

Currency Boards and Chinese Banking Development in pre-World War II Southeast Asia: Malaya and the Philippines

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This article examines the relationship between currency boards and the development of local Chinese deposit banking in pre-World War II Malaya and the Philippines. While in both countries Chinese banks filled an important gap in financial intermediation, the currency board system — an especially strict version of the classical gold standard — virtually ensured that these institutions remained small. Moreover, in the 1930s slump the currency board system's preclusion of a central bank and requirement to pay depositors in 100 per cent metropolitan currency, together with the volatility of highly staple-dependent export economies, pushed Chinese banks to the verge of bankruptcy or beyond. Examination of the 1930s crisis in Southeast Asia and role of banks in it reveals more differences from than parallels with 1990s experience.

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INTRODUCION¹

Boards and banks are not necessarily incompatible. Indeed, it might be argued that a colonial or classic currency board system such as pre-World War II Southeast Asia's does much of what is needed to promote banking development, by ensuring international currency convertibility and by virtually eliminating exchange rate risk in currency dealings. Such an argument presupposes important conditions, however. As well as the usual caveats attaching to currency board operation of fiscal prudence and highly flexible wages, at least three further conditions should obtain. One is that banks have good access to an external wholesale credit market. Second, it requires that foreign exchange transactions involve the mother country or other countries to which the colony is also linked in an unvaried relationship through the gold-exchange standard. Third, effective bank regulation must exist.

The present article argues that none of these last three conditions fully obtained for local Chinese banks that developed in Malaya and the Philippines from the early twentieth century

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onwards.² A result was to restrict the growth of local banks and consequently also pre-World War II financial intermediation in the two countries. Moreover, given a colonial currency board system's strict monetary constraints and lack of effective regulatory functions, the 1930s depression exposed the fragility of banks still at a comparatively early stage of development.

The next section of this article describes the currency board system in Malaya and the Philippines. A third section traces the growth of Chinese banks in the two countries, while a fourth analyzes the effect of the 1930s crisis on them. I draw attention to the incompatible aspects of currency boards in Malaya and the Philippines and Chinese banks in the two countries. It is suggested that effective government regulation could have gone some way towards overcoming this incompatibility. The final section concludes and contrasts the 1930s and 1990s crises in Southeast Asia.

CURRENCY BOARDS AND THE GOLD-EXCHANGE STANDARD

Twentieth-century colonial monetary arrangements made the currencies of Malaya and the Philippines part of the prevailing international monetary system by closely tying each country's currency to that of the ruling country. A gold-exchange standard began in the Philippines in 1903 when the American colonial government linked the local peso to United States' currency at two pesos = one dollar. The authorities in Malaya instituted similar arrangements with the ir decision in 1906 to tie the Straits dollar to sterling at one dollar = 2s.4d. In both countries the gold-exchange standard led to the creation of a pre-World War II type of currency board characteristic of colonial areas, especially those under British control.³ The gold-exchange standard incorporated the colonial currency into the gold standard by fixing it to the gold-based

² Malaya refers to the three Straits Settlements ports of Singapore, Penang and Malacca together with the nine states in the Malay Peninsula under British control. The Philippines, after being ceded by Spain to the United States in 1898, became an American colony.

³ Due to recent interest in currency boards in a number of counties including Hong Kong, Argentina and Estonia, a large currency board literature has appeared. Typically, however, these currency boards differ from the type that operated in colonial areas before World War II. This currency board system, if sometimes with modifications,

currency of the mother (or metropolitan) country, and so could be described in Malaya as the sterling-, and in the Philippines as the dollar-exchange standard. Philippine and Malayan experience was typical: as Keynes (1971: 25) observed in 1913, during 'the last ten years the gold-exchange standard has become the prevailing monetary system of Asia'.

The overriding feature of the colonial currency board system is minimal government involvement. Because colonial currency boards offer no scope for government regulation or intervention, they are the antithesis of a central bank. By law local high-powered or base money can exist only if 100 per cent backed by foreign reserves, typically in the currency of the metropolitan currency. Adjustment of local high-powered money to foreign reserves is, therefore, automatic. Currency boards in Malaya and the Philippines merely responded to requests via the commercial banks for local currency by issuing this in exchange for an equivalent amount of metropolitan currency. Unlike a central bank, they could not act as a lender of last resort, nor did they regulate the banking system. Such currency boards amounted to an extreme version of the classical gold standard. Monetary reserves kept in metropolitan currencies rather than gold did not give the leeway of the classical gold standard for adjustment to disequilibria in the balance of payments. Whereas under the gold standard adjustment to a payments deficit might be postponed or partially avoided, under a currency board contraction of the money supply was unavoidable and immediate (Bloomfield, 1959:14; Friedman and Schwartz, 1971: 359).

Exchange rate fixity, along with a currency board system's requirement of 100 per cent foreign reserve backing, had the advantage of giving credibility to local currency and so encouraging monetization. A further advantage of currency boards was that they practically eliminated exchange rate risk for dealings with countries remaining in fixed alignment under the

generally continued until the colony gained independence. For the recent currency board literature, see Hanke and Schuler, *Currency boards*; Williamson, *What Role* ; and Dornbusch, *Fewer monies*.

gold standard. But for colonial authorities, ideologically committed to minimum government, perhaps the most attractive feature of the currency board system was its automatic, self-regulating quality.

