one of the most tumultuous periods for financial markets in the 20th century.

It was Dr Goh who masterminded the formation of MAS. The International Monetary Fund (IMF) provided technical advice and, at the request of the Singapore Government, produced the initial draft legislation and framework. But Dr Goh took an active role in shaping the legislation, recalls Elizabeth Sam, a Finance Ministry official then. “He actually went into the details”^①. He would “discuss what (the IMF's proposals) meant, what he didn't like or what we should put in or not”^②.

An illustration of a woman with dark, wavy hair, wearing a white top with a dark collar. She is looking slightly to the left. A green speech bubble is positioned in front of her, containing text. The background is a light blue and green wash, suggesting a landscape or sky.

He actually went into the details. He would discuss what (the IMF's proposals) meant, what he didn't like or what we should put in or not.

However, by the time the legislation was ratified by Parliament in December 1970, Dr Goh had moved from Finance to Defence. Hon Sui Sen, a mandarin par excellence who had played key roles in Singapore's economic development from 1960 and a man of deep integrity with a profound sense of commitment to his fellow human beings, replaced Dr Goh at Finance, and became the first Chairman of MAS.

In 1967, in the lead-up to the currency split with Malaysia, Dr Goh had resisted the idea of a central bank replacing the currency board. Two years later, he championed the establishment of an institution that was in effect a central bank. Did his position change, and if so, why?

Dr Goh himself saw no contradiction between his positions in 1967 and 1970. In 1967, the urgent need to establish confidence in the new currency demanded retention of the currency board system. But even then, Dr Goh was conscious that the currency board would not meet all of Singapore's needs. The currency board only catered to note issue. But a sophisticated financial system would also require the direction and coordination of the banking sector, capital markets and the exchange rate. And by 1971, Singapore needed such a central coordinating financial authority. However, in creating MAS, Dr Goh shaped the product of his vision to possess two unique features that distinguished it from the typical central bank.

First, he insisted that the institution be called a monetary authority and not a central bank. The choice of nomenclature was deliberate, intended to highlight the fact that the institution was not a full-fledged central bank as it would not have the power to issue currency, which still resided with the currency board. In other words, Singapore would have an unheard-of mix of a quasi-central bank and a currency board, a feature that intrigued monetary experts. As the 1971 IMF mission to Singapore noted: "the combination of a monetary authority together with an autonomous currency board is an interesting innovation which marks a departure from the conventional wisdom of central banking in the emergent countries" ³.



“The combination of a Monetary Authority together with an autonomous currency board is an interesting innovation which marks a departure from the conventional wisdom of central banking in the emergent countries”

Second, in an even more controversial departure from conventional practice, Dr Goh insisted on the Minister for Finance chairing MAS. This was equivalent to having the US Secretary of the Treasury double up as Federal Reserve Chairman or Britain’s Chancellor of the Exchequer head the Bank of England. Naturally, the IMF advised against such an arrangement. It would place the central bank at the mercy of a profligate government if one should arise, it warned; instead, the central bank should be helmed by someone with the independence to counter or check feckless fiscal policy.

Dr Goh took a pragmatic view of the relationship between governments and central banks. The fact was, at that time, the practice of appointing nominally independent central bank chiefs did not guarantee the independence of central banks. There were numerous examples of central banks, in both developing as well as developed countries, bending to pressure from governments to pursue expansionary, and ultimately, inflationary policies.

Indeed, even as MAS was in its inaugural year of operations, events in Washington DC were illustrating how a wily US President could sway the Federal Reserve, a putative bastion of central bank independence, to pursue an

expansionary monetary policy to boost his re-election prospects. The President was Richard Nixon and the Federal Reserve's Chairman then was Arthur Burns.

Nixon's then secret taping system has preserved for posterity a record of his conversations with Burns in the period leading up to the US Presidential Elections in 1972. The evidence from the tapes "clearly reveals that President Nixon pressured Burns, both directly and indirectly... to engage in expansionary monetary policies prior to the 1972 election" ⁴. The tapes record how Burns initially resisted Nixon's calls for accommodative monetary policy but eventually gave in when Nixon "craftily engineered credible threats to Burns' power and to the Fed's independence" ⁵.

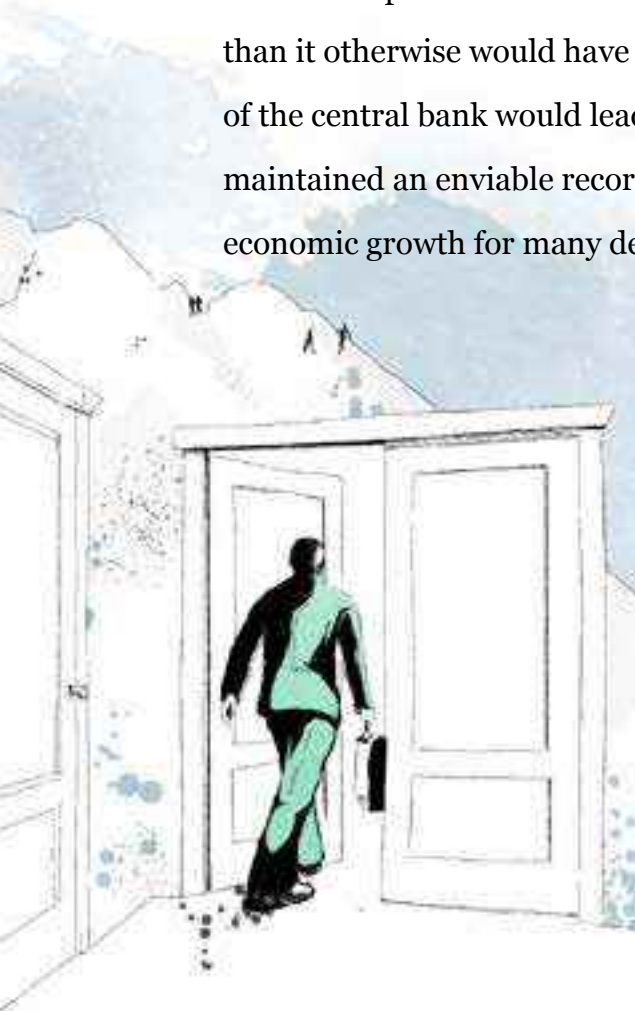
In the short run, Nixon benefited from the monetary stimulus injected into the US economy, romping home to a landslide re-election victory against George McGovern in November 1972. In the long run, he did not. By 1973, inflation was at 8.8 per cent, double the 1972 rate. "Arthur" slammed on the brakes then, and the result was an unemployment rate of 9.1 per cent by the end of the year. Many historians believe that Nixon lost public support rapidly in 1974 not only because of Watergate, but also because of the deteriorating economy.

It was only in the 1990s that central bank independence in Europe and the United States was given stronger legislative teeth. In 1970, as Dr Goh saw it, the setting in which MAS would operate required a different approach. A tradition had developed in Singapore of prudent fiscal policy, resulting in the government posting regular fiscal surpluses. MAS was unlikely to be called on to finance budget deficits. In any event, the currency board system effectively prevented the government from resorting to deficit financing. In the circumstances, having the

Finance Minister responsible for both fiscal and monetary policy would ensure a high degree of coordination.

The MAS Act provided for a board of seven directors. Apart from the Finance Minister, its other members included the Permanent Secretary of the Finance Ministry serving as Deputy Chairman, the Accountant-General and four others appointed by the President. Of the four, one would be the chief executive of the organization, the Managing Director.


In 2003, the Act was amended to allow for any minister, not necessarily the finance minister, to be Chairman of MAS. The principle that Dr Goh had insisted on, that MAS be overseen by a minister, has remained to this day. Indeed, apart from its Chairman, other ministers have also served on the MAS Board. The ministerial presence has lent the institution a stronger voice in policy making than it otherwise would have had. And contrary to the fear that political control of the central bank would lead to sub-optimal monetary policy, Singapore has maintained an enviable record of low inflation, low unemployment and high economic growth for many decades.

An illustration of a person in a green suit walking through a doorway. The person is carrying a briefcase and is walking away from the viewer. The background shows a building with a blue sky and some trees.

The first Managing Director of MAS was Michael Wong Pak Shong, who was at the Oversea-Chinese Banking Corporation (OCBC) when he was handpicked by Dr Goh to head the new organization. He helmed MAS for 10 years, guiding the organization through its formative years. It was a demanding job but one that he looked upon “as the most exciting in my whole career” ⁶.

Wong's departure from MAS in 1981 would not be in the happiest of circumstances, for it was the consequence of a radical restructuring of the institution by Dr Goh himself, the very same man who had picked him a decade earlier. In accepting Wong's resignation, Dr Goh commended Wong for having carried out his responsibilities with "total dedication and complete integrity" ⁷. MAS pioneers recall Wong's urging them to act with decorum and integrity, and reminding them that their word should be their bond. On one occasion, Wong had a London-based MAS officer personally deliver a cheque to a London broker to rectify an error by MAS traders. Young officials learnt from such examples that it was just as important to be trustworthy as it was to be sharp currency traders.

MAS could not have begun its existence at a more stressful time for foreign exchange markets. Barely months after MAS was established, the international monetary system of fixed exchange rates was shaken to its foundation. The US dollar had come under attack because of perceptions that the Nixon Administration was continuing with an expansionary fiscal policy even as the US trade deficit was widening. There were heavy speculative inflows into European currencies, particularly the Deutsche mark and the Swiss franc. The West German central bank, the Bundesbank, after absorbing more than US\$2 billion within two days, suspended further purchases of US dollars on 5 May 1971 and allowed the mark to float – thus becoming the first member country to unilaterally leave the Bretton Woods system. Other European countries like Belgium, the Netherlands, Austria and Switzerland soon followed suit. Speculation then turned to a possible revaluation of the yen.



Under the Bretton Woods system, Washington was obliged to convert US dollars to gold at the fixed price of US\$35 per ounce. With major central banks deluged with US dollars, there was fear of a run on the US government's gold stocks. Switzerland redeemed US\$50 million of paper for gold in July, and France redeemed more than US\$191 million. There obviously would not be enough gold in Fort Knox if all the world's central banks began redeeming their US dollars in earnest. Consequently, President Nixon announced on the evening of 15 August, a Sunday, that the gold window would be closed. With one stroke, the "Nixon shock", as the media dubbed the series of steps Nixon announced that evening, effectively ended the fixed exchange rate system. As the MAS Annual Report put it: "Monetary developments (in 1971) culminated in a crisis undermining the fabric of the international monetary order which had served the world for more than a quarter of a century" ⁸.

The "Nixon shock" was to have long-lasting consequences. Except for intermittent periods of calm, markets would generally be in a state of disarray for the rest of the decade. In December 1971, the major economies cobbled together the Smithsonian Agreement in an attempt to restore fixed exchange rates. The exchange rates of most currencies were revalued against the US dollar, with wider trading margins around the new parities. But the Agreement did not last.

The root cause was a lack of international policy coordination and Washington's unwillingness to continue shouldering the burden of upholding the Bretton Woods system. The US shifted to a policy of "benign neglect" of its currency. As the then-US Treasury Secretary John Connolly told his foreign counterparts laconically, "The US dollar is our currency, but your problem".

In June 1971, sterling fell victim to a fresh wave of speculative attacks and was forced off its Smithsonian parity. Worse was to come. In March 1973, there was a crisis of confidence in the US dollar, “regarded as the most disruptive to have occurred in over two decades” ⁹, and markets were closed for two weeks. When they reopened, all the major currencies were floated against the US dollar. The attempt to revive Bretton Woods was finally abandoned and the world shifted to a regime of floating exchange rates.

As Dr Goh wryly observed some years later, it was a telling commentary on the times that the shift to floating exchange rates “was not devised by a committee of financial experts the way the Bretton Woods system was constructed. In fact, whenever experts had met, usually in secret sessions during weekends, they were unable to reconcile their differences. Floating rates grew out of a situation that was increasingly unmanageable and when experts had run out of options” ¹⁰.

The international economy was racked by problems in the 1970s. Global inflation rose to double-digit levels. The Organization of the Petroleum Exporting Countries (OPEC) quadrupled the price of oil in 1973, in part because US dollar weakness had caused commodity exporting countries that invoiced their exports in US dollars to incur large currency translation losses. This led to a further spike in inflation, followed by a global recession from 1974-75. There was a second oil price shock in 1979 and inflation climbed. A new term, “stagflation”, was coined to describe the plight the industrialised countries found themselves in. The price of gold increased by about 18-fold, from US\$48 per oz in August 1971 to US\$850 per oz in January 1980.



Throughout this period, even as MAS was wrestling with the repercussions from the unprecedented turbulence in the international financial system, it had to develop its capabilities in the arcane field of central banking. Neither Wong nor his staff had “much central banking experience and (they) had to find (their) way and learn” ¹¹, as Wong himself confessed later. But they were quick learners, securing notable achievements in several areas: developing Singapore as an international financial centre, putting in place credible banking supervision and licensing standards, ensuring the stability of the Singapore dollar, and managing the reserves.

The MAS department managing the reserves was initially called the Investments and Exchange Control – for it was in effect an amalgamation of two finance ministry units, the Department of Exchange Control and the Department of Overseas Investments (DOI). Exchange Control was a legacy of the Sterling Area and its system of exchange controls. It withered over time as MAS progressively liberalised exchange controls. The DOI, on the other hand, became the nucleus of a reserves management capability that in time expanded in scope and sophistication.

The staff transferred from DOI to the new unit, eventually named the International Department, brought with them the culture and ethos that Dr Goh had instilled in them. Hence, MAS “approached reserves management without the baggage” ¹² of preconceived notions that reserves management should be a staid, largely passive operation, remembered Wong. Instead, the style and approach that Dr Goh had set at DOI was accepted as the model. As a result, MAS, unlike other central banks, was not just permitted but tasked, to invest for returns. It was “pretty radical” ¹³ in its investment approach right from the start, recalled Sam.

The reserves were the product of the hard work and thrift of Singaporeans. Managing the reserves should thus be considered an important function in its own right, not a sideshow. There was no need for the institution to be defensive or apologetic about applying the profit motive to reserves management. Accordingly, MAS officials put aside conventional notions of how reserves should be invested, and were open to investment practices even if they were outside the traditional scope of central banks.

The Monday morning meetings that Dr Goh had instituted at the Finance Ministry were carried over to MAS, with Hon Sui Sen in the chair. A theme that dominated discussions in the early years was currency diversification of the reserves, which effectively meant reducing holdings in the two reserve currencies, sterling and the US dollar, and increasing holdings in the Deutsche mark, the Swiss franc and the Japanese yen. The currency diversification policy that Dr Goh had initiated earlier was continued, even accelerated. This was fortuitous, as the traditional passive stance of keeping holdings in the reserve currencies would have cost the country dearly in the aftermath of the break-up of Bretton Woods.

Implementing the currency diversification policy, though, required tenacity and ingenuity. A case in point was sterling. Just after MAS began operations, the Sterling Agreement was extended in 1971 for another two years. The Agreement required Singapore to adhere to a Minimum Sterling Proportion (MSP). This meant it would not be able to reduce its sterling holding below the stipulated threshold. Hon and Wong repeatedly pressed the British for more generous guarantees to cover the sterling held by Singapore. Eventually, Britain agreed to reduce Singapore's MSP to 36 per cent of the stipulated base.

Soon after, Wong and Sam detected a “special situation”, a quirk in the Gilts market that could be exploited to Singapore’s advantage. This was the availability of long-dated British Government Securities and Consols that had been issued during World War II to help London finance the war effort and the subsequent reconstruction. These securities could be bought at a large discount to their par value because interest rates had risen significantly since their issuance. Normal accounting convention however allowed the Consols to be valued in the books at their nominal value, which would be actualised if they were redeemed. MAS made large purchases of these Consols, which raised Singapore’s nominal sterling exposure, but with a much lower outlay in sterling.

British Treasury officers were annoyed when they learnt of these transactions. The Bank of England was asked to query Singapore’s method of valuing the Consols. In his reply, Singapore’s then Accountant-General, Chua Kim Yeow, explained the accounting conventions his department used to value government assets: Gilt-edged securities and other government bonds were valued at their nominal value as they could be held to maturity; equities were valued at cost or market price, whichever was lower; all other official reserves were valued at book cost.

Chua's reply conveyed two messages. The first, a straightforward response to the British, was that there had been no gimmickry in how the Consols had been valued. The accounting conventions adopted conformed to international practice. The second message, implied rather than explicit, was however of greater interest because of what it signified about the approach taken to value government assets. This was that the valuations were derived from prudent principles, not based on optimistic assumptions to inflate asset values.



The MAS investment team displayed a similar agility in buying gold. Up to the closing of the gold window in August 1971, MAS was constantly alert to opportunities to redeem its US dollars for gold. Pioneers of the MAS gold team recalled a dramatic occasion when they placed US dollars for gold with the New York Federal Reserve the day before Nixon closed the gold window. When Nixon announced his “shock”, the MAS team was on tenterhooks as to whether their order would be honoured. It was. MAS was a net buyer of gold through the 1970s.

By the end of the decade, the Cabinet began to pay increasing attention to how MAS was managing the reserves. Despite the uncertainties in the international economy, the Singapore economy had grown consistently through the 1970s,

averaging a growth rate of about nine per cent per annum. Government revenue grew healthily and Singapore accumulated annual fiscal surpluses amounting to three to four per cent of GDP. This, coupled with a high savings rate in the private sector and capital inflows, meant hefty balance of payments surpluses and the substantial accumulation of reserves. The Cabinet was concerned whether MAS could do more to secure better returns from the reserves under its management.

MAS encountered two fundamental quandaries in managing the reserves. One was the extent to which central banking could co-exist with investment management. Or to put the question differently, the extent to which a central bank can breed and nurture within itself a fully fledged investment management arm.

Central banking and investment management both operate in financial markets using similar tools, instruments and analytical methods. But each approaches its task with different, sometimes conflicting, goals, attitudes towards risks, performance measurement systems and reward schemes. Central banking and investment are in effect two cultures that are best kept separate so as to allow each to flourish, a thesis that now finds expression in the decision of many central banks to hive off their investment management functions to a separate legal entity, the Sovereign Wealth Fund (SWF).

One practical problem that arises from locating central banking and investment management within the same entity is compensation. Central bankers and fund managers are paid differently. Salary scales suitable for central bankers would not attract the high-flyers required in investment management. On the other



hand, paying the central bank's investment managers higher salaries than their colleagues in other central banking areas would have had divisive consequences.

As a central bank, MAS had to develop capabilities covering the full spectrum of central banking functions, of which reserves management was just one. It understandably never saw itself as a dedicated investment management company and hence did not build up the expertise to invest in all the asset classes that global portfolio managers would normally invest in. MAS' expertise in reserves management was in currency management and the short end of the fixed income markets. Thus, although MAS was a pioneer among central banks in investing in equities, it did not develop a team of specialists in the equity markets. Equity investments were done by officers with fixed income responsibilities as well.

The situation was similar in real estate. MAS did make one investment in real estate – the 1973 purchase of Granite House, a commercial property in London. The purchase was marked by controversy as it occurred just before a sharp fall in London property prices and in the value of sterling. The Public Accounts Committee convened a series of hearings to question the Finance Ministry and MAS officials on the purchase. The broader issue was not so much the timing of the purchase but that MAS had not developed an expertise in property. Perhaps because of its bad experience with Granite House, MAS did not make another real estate investment.

There is one example of a central bank hosting successfully a robust investment management unit, that is, Norges Bank, Norway's central bank. Enfolded within it is Norges Bank Investment Management (NBIM), which manages the

Government Pension Fund Global (normally referred to as the Norwegian Oil Fund) and most of Norges Bank's foreign exchange reserves. Since its formation in 1998, NBIM has gained a reputation as one of the most progressive public sector investment management units in the world. It is now classified as an SWF.

One should note, however, NBIM's unique organizational features. Though it is a unit within the central bank, strict Chinese Walls regulate the exchange of information between it and the rest of the central bank. It has its own policies on recruitment, talent development, budgeting and compensation.

The second constraint MAS faced in managing reserves lay in balancing its reserves management mandate with that of managing the Singapore dollar exchange rate.

Herein lay the nub of the issue: MAS manages the Singapore dollar to prevent it from being whipsawed or gyrating like a yo-yo because of the speculative actions of currency traders. Like any central bank, MAS seeks to smooth wide fluctuations in the exchange rate by intervening in the currency markets, selling Singapore dollars if the currency is deemed to have appreciated too much or buying Singapore dollars if the currency has been beaten down too much. This is why central banks need a "war chest" of reserves that are liquid enough so they can be activated quickly to defend the currency.

But maintaining such a war chest or float has an opportunity cost. Liquid assets, typically short-term treasury bills, generate low returns. Hence, the dilemma MAS faced. The volatile markets it had experienced since its formation counselled a "safety first" policy of maintaining a large pool of liquid assets, but

such a preference would serve to depress the returns on the reserves it managed.

In 1980, Dr Goh, at the behest of Prime Minister Lee Kuan Yew, initiated a review of MAS. The review would lead to the formation of GIC and its taking over the task of managing the reserves from MAS. It is easy to sensationalise the developments surrounding the change. In reality, there was a great deal of continuity between what MAS had accomplished and the growth of GIC.

To begin with, GIC benefited from MAS' expertise in currency management, as currency movements are important to an international investor. Also, the international department in MAS continued to manage the fixed income portion of GIC's portfolio for several years. Later, the MAS team moved over to GIC to become the nucleus of its fixed income department. Finally, apart from fixed income, GIC would also depend on MAS' expertise in a number of areas such as economic analysis and various corporate functions.

In short, the MAS years were an interregnum in the story of Singapore's reserves management, an especially productive interregnum.

1 Elizabeth Sam: Interview by Freddy Orchard and Janadas Devan, 22 April 2010

2 Elizabeth Sam: Interview by Freddy Orchard and Janadas Devan, 22 April 2010

3 AG Chandavarkar, IMF: Concluding Statement, IMF Article VIII Consultation, 1971

4 Burton A Abrams, How Richard Nixon Pressured Arthur Burns: Evidence from the Nixon Tapes, *Journal of Economic Perspectives* Vol 20, No 4, Pg 178, Fall 2006

5 Burton A Abrams and James L Butkiewicz, The Political Business Cycle: New Evidence from the Nixon Tapes, *Journal of Money, Credit and Banking* Vol 44 (3), Blackwell Publishing, Pg 385 - 399, March – April 2012

- 6** Michael Wong Pak Shong: Interview by Freddy Orchard, 3 December 2003
- 7** Dr Goh Keng Swee: Letter of reply to Michael Wong's letter of resignation, *The Straits Times*, 15 January 1981; (Reprinted in *The Straits Times*, 15 June 1981)
- 8** Monetary Authority of Singapore: Annual Report 1972, Pg 1
- 9** Monetary Authority of Singapore: Annual Report 1973, Pg 5
- 10** Dr Goh Keng Swee: The International Financial System, 23 June 1978. Reprinted in *The Wealth of East Asian Nations* (Marshall Cavendish, 26 November 2004, Pg 156)
- 11** Michael Wong Pak Shong: Interview by Freddy Orchard, 3 December 2003
- 12** Michael Wong Pak Shong: Interview by Freddy Orchard, 3 December 2003
- 13** Elizabeth Sam: Interview by Freddy Orchard and Janadas Devan, 22 April 2010



THE

GENESIS OF AN IDEA



IT WAS QUINTESSENTIAL DR GOH:

the conception of an idea that was compelling and visionary. Singapore, of course, was not the first country to establish an investment corporation to manage its reserves. But it was the first non-commodity exporting country to do so.

Dr Goh's genius consisted in finding long-term solutions, rather than short-term palliatives, to problems. He was the first to identify the constellation of forces in play where Singapore's reserves were concerned, to see their inter-connections, and to arrive at a solution that fitted Singapore's needs and which was, moreover, years ahead of international practice. Nobody within or without the Government had conceived of an organization like GIC before Dr Goh proposed it. Retracing the events that led to the founding of GIC illustrates yet again Dr Goh's facility for thinking out of the box, for inventing a solution that was a game-changer, this time in the field of reserves management.

GIC was conceived within a time span of just seven months: between 1 August 1980, when Dr Goh was appointed Chairman of MAS, and 27 February 1981, when he issued a press statement announcing the Government's intention to establish an investment company.

Those seven months were an intense and dramatic period for two organizations – one already in existence for 10 years, the Monetary Authority of Singapore, and the other, still just a glimmer in Dr Goh’s mind, the Government of Singapore Investment Corporation. He juggled simultaneously two different challenges during this period: restructuring MAS and laying the foundation of GIC.

Dr Goh’s appointment as MAS Chairman required an exception to the MAS Act, as the Act stipulated that the Chairman was to be the Minister for Finance. Accordingly, it was gazetted that Dr Goh, on the authority of the Prime Minister, “shall with effect from 1 August 1980 be charged with the responsibility of the portfolio of the Minister for Finance insofar as such responsibility relates to the MAS Act and the Currency Act”. This allowed Dr Goh to be Chairman of MAS as well as Chairman of the Board of Commissioners of Currency, though Hon Sui Sen remained Minister for Finance. Dr Goh was Minister for Education at that time, and also First Deputy Prime Minister.

When announcing his appointment, the Prime Minister’s Office (PMO) alluded to his role in establishing MAS. Dr Goh “would assess how MAS had developed against his own expectations”, the PMO statement said, and “will make his recommendations to the Prime Minister in 18 months’ time” ^①. Accordingly, Dr Goh reviewed monetary policy and re-examined MAS’ approach to supervision of the financial system. But it was reserves management that he turned his attention to first. This was not surprising since it was principally because the Cabinet had reservations about how MAS was managing the reserves that Dr Goh was posted there.



Dr Goh moved quickly to size up the central bank’s organizational capabilities and the operations. He began by interviewing the senior staff, one by one, privately, with no observers present. The interviews were taped, with the transcript of each session being reviewed and corrected by the interviewee himself or herself by the next day. Dr Goh would then pore over the corrected transcript, mark and underline the points that had caught his attention and scribble follow-up questions.

The interviews were “fact-finding” ² exercises for him. But some found the process, if not Dr Goh himself, intimidating. When he sensed his interlocutor was being too defensive or nervous, he would end the session quickly. With some officers, though, notably Koh Beng Seng, who would eventually be promoted to Deputy Managing Director in charge of banks and financial institutions, and Elizabeth Sam, he conducted several interviews, gaining in the process an acute understanding of the organization’s operations and problems.

Although he had been away from the world of finance for 10 years, having been at Defence and Education in the 1970s, Dr Goh had kept himself apprised of developments in the financial field. More importantly, he had not lost that unerring “feel” of the Singapore economy, that intuition for what made it tick and how Singapore differed from other economies.

One example of this was in the field of monetary policy. In the early 1980s, central banks in the developed economies shifted their monetary policy

framework to targeting the money supply. Later, because of innovations in the money and credit markets, they moved to targeting interest rates, a practice that still prevails. Dr Goh did not follow suit. Instead, he held that because of Singapore's openness to trade and capital flows, the more effective lever of controlling inflation in the country was to target the exchange rate. That framework remains in place 30 years later, albeit with some refinements.

It would be another of Dr Goh's singular insights about the Singapore economy that would have equally pivotal policy implications. This was his conviction, so firm it was as to be almost instinctive in character that for various structural reasons Singapore would have a chronically high savings rate. It was this insight that led him to propose the founding of GIC.

Among the first steps Dr Goh took on arriving at MAS was to commission a team from the Management Services Department (MSD) of the Finance Ministry to "review the objectives, functions, organization and operations of MAS and BCCS"³. The team was led by Chuang Kwong Yong, the then director of MSD, and included seven other members. On completion of the review, Chuang stayed on at MAS to carry through the organizational changes that Dr Goh had endorsed. One of the areas Dr Goh had asked the team to focus on was how "MAS' investment expertise could be improved"⁴.

Another step Dr Goh took was to travel to Europe in September 1980 to meet central bankers and commercial bankers on the issues that had been raised in his interviews of MAS staff and by the MSD team. He visited Zurich, Frankfurt and London. One meeting in particular was especially productive: Dr Goh's reunion with his former London School of Economics (LSE) tutor, Sir Claus Moser, then with Rothschild Bank in London.



Moser was a German Jew whose family had fled Nazi Germany for London in 1936. He studied at the LSE, from which he graduated with top honours, and he returned to the School after World War II to do a doctorate in statistics. He eventually became a lecturer and then professor at the School, in which capacity he tutored Dr Goh, when the latter was a doctoral student in the 1950s.

Moser would later gain renown for co-authoring with Lord Lionel Robbins what came to be known as the Robbins Report on Higher Education. He subsequently left academia to direct Britain's Central Statistical Office, a post equivalent to being the Chief Statistician of the country. In that capacity, he served three Prime Ministers – Harold Wilson, Edward Heath and James Callaghan. In 1978, he joined Rothschild as Deputy Chairman.

Dr Goh and Moser had maintained intermittent contact with each other over the years. When Dr Goh informed him of his European tour, Moser invited him to visit Rothschild. Moser asked Richard Katz, then head of fixed income and currency at Rothschild, to join in the meeting with Dr Goh.

Reporting to his Executive Committee on the meeting later, Moser noted that Dr Goh had sought “investment advice with regard to proposals for cash management and the structure of the investment department (of MAS)”⁵.

MAS, Dr Goh said, had been investing the reserves chiefly in short-term paper and bonds, and the returns generated were being eroded by inflation. Dr Goh

had asked Moser and Katz how the reserves could be invested to achieve better real returns over the long term.

Katz replied that history showed that “equities achieved a return over and above inflation whereas cash and bonds did not” ⁶. Dr Goh reacted excitedly: “He sort of jumped at the remark”, Katz recalls, “and asked for evidence” ⁷. Katz referred to various studies and later sent Dr Goh several papers on the subject.

Dr Goh then asked how MAS’ investment department could be organized to invest in various assets, including equities. Katz suggested that an investment organization, separate from MAS, be formed to be responsible for long-term investments. There were “pragmatic reasons” for such a separation – chief among them, because central banking and asset management required “different types of persons” ⁸, Katz explained. He went on to note that he had advised an oil-exporting country in the early 1970s to set up such a company, though it was moribund from the start.

The discussion at Rothschild “stretched through the afternoon, lasting several hours” ⁹. At its conclusion, Dr Goh asked Moser and Katz to submit a proposal for a consultancy. He wanted them to focus on two areas: review the performance of various asset classes over different periods of time and recommend a portfolio for the long term; and, propose the organization and structure of an investment management company.

Moser and Katz accepted the task and co-opted a third person, Kate Mortimer, for the project. She had a reputation as “a financial advisor of daunting

intellect”¹⁰. Before joining Rothschild, she had worked at the World Bank and then at a think-tank for the Cabinet Office established by Edward Heath when he was Prime Minister. The think-tank was reputed as a “sort of gilded nursery for bright young things”^{10a}.

In December 1980, the MSD team issued its report on MAS. A confidential document circulated only to the Cabinet, it recommended that MAS should concentrate on two areas: develop Singapore as a financial centre and invest the reserves. Other areas extraneous to these functions could be whittled down or shed, the MSD team recommended, adding that MAS could reduce its staff strength by about 20 per cent without affecting its effectiveness.

As an example, the study recommended that MAS’ International Department could be re-organized to relinquish functions that would distract it from its investment focus. One such task that could be relocated was developing the Asian Dollar Market, the offshore market that attracted global financial institutions to operate in Singapore. This function could be transferred to a new department overseeing banking and financial institutions, the MSD team observed. The team also recommended the setting up of an investment research unit to improve investment performance.

The MSD review produced useful insights, but also fell short in certain areas. The finding that MAS had taken on more functions than warranted by its mandate was a fair one. So was the observation that the International Department could be re-organized for better focus. However, the report did not examine a core function of central banks: namely, monetary policy. Dr Goh would later acknowledge this deficiency and initiate the effort to develop

a monetary policy framework based on the exchange rate. Furthermore, the report did not address the problems inherent in having a central bank manage long-term reserves. What was needed was more than a reorganization of MAS' International Department. The mould had to be broken.

Within two months of the MSD report, Wong Pak Shong submitted his resignation as Managing Director. Later, others among the management team also left. These developments captured the headlines in both the local and foreign press. Everyone assumed Dr Goh was doing little more than cleaning house at MAS.

It went largely unnoticed though that there had also been significant developments concerning reserves management. Though Dr Goh endorsed the bulk of the MSD report, Herman Hochstadt, then MAS Deputy Managing Director, recalls him commenting that the report had “missed a very essential point”, namely, that “there must be a separate body to manage the reserves”¹¹. Having come to that conclusion, Dr Goh set the wheels in motion for the formation of such a company.

Dr Goh asked Prime Minister Lee Kuan Yew to be Chairman of the new company. Lee was “not keen”¹² to have this additional responsibility, but Dr Goh persuaded him. He argued that Lee's appointment as Chairman would signal clearly that the country's reserves were so crucial as to merit the oversight of the Prime Minister himself. Ultimately, Dr Goh asserted, the head of government had to bear responsibility for deciding on the disposition of the reserves. It was therefore imperative that the prime minister should be privy to all the discussions about the reserves.



“Get people who would not take advantage of their knowledge of our funds and what we are going to do, (so as) to invest on their own accounts”

After Lee agreed to be Chairman, both he and Dr Goh got down to the business of deciding on the composition of the rest of the Board. Integrity was the paramount criterion. Directors would be privy to sensitive information about the company’s investment intentions. It was essential to “get people who would not take advantage of their knowledge of our funds and what we are going to do, (so as) to invest on their own accounts”¹³,

recalled Lee later. But this consideration also meant that potential directors, especially those from the private sector, could conceivably find their latitude in business activities severely curbed. Mindful of this consideration, Lee and Goh began their search for directors among ministers and senior civil servants. Then, they looked for “people outside”. Lee thought it was vital to have some representation from the private sector to assure the financial community and the public at large that the new company was being managed well.

In February 1981, the Rothschild team of Moser, Katz and Mortimer arrived in Singapore to vie for a consultancy. The team had worked hard for months to prepare their proposals, having visited Singapore earlier to gather information. It would be a boost for Rothschild if it were to win the consultancy as three other prominent financial institutions were competing for it.

There were two rounds of interviews, the first conducted by a panel chaired by Dr Goh and including ministers who were to be directors of the new company,

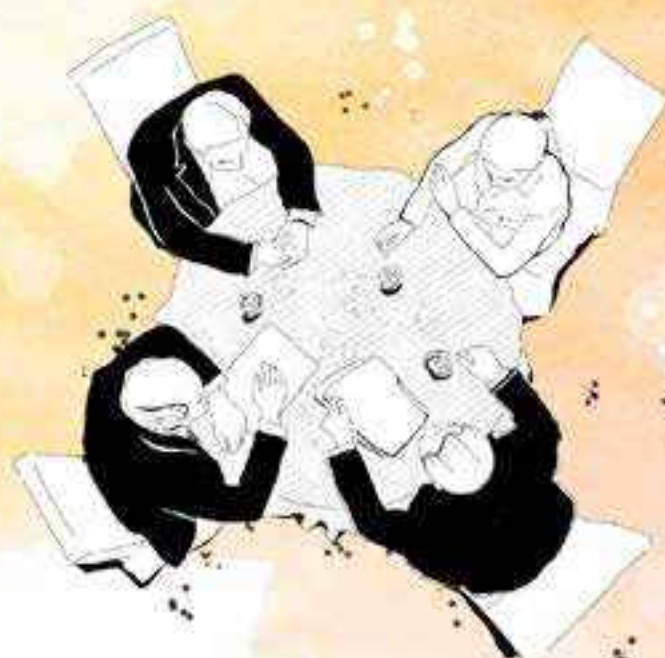
among them Hon Sui Sen, Goh Chok Tong, Dr Tony Tan and S Dhanabalan.

The interview was searching and thorough, Moser recalled. Dr Goh and he had become “rather close personal friends over the years”¹⁴, according to Moser. They shared common interests like music and they would go to the opera together at the Royal Opera House in London whenever Dr Goh was in town. But “there was no sign of friendship” at the interview; “it was bloody tough”¹⁵. Dr Goh led the questioning, quizzing the team as to how an investment company could be structured and organized.

After the interview, Moser and his colleagues were shown to a room to wait for the panel’s decision. They were nervous, for they did not think they had done particularly well. After about an hour, they were summoned back. Dr Goh informed them that the panel had decided to appoint them as consultants but the decision had to be confirmed by the Prime Minister. Dr Goh emphasised that it would be the Prime Minister who would have the final say on the appointment. The Rothschild team was scheduled to meet Lee that same evening, at 5pm.

It would be an interview that each of the three would recall vividly. Mortimer, in reminiscing about the interview with her friends, was reported to have said she felt “like a rabbit transfixed by a snake”¹⁶.

Katz recalled that he was already a senior director at Rothschild by 1981 and had met an enormous range of people in authority by then. Yet, he too had been unprepared




for the “very direct, very testing questions and the sheer incisiveness and ferocious intelligence”¹⁷ of the Prime Minister. For Moser the interview would become inextricably linked in his memory with a boast that he had uttered in order to soothe the nerves of his colleagues as they entered the Prime Minister’s office. “I’m used to dealing with Prime Ministers”¹⁸, he had said breezily. He was to discover that his experience of British Prime Ministers Wilson, Heath and Callaghan was no preparation for Lee.

Moser expected the meeting with Lee to be “a formality”¹⁹. After all, he had come with Dr Goh’s recommendation. There was also, he told himself, the “terrific reputation” he had acquired through his work in statistics, both in government and in academia. It was all to no avail, Moser recalled ruefully, as Lee “demolished (him) with one question”²⁰ by zeroing in on his lack of experience in investments. Moser added that after a short exchange, during which he became “more and more nervous”²¹, Lee turned his attention to Katz, the investment expert in the team.

Katz recalled that he was subjected to a similarly sharp interrogation. Lee asked him about his achievements at Rothschild, his views of the financial markets and of the countries and entities he had advised. Katz remembered “very vividly”²² how Lee had brushed aside his reluctance to divulge whom his clients were by retorting that he could get the answer himself “in five minutes with just one phone call”²³. In the event, Lee did not press Katz further for specific names but was content with a breakdown of Rothschild’s clients by regions.

The interview took about 30 minutes and ended with Lee telling the Rothschild team he had decided to appoint them for a six-month trial period. The team



had no doubt that it was Lee who made the decisions. The three left the room “sweating” and “shaken” ²⁴ . Both Moser and Katz acknowledged, though, that Lee had been fair and civil. It was “absolutely right” ²⁵ that he had asked them these searching questions, Moser was to recall 30 years later. Lee had impressed them “as a Prime Minister of a power and directness which (they) had never experienced” ²⁶ .

The Rothschild consultancy comprised three parts. Two parts concerned MAS: assisting it in the reorganization of its International Department and reviewing the investment portfolio of MAS and BCCS. The third part of the consultancy required Rothschild to advise on the organizational structure of the new investment company and to suggest a long-term asset allocation, together with the timing of the shift from cash to the desired portfolio.

On 27 February 1981, Dr Goh released a press statement. It was the first public intimation of the drama that had occurred since he became Chairman of MAS.

The “root of the problem”, Dr Goh said, was that MAS and BCCS had been managing the reserves under their charge in a manner more suited to countries in chronic deficit. Singapore, by contrast, would probably have “regular surpluses” in its balance of payments. There was no need to concentrate the reserves in liquid assets in excess of what would be “required to meet the legal obligations of the currency board or the resources needed by the MAS to manage the floating parity of the Singapore dollar” ²⁷ , the statement added.

These excess reserves should in fact be managed as long-term investments, with the aim of gaining from capital appreciation. The Government had thus

decided that funds beyond what was required to manage the currency would be transferred in stages to an “Investment Corporation” wholly owned by the Government. The statement went on to say that the Prime Minister would be the Chairman of the Board of Directors of the new company, and named the other directors.

The press release was characteristic of Dr Goh’s style: succinct to the point of being terse, never trite, and deserving of close scrutiny. But alas, most journalists missed its implications. They overlooked the significance of the recommendation to establish a new investment corporation and dwelt instead on the sensational staff changes at MAS. They failed to see that embedded in the short statement were four profound insights, insights that would mould how Singapore has managed its reserves.

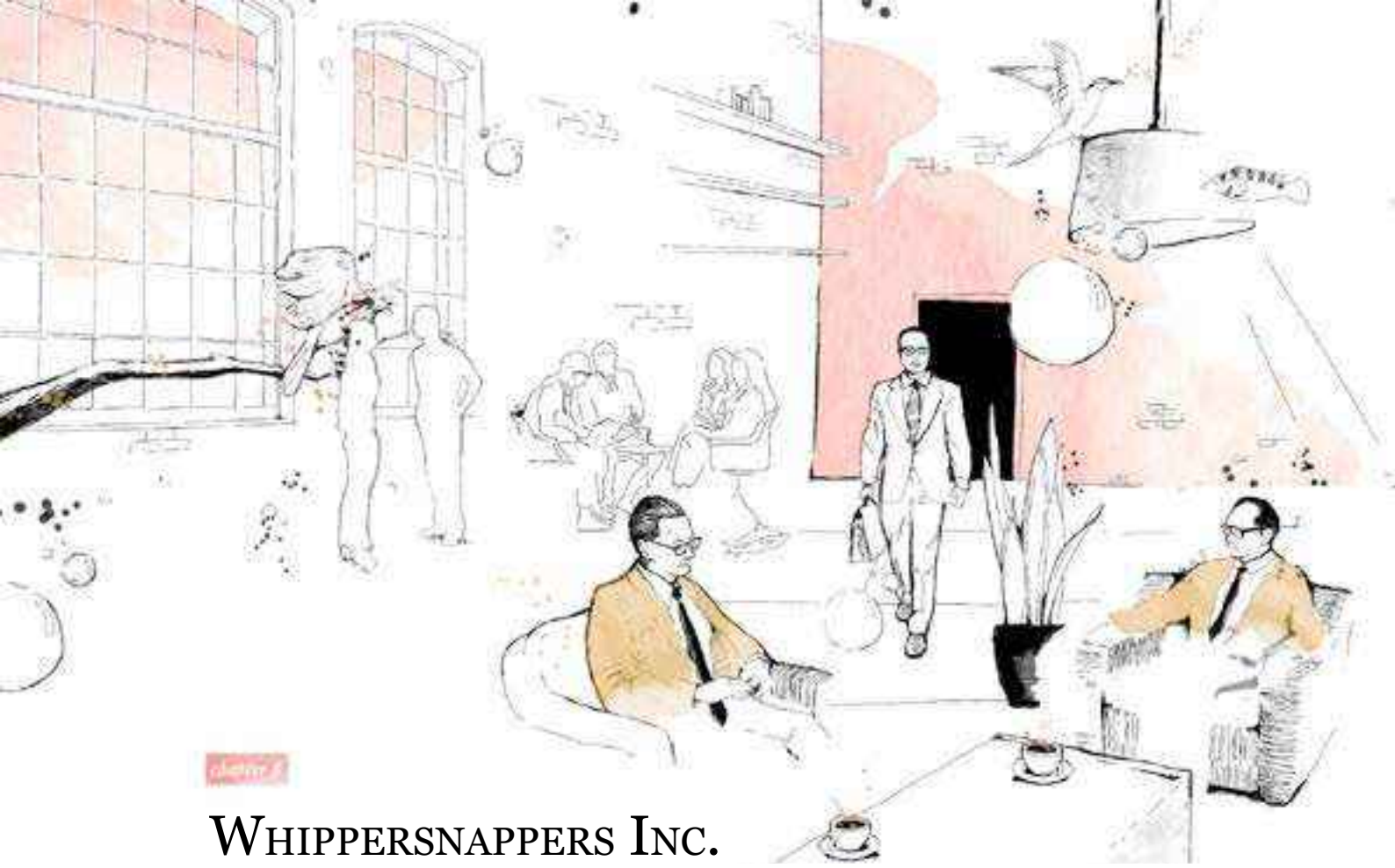
First was Dr Goh’s allusion to the “regular” financial surpluses that resulted in balance of payments surpluses. Dr Goh would on other occasions use the term “chronic surplus” to describe Singapore’s situation, a phrase that conveyed well the idea that there were deep forces accounting for Singapore’s high savings rate and hence surpluses. As Dr Goh saw it, Singapore would continue to have a high savings rate because of its tradition of prudent fiscal policy and the mandatory contributions all working Singaporeans made to their Central Provident Fund (CPF) accounts. History has proven him right. The national savings rate in Singapore has ranged between 45 and 50 per cent of GDP over the last 30 years. In highlighting Singapore’s structural propensity towards high savings, Dr Goh was underlining the need for a radical change in the approach to reserves management.

Second was Dr Goh's recommendation that the reserves be allocated to two "pots" or portfolios, one, to manage the Singapore dollar exchange rate and to provide the BCCS with the resources to back the Singapore dollar; the other, to be invested in long-term assets for capital appreciation. This idea harked back to Dr Goh's exchanges with Roy Jenkins in 1967 when he had propounded the then startling thesis that there were "monetary reserves" (what was needed to back the currency) and "non-monetary reserves" (what could be invested for long-term gain). This distinction between two categories of reserves – one to be kept liquid and the other to be invested in relatively illiquid assets – gave reserves management an extra degree of freedom.

Third was the decision to set up an investment corporation to manage the second pot, the "non-monetary reserves". The decision arose from the recognition that "investment portfolio management and the management of the float required different approaches", as the statement put it. Singapore did not originate the idea of having an investment entity separate from the central bank, but it was nevertheless still regarded as an unconventional practice. Commentators at that time did not appreciate the significance of the move.

And fourth was Dr Goh's recommendation that the Prime Minister himself chair the Board of the new company. The company would have the distinction of being the only one in Singapore with ministers as its directors and the Prime Minister as its Chairman. That alone would signal the importance the Government attached to the endeavour. As a result, over the years, ministers have acquired an appreciation of global financial markets and the returns and risks arising from investing. This was precisely as Dr Goh had intended.

- 1 Statement from the Prime Minister's Office, 1 August 1980
- 2 Koh Beng Seng: Interview by Freddy Orchard and Janadas Devan, 19 April 2010
- 3 Internal Report on Organisational Review of the MAS: MSD Study Team, Ministry of Finance, Dec 1980
- 4 Internal Report on Organisational Review of the MAS: MSD Study Team, Ministry of Finance, Dec 1980
- 5 Claus Moser: Notes of meeting with Dr Goh Keng Swee, Chairman MAS
- 6 Richard Katz: Interview by Freddy Orchard, 14 November 2010
- 7 Richard Katz: Interview by Freddy Orchard, 14 November 2010
- 8 Richard Katz: Interview by Freddy Orchard, 14 November 2010
- 9 Richard Katz: Interview by Freddy Orchard, 14 November 2010
- 10 Tim Heald. *The Independent*, 21 July 2008
- 10a Tim Heald. *The Independent*, 21 July 2008
- 11 Herman Hochstadt: Interview by Freddy Orchard and Janadas Devan, 2010
- 12 Lee Kuan Yew: Interview by Teh Kok Peng, Freddy Orchard and Janadas Devan, 4 June 2010
- 13 Lee Kuan Yew: Interview by Teh Kok Peng, Freddy Orchard and Janadas Devan, 4 June 2010
- 14 Claus Moser: Interview by Freddy Orchard, 11 November 2010
- 15 Claus Moser: Interview by Freddy Orchard, 11 November 2010
- 16 Herman Hochstadt: Interview by Freddy Orchard and Janadas Devan, 2010
- 17 Richard Katz: Interview by Freddy Orchard, 14 November 2010
- 18 Claus Moser: Interview by Freddy Orchard, 11 November 2010
- 19 Claus Moser: Interview by Freddy Orchard, 11 November 2010
- 20 Claus Moser: Interview by Freddy Orchard, 11 November 2010
- 21 Claus Moser: Interview by Freddy Orchard, 11 November 2010
- 22 Richard Katz: Interview by Freddy Orchard, 14 November 2010
- 23 Richard Katz: Interview by Freddy Orchard, 14 November 2010
- 24 Claus Moser: Interview by Freddy Orchard, 11 November 2010
- 25 Claus Moser: Interview by Freddy Orchard, 11 November 2010
- 26 Claus Moser: Interview by Freddy Orchard, 11 November 2010
- 27 Dr Goh Keng Swee: Press Release, 27 February 1981



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WHIPPERSNAPPERS INC.



THE CONCEPT HAD TO BE **TURNED INTO** REALITY.

It was done pragmatically and expeditiously. There was no inauguration ceremony, no fanfare to mark the birth of the new company. The company's first Managing Director began his tenure with only a desk and an unusable telephone. He had no staff, not so much as a secretary. Observers might have doubted if the new company, which did not even have a name then, was a serious concern. Events would prove these doubts to be unfounded. How GIC became a going concern is a story of initiative, resourcefulness and sense of duty.

On 9 March 1981, Dr Goh released a press statement on the recent appointments he had made at the Monetary Authority of Singapore and at the proposed government investment company. The Rothschild consultancy was also announced ¹.

One of the appointments was of Dr Teh Kok Peng, previously of the World Bank, as Head of the Economics Department at MAS. Teh would eventually hold senior positions at both MAS and GIC, including as President, GIC Special Investments, the private equity arm of GIC.

Dr Goh also announced the appointment of Yong Pung How as Managing Director of the yet-to-be-named investment company. Yong was to be released on no-pay leave from OCBC, where he was Vice-Chairman.

Yong was multi-talented, a lawyer by training but also an accomplished banker, administrator and businessman. Malaysian-born, he had read law at Cambridge University and later attended Harvard Business School. He practised law for

many years at his father's law firm, Shook Lin and Bok, in Malaysia and was Chairman of Malaysia-Singapore Airlines from 1964 to 1969.

Yong's career in banking began in 1969 when, at the request of the Malaysian central bank he was appointed Vice-Chairman of Malayan Banking to help in its reorganization. After a stint as Chairman and Managing Director of the Singapore International Merchant Bankers Limited and the Malaysian International Merchant Bankers Limited, Yong became Vice-Chairman of OCBC in 1976.

Lee Kuan Yew later recalled that he and Dr Goh had looked for "someone who was, first, trustworthy and, second, careful" ² to helm GIC. Lee chose Yong because he knew him well, having been together with him at Cambridge University, and had found him over the years to be someone of impeccable integrity. Still, when Dr Goh approached him, Yong was startled, for the proposal had come "out of the blue" ³.

He initially "declined Dr Goh as politely as (he) could" ⁴, citing his lack of experience in investments as the reason. In addition, he was being groomed then to succeed Tan Chin Tuan as the Chairman of OCBC Bank, one of the largest Singapore banks. So, Yong was loath to leave the bank just then, he explained to Dr Goh. Later that day, Yong wrote a note to his Chairman Tan, explaining that he had met Dr Goh and had turned down his offer. But that was not to be the end of the matter.

The next evening, Tan walked into Yong's office to inform Yong that he had lunched with Dr Goh that day and had had discussions with the other directors.

The upshot of these meetings was that OCBC was prepared “to lend”⁵ Yong to the government. So Yong dutifully set off to see Dr Goh again the next day. Dr Goh told him little more than that he was expected to set up the new unit and “take it over the first hump”⁶. Yong accepted the challenge, taking a pay cut in the process.

Yong’s task for his new appointment was stark in its objective, daunting in its scope. He was to turn a concept into reality, to develop the intended company from scratch. This meant he had to incorporate it, devise an appropriate corporate structure, staff the company and make it operational, virtually all by himself, as he had no one he could delegate the tasks to.

Yong began his first day at his new job at the MAS offices in the old SIA Building on Robinson Road. The investment corporation he was to head did not as yet exist; hence, it had no office of its own. Yong was met by Herman Hochstadt, who could add little more than what Yong knew.

Hochstadt showed Yong to a room formerly occupied by Dr Goh. Dr Goh had vacated it only recently to move to the Ministry of Education headquarters. The room was bare save for a huge desk and an odd looking contraption that turned out to be a telephone scrambler. Hochstadt explained that the phone was connected directly to the Prime Minister’s office and had been used by Dr Goh to call Lee. A key that nobody seemed able to locate was needed to activate the phone. There was no chair. So Yong had to sit at his desk and lean over with a pencil to write his memorandums, before walking a few floors down to the pool of typists to get them typed up. Subsequently, Yong found a chair in an unused room and dragged it to his office.

As if this was not enough of an inauspicious start, Yong's ego was to take a further battering when Dr Goh introduced him to Lim Kim San. Lim had just been appointed Managing Director of MAS a few days earlier, on 1 March, and had his office on the same floor as Yong's. It was a "terrible introduction" ⁷, Yong recalled. Lim had brusquely asked Dr Goh why he had brought in "this young whippersnapper" ⁸ who would only be interested in "empire building". Yong was mortified – and doubly so when he found out, upon checking the dictionary later, what "whippersnapper" meant:

Whippersnapper: n., an unimportant but offensively presumptuous person, especially a young one.



To Yong's credit, he did not let all this get to him. Soon, he would impress Lim with his business-like ways and lapidary submissions. Yong knew that the relationship had turned when one morning Lim offered to "belanja" or treat him to lunch. Later, Lim would support the idea of Yong taking over from him as Managing Director of MAS. And when Lee sought Lim's opinion about Yong's suitability to be a High Court Judge and later Chief Justice, Lim seconded the proposals, remarking that it would be a case "of fish returning to water" ⁹.

But all that was in the future. In his first months at the company that had as yet no name, Yong had to forage for staff. He asked Hochstadt for advice and

Hochstadt pointed him in the direction of Tan Teck Chwee, then Chairman of the Public Services Commission (PSC). The PSC was in charge of awarding government scholarships to deserving students and posting them to various government departments upon their graduation. Yong called on Tan, who told him that the PSC was short of scholars. Indeed, at the request of Dr Goh, it had only recently sent some of its best officers to MAS. Nevertheless, Tan did manage to secure one fresh graduate for Yong.

Yong also enquired about getting a secretary for himself. Strangely, he was told that the government had no provision for a secretary for his position. Yong eventually brought over his secretary at OCBC. Together, they then “cleaned up the room, bought some furniture, arranged for a telephone, typewriters, shredding machine, copying machine and so on and we got started”¹⁰.

In recruiting staff, Yong sought fresh graduates with outstanding academic records from the best universities. He did not mind their inexperience in fund management but felt they would be an investment for the long term. Yong also invited serving MAS officers to apply. One of the first of these to be selected was Aje Saigal, whose initial portfolio was Japanese equities. Saigal would rise through the ranks to become GIC’s Director of the Equities department and subsequently Director of Investment Policy and Strategy. Yong also posted advertisements in the local and foreign press, and succeeded in attracting a handful of capable young people willing to chance what was then still the relatively unknown field of investment management.

There was another fundamental issue that had to be resolved urgently: the form the proposed company should take. Dr Goh had asked Yong to consider the matter and make recommendations.

Yong's knowledge of the law and his banking experience came in handy here. He suggested that the new entity be incorporated as a private limited company, wholly owned by the government and which would manage, but not own, the foreign reserves under its charge. Yong's reasoning for this arrangement was that it would leave the investment company free of various complications arising from the ownership of foreign assets, especially with regard to taxation. The country's assets also "would be better protected that way"¹¹ as it would still be owned by the government. As Yong put it, structuring the new company "as a management company was the simplest arrangement. It turned out to be the correct arrangement. Had GIC owned its assets, we would have been caught in all sorts of difficulties"¹².


Dr Goh asked about the legal structure that would provide for the government's ownership of the company. Yong said the solution lay in a legal concept known as Corporation Sole. Corporation Sole allowed for the creation of a legal entity of a public office, which would be independent of the individual occupying that office. Thus the office of the Minister for Finance, for example, could be the Minister for Finance Incorporated, which would be the owner of the investment company. This entity would retain its legal power regardless of who the Minister of Finance was. Lee and Dr Goh accepted Yong's recommendations.

Yong also recommended that the new company begin with a small staff. The MAS had efficient administrative and corporate services divisions. The new company could "piggy back"¹³ on MAS for these services, including accounting, auditing and personnel management, rather than develop them on its own. It could also continue to operate out of the MAS premises.

Yong then set out to incorporate the company. He asked the Attorney-General's Chambers to draft the Memorandum and Articles for the new company. A draft was delivered to him the same day and he realised that it was essentially the standard form for the incorporation of companies. Deciding however that it was good enough for his purposes, he submitted the completed documents to the Registry of Companies. In those days, before the Civil Service computerised its operations, it usually took about two weeks to incorporate a company. But the Registry told Yong that it could issue the certificate of incorporation the next day. It asked for the name of the proposed company.

The name of the company had been decided earlier, almost by default. Dr Goh had always referred to the proposed company as the "outfit" or "unit", while the press had called it the "government investment corporation". Civil servants had adopted the latter, but added the words "Government of Singapore" as the term connoted "respectability". After all, international credit agencies had given Singapore an AAA credit rating, citing its large reserves and the government's provident fiscal policies as the reasons. Taking advantage of that brand, it was decided, more or less tacitly, to call the new "outfit" the "Government of Singapore Investment Corporation Pte Ltd". It was duly incorporated as such on 22 May 1981.

While external parties would and did use a variety of abbreviations for the company – one was GOSIC – the abbreviation used within the establishment from the beginning, and the version now accepted, was GIC.



GIC was established on the proposition that the country's reserves should be managed by an indigenous, national entity rather than by external fund managers. Lee and Dr Goh would have it no other way. For them, leaving the management of the country's money to others meant a "good chance that they would enrich themselves instead of the country"¹⁴. However both Lee and Dr Goh knew that there was limited local expertise in fund management and that, willy-nilly, GIC would have to obtain a nucleus of experienced portfolio managers to jump start the new company.

Yong recognised that GIC would not be able to "find experienced professional managers in Singapore to satisfy its requirements"¹⁵ and suggested to Dr Goh that their search for talent be extended to London and New York. Dr Goh agreed and executive search firms were hired to identify suitable candidates overseas. Dr Goh and Yong then flew to London to interview the short-listed candidates. London, however, proved fruitless. The problem was not the quality of the candidates but their generous superannuation plans: They had to give as much as six months' notice to their current employers to avoid forfeiting those benefits.

Yong was unwilling to wait that long to get GIC started.

The next stop was New York, to which Yong went alone. Unexpectedly informing Yong that he had to return to Singapore, Dr Goh asked him to do the New York interviews himself and have them taped. Yong was then to submit a summary of his recommendations and the taped interviews to Dr Goh.

Yong did find American fund managers prepared to work overseas at short notice, in some cases, within a week. Yong informed his interviewees that if they were short-listed they would be required to fly to Singapore to be interviewed by Lee himself. This was a sine qua non: Lee would personally interview all senior appointments to GIC. Lee had also asked that the wives accompany the candidates to Singapore, reasoning that the fund managers would not stay long in Singapore if their wives were unhappy with living conditions in the country. The upshot of Yong's New York expedition was the selection of three American fund managers.

They were Douglas Salmond, Leo Bailey and Theodore Garhart. Each was a specialist in an investment field that the GIC Board had wanted GIC to begin with. Salmond was from the College Retirement Equities Fund, which, with its sister company, the Teachers Insurance Annuities Fund Association, was one of the largest institutional fund management companies in the United States. He was an expert on Japanese equities. Bailey, also from the College Retirement Equities Fund, was an authority on US equities. And Garhart, from the Prudential Insurance Company of America, was a US real estate investment maven.

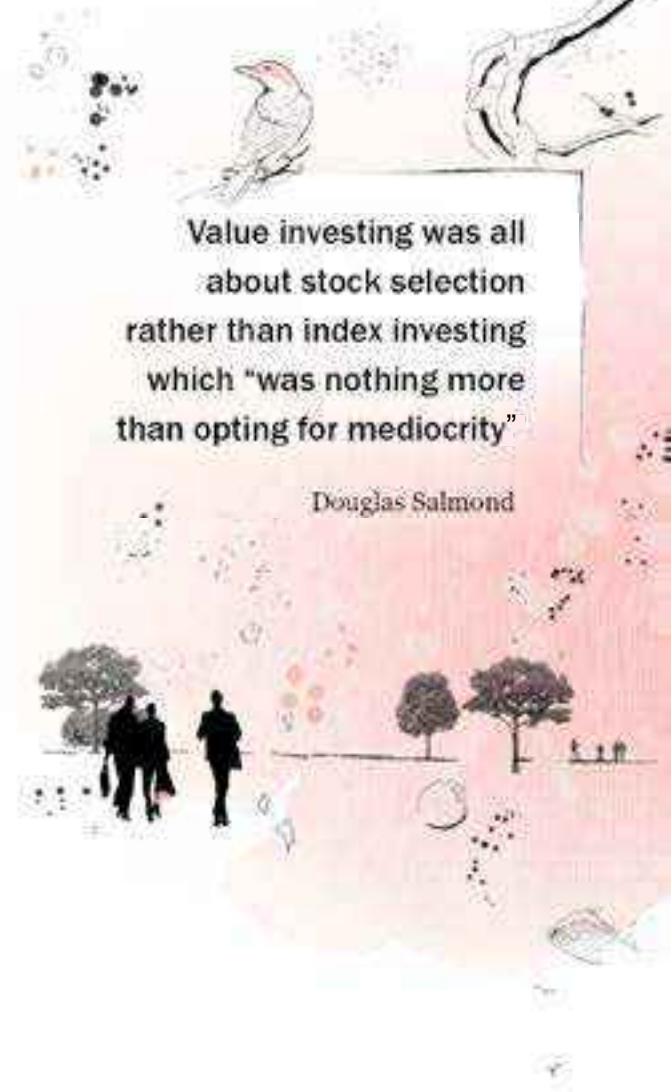
All three would arrive in Singapore by the last quarter of 1981, by which time GIC had established three investment units: Japanese equities, US equities and real estate, the last focusing on US property markets.

The three Americans proved to be exceptional mentors, evidence indeed that Yong was a good spotter of talent. They were thoroughbreds in their fields,

technically competent, with a deep knowledge of their industry and a wide network of contacts. And most importantly, they were committed to developing their respective teams. The rookies under their charge received grounding in the basics of investment, a sense of the rigour required to perform due diligence, and encouragement to form their own conclusions.

The impact of each of the Americans varied. Bailey left after a year, for a variety of reasons. Salmond stayed through his three-year contract, impressing those who worked with him with his knowledge of the Japanese market and his stand that value investing was all about stock selection rather than index investing, which “was nothing more than opting for mediocrity”,¹⁶ he famously said. And Garhart worked for GIC until his retirement in 1989. He resisted investing in US properties up to the mid-1980s, believing that the deluge of Japanese money in the US real estate market had caused US properties to be over-valued.

The GIC pioneers who worked with Bailey, Salmond and Garhart, and who are now themselves leaders in their fields, recall their American mentors with gratitude. Among the accolades from them: the Americans were “three extraordinary individuals”¹⁷, one said; “true professionals”, said another, “people from whom we learnt a lot”¹⁸.



GIC achieved a great deal in the first year of its existence; in a manner that would exemplify the GIC culture that was to emerge. Yong Pung How's unaffected but effective style of management would be the model for future GIC CEOs. That Lee Kuan Yew made it a point to interview all senior candidates signalled the attentiveness that would be given to the recruitment of high-calibre people. And the willingness to seek expertise worldwide and to learn from others would become second nature to the company.



- 1** Dr Goh Keng Swee: Press Release, 9 March 1981
- 2** Lee Kuan Yew: Interview by Teh Kok Peng, Freddy Orchard and Janadas Devan, 4 June 2010
- 3** Yong Pung How: Interview by Freddy Orchard and Janadas Devan, 29 September 2010
- 4** Yong Pung How: Interview by Freddy Orchard and Janadas Devan, 29 September 2010
- 5** Yong Pung How: Interview by Freddy Orchard and Janadas Devan, 29 September 2010
- 6** Yong Pung How: Interview by Freddy Orchard and Janadas Devan, 29 September 2010
- 7** Yong Pung How: Interview by Freddy Orchard and Janadas Devan, 29 September 2010
- 8** Yong Pung How: Interview by Freddy Orchard, 15 October 2003
- 9** Yong Pung How: Interview by Freddy Orchard, 15 October 2003
- 10** Yong Pung How: Interview by Freddy Orchard, 15 October 2003
- 11** Yong Pung How: Interview by Freddy Orchard, 15 October 2003
- 12** Yong Pung How: Interview by Freddy Orchard, 15 October 2003
- 13** Yong Pung How: Interview by Freddy Orchard, 15 October 2003
- 14** Yong Pung How: Interview by Freddy Orchard, 15 October 2003
- 15** Yong Pung How: Interview by Freddy Orchard, 15 October 2003
- 16** Douglas Salmond: Internal GIC Note
- 17** Aje Saigal: Interview by Freddy Orchard and Janadas Devan, 13 October 2010
- 18** Wong Kok Hoi: Interview by Freddy Orchard and Janadas Devan, 18 June 2010

EPILOGUE

Over the thirty-odd years since GIC's founding, investors have had to cope with unprecedented changes in the global economy and financial markets. These included a transformed Europe and the inception of the Euro; the emergence of large developing economies like China and India; secular economic stagnation in Japan; the downward shift in inflation experience to disinflation, even deflation in some parts of the world economy; and traumatic financial upheavals such as the Asian Financial Crisis and the 2008 Global Financial Crisis, the reverberations from which linger. That GIC has navigated these testing developments and grown from a fledgling company to what it is today testifies to the character of its DNA. It is a DNA embodying the values and ideals that inspired the pioneers whose efforts to protect Singapore's reserves are commemorated in this book, a DNA inherited by the men and women of GIC.