

## THE ROLE OF CENTRAL BANKING IN A WORLD OF TENSIONS\*

My subject this evening is “The Role of Central Banking in a World of Tensions.” The first question which has to be answered is: what has central banking to do with world tensions? Central bankers are creatures that other people usually regard with a feeling of awe mixed with contempt. They appear to be projected in people’s mind and imagination as those who live in ivory towers, with plenty of money which they could create ad libitum, but with which they prefer not to part easily. According to another popular vision, the

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central banker is compared with a rich spinster aunt, rich but utterly mean, from whom you could expect to extract great wealth only through deception or plunder or murder. It is not without reason, but I think without entire justification, that we hear of the "Old Lady of Threadneedle Street", or in Bangkok the "Old Treasure-Guardian of Bang Khun Prom." There is no doubt in Kuala Lumpur another "Old Lady" in Jalan Raja, although she is only five years old.

I hope this evening to present to this Conference a more up-to-date picture of the central bank, particularly of the central bank in developing countries. I hope to suggest, that the central bank, in its new role, can make effective contributions towards economic and social development, and thus contribute to the reduction of tensions in the world.

Let me at this stage explain in a few words what a central bank is. A central bank, in the modern world, is an institution normally owned by the Government; it is entrusted with the power and responsibility of currency issue; it acts as the Government's banker, and also serves as banker to commercial banks. Through the commercial banks, it can also generate and regulate another form of money, which consists of bank deposits. The first central bank, the Bank of England, came into existence as a private corporation, whose main purpose was to help finance a long and expensive war against France. Subsequently, the Bank of England and other central banks have assumed such a respectability that they consider themselves splendidly isolated from politics. The Governor of the central bank rightly must be independent, and must behave in such a manner as to show his independence

from the Government. He looks after monetary policy, he advises, coaxes, sometimes he even goes as far as blackmailing (of course in a tactful way) the Government in order to guide the financial and fiscal policies along the path he thinks right. Of course, should there be a final showdown on any serious conflict of principles of policy with the Government, he must be prepared to tender his resignation which will also serve as a strong protest against Government policy. I hope you will agree with me that, having been born in history out of the necessity of financing war, having been given such responsibilities with powerful weapons in its armoury, the central bank should, and can play important roles in the cause of peace and prosperity. To perform this modern duty, a central banker will have to combine orthodoxy with boldness and imagination.

To start with orthodoxy: the first duty of the central banker is to preserve the stability of money. The unit of national account must have a stable value, the currency must enjoy the confidence of the nation and of the other nations. This is necessary for the conduct of day-to-day business, both in the public sector and the private sector. It is also an essential condition of development. In one of the background papers, it has been well said that when a paper inflation sets in, it can-although it does not invariably do so-act as a brake on expansion. People move their capital into land and houses, or smuggle it abroad, or hoard gold. Productive investment falls away and the budgetary strains increase still further ! ! \*

If I may cite the example of my own country, Thailand at the end of the Second World War suffered

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\* *Barbara Ward-Prospects for Stability in South East Asia.*

from the worldwide disease of monetary instability. A system of multiple exchange rate was adopted and in time it became so complicated that exporters and importers found it difficult to make accurate calculations of their costs and proceeds. Violent fluctuations in the free exchange rate, coupled with big budget deficits, added to the uncertainties and risks of traders and investors. In 1955, the authorities took courage and a drastic reform in financial management took place. Exchange rates were unified, an Exchange Equalization Fund was established and operated in a manner to inspire confidence. Tax and budgetary systems were reorganized, trading policy liberalized. All this reform is generally considered to be the basis of the progress from 1959 to date. The Government has been able to increase its spending both on current and investment accounts. Foreign lenders and investors have been

forthcoming. It was not due to chance that after this reform, new products have begun to appear; maize, kenaf, tapioca have been added to the list of principal export commodities, which increased from 4 to 10. More eggs have been obtained, and they have been put into more baskets. The Gross National Product has increased at an average annual rate of 7%, double that of the previous period. In short, as long as human actions are motivated, to a large extent at least, by monetary incentives, stable currency is essential for development. A central banker neglects this principle at his country's peril.

However, orthodoxy, like nationalism or patriotism, is not enough. I suggest that a good central banker in a developing country needs more imagination and boldness than hitherto is credited to him traditionally. Let me say from the outset that this is no

easy task, and it demands watchfulness, alertness and even opportunism. Dr. Francois Cloutier, in his background paper entitled "Psychological Implications of Accelerated Development" has warned us that in any society, the impact of rapid modernization may constitute a threat to mental health. In the case of a reforming central banker, if I understand Mr. Cloutier rightly, once he relinquishes orthodoxy and starts thinking and acting in a new way, not only the City of London or Wall Street will raise eyebrows, but tensions will be created within him and his institution "There is a threshold of tolerance. If this threshold is exceeded, tensions might give way to abnormal reactions at the individual or at the social level." (Cloutier).