In pre-World War II Malaya and the Philippines money supply consisted chiefly of base money, MO, issued by currency boards. During this period base money supply changed principally in response to changes in the current account of the balance of payments (Hazelwood, 1954: 299-301; Short, 1971: 65-69; International Bank for Reconstruction and Development, 1955: 473-74). In both countries current account behaviour mainly reflected fluctuations in the price of exports. Beginning in 1915 these were extreme in Malaya because rubber, highly volatile, became the chief export, and because price movements in tin, the other main export, tended to complement those of rubber. In Malaya when the price of rubber, and with it the entire economy, slumped base money supply fell precipitately. It contracted by almost a half between 1919 and 1922 and by a third in the two years beginning at the end of 1929. Periods of extremely rapid expansion were equally in evidence, for example between 1922 and 1926. Although the Philippine's principal exports — sugar, coconut oil and abaca — had a more stable price history than Malaya's, large swings in Philippine money supply were also evident. Between 1919 and 1922 and again from 1929 to 1932, base money supply fell by around a third (table 1).

CHINESE BANKING DEVELOPMENT

After the turn of the century Chinese banking was an important developmental feature in Southeast Asia. The new banks provided a domestic sector alternative to the region's heavy reliance on European finance. Although small in comparison to their European counterparts, Chinese banks, helped by good local connections and information, tapped a market of Chinese savers, businessmen and entrepreneurs that European banks did not reach.

The pattern of Chinese bank establishment was similar in Malaya and the Philippines. Almost invariably banks located initially in the main commercial centres — Singapore in Malaya and Manila for the Philippines — and in both countries were an outgrowth of Chinese business success. In each country the confidence vital to deposit banking was gained by the participation of major entrepreneurs as founders and directors. These men instilled sufficient trust of the new banks among a wider Chinese public to persuade them, as depositors, to lend their money to the banks.

Beginning in 1903 Chinese banks were established in Malaya and by World War II 13 (11 in the Straits Settlements and two in Peninsular Malaya) had been founded (Tan, 1953). But several of these banks, including some of the earliest, were hampered because their promoters had a base in only small or declining sectors of the economy. In 1914 deposits in Chinese banks incorporated in the Straits Settlements (effectively Singapore) remained small (table 2). The development of Chinese deposit banking in Malaya divided along dialect (speech group) lines and related mainly to three, predominantly Hokkien (Chinese originating from Fujian) banks first set up in Singapore: the Chinese Commercial Bank (1912), the Ho Hong Bank (1917) and the Oversea-Chinese Bank (1919). The banks' growth paralleled Malaya's development as the world's main rubber exporter, and all three relied fundamentally on sponsors and directors involved in the production and processing of rubber. These included men like Lee Kong Chian, Lim Nee Soon and Yap Pheng Geck (Huff, 1994). Since in addition to banking most of the large Chinese trader/entrepreneurs whom the rubber industry brought to prominence moved into other sectors of the domestic economy, such as pineapple canning, manufacturing and construction, this diversification must have helped to broaden the banks' appeal to the public.

Scope for effective diversification from Chinese banking's export economy base was, however, limited by the overriding importance of rubber to the Malayan economy. It made industry-specific risk for the rubber sector and systemic risk to the entire economy almost

synonymous. Deposits in the banks largely reflected the impact of rubber and its price volatility. During World War I, when Malaya first began to export large quantities of rubber, Chinese bank deposits grew fourfold, and between 1924 and 1925 more than doubled when rubber prices sharply increased under the influence of the Stevenson restriction scheme. But with downturns in rubber prices depositors tended to withdraw funds. They did so both because of uncertainty over Malaya's economy and so bank liquidity and because of a need, with terms of trade decline, to draw on cash to finance imports. Chinese bank deposits more than halved between 1919 and 1922 and from 1929 to 1932 fell by almost a fifth (table 2).

Within the pattern of Chinese banking development, Philippine banks faced two important constraints compared to Malayan banks. One was the smallness of the Chinese community. Whereas Chinese comprised almost two-fifths of Malaya's inhabitants and Singapore was a Chinese metropolis, Philippine Chinese, mainly from Fujian and Guangdong, were no more than about three-quarters of one percent of the Islands' population. In Manila, where about half of all Philippine Chinese lived, the Chinese community numbered, even in 1939, only some 46,000. The other constraint, which reflected the first, was the restricted scope of Philippine Chinese business interests. These concentrated largely in mercantile establishments, which in 1930 made up 46 per cent of Chinese investments compared to 25 per cent in real estate, 14 per cent in manufacturing, 5 per cent in forests and lumber and 4 per cent in banking (Fukuda, 1995:185). In the inter-war years textiles accounted for some 20 to 30 per cent of total Philippine imports and the import and distribution of cotton and silk goods constituted the chief Chinese mercantile interest.

Of the two Chinese banks set up in the Philippines, the China Banking Corporation (