Respectfully accepting the eminent psychiatrist's warning, let me proceed to show how a modern central



banker can depart from orthodoxy and convention, in order to help reduce world tensions, at the risk of his own personal tensions. Perhaps, setting it out in speech or writing, might help to sublimate any tensions that are indeed threatening.

There is, in almost every developing country, a new institution charged with the duty and responsibility of planning for development. Emphasis is on increased expenditure for development. Unfortunately, Government arithmetic often is confined to addition. New expenditure on investment are added to old and new expenditure on administration. The result is usually an enormous increase in budgetary expenditure. Inability to subtract (i.e. reduction in the percentage of expenditure on administration), and blindness to substitution (i.e. filling the deficit gap with extra tax measures) have led the Government to the cul-de-sac of making

more and more demand on the Central Bank to finance it more and more. And this, as has been shown previously, constitutes a threat to the rampart of monetary stability. It is not helpful of the central banker at this stage, to throw his hand, and cry out that sanctity of the stability principle is being violated. The "Old Lady" of yesteryear must be rejuvenated. She must climb out of her ivory tower, and, if I may use a more martial expression, she must carry the battle into the enemy's territory, instead of waiting to be the target of assault.

The central banker must, at an early stage, join in the discussion and deliberation of development plans. He must take a positive attitude towards Governments' aspirations and legitimate ambition for development. He must endeavour to join the National Economic Development Council, where he can help convince and

be convinced, about the cost/benefit relationship of the development projects, about their priority, about the timing and opportunity of their execution. He must take part in the annual budgetary formulation, suggest economy where possible and profitable, urge tax measures and loan measures. In this way, he will be able to prevent instability threats, and by his positive and co-operative attitude, by dangling the carrot of money available for worthwhile donkeys, he will be able also to earn gratitude and prestige in the eyes of his colleagues.

( Have you ever seen a man who attempts to climb up a steep hill ? He may have to puff and huff and slip down and get up again and finally gets to within a foot or so of the top. A friend of his comes from above and comfortably sits at the ledge above, encouraging him with mere words, and guiding him

somewhat, and finally stretching a helping hand. The climber does all the work himself: his friend just sits and pulls him up for the final foot. The Minister of Finance is the climber, he may have been obliged to impose an unpopular tax in order to finance development, and consequently he slips considerably in the public popularity. The central banker just helped him with a little loan and got a "thank you" from the poor Minister.)

Some of my colleagues will rightly accuse me of advocating that a central banker should concern himself with so many things outside the strict boundary of banking. My plea is that central banking nowadays has perforce become invariably central banking for development, not "central banking" and then full stop. Therefore, a central banker has to be better equipped and more versatile than of old. He must be able to

examine and judge on the planning and programming of infra-structure, structure and supra-structure of economic and social development. This, if correct, will inevitably lead him into alien lands, like education, health, city planning, sewerage etc. Of course the Governor of a central bank cannot do this alone, but he must be interested enough to recruit appropriate staff for appropriate tasks in hand.

The task of any Government in trying to break through in development is not an easy one. In the experience of many countries, the development projects are frequently delayed, not only because of lack of finance, but mostly through lack of skilled and well trained manpower. Government salaries are usually too low to attract good and qualified people in sufficient quantities. In this, from my experience, the Central Bank can lend a hand, also with much profit. Central

Bank usually have more qualified staff and they can afford to recruit and pay better administrators. A programme of technical assistance should be devised and operated between the Central Bank and the Government. After all, lending members of your staff to the Government is a much better alternative to lending money to it. Much money may be saved, inflation avoided and financial stability upheld.

I have so far discussed only the role of the modern central banker in the national development and national co-operation. Time does not allow me to enlarge upon the regional and international aspects of the usefulness of central banking. Let me just mention briefly that central bankers have now become members of international clubs. They know each other much more intimately and see each other more frequently than before. And regional or international development

and co-operation must have its monetary and financial aspects and central bankers are in a good position to deal with these aspects, in order to influence the courses of action and events to the benefit of the developing section of the world.

Mr. Chairman, I must conclude now by expressing my gratitude to my audience for having patiently listened to me blowing my own trumpet. I hope I have not given the impression that the participation of central bankers in any development co-operation will have always the desired result. All I can claim is that we, central bankers, might be able to help and must be ready to help. Another warning is that the co-operation of a central banker in helping reduce tensions, can bring result only if time is on his side. In a situation of political or military crisis, a central banker, like myself at any rate, feels very frustrated, because he feels he is useless.

Thank you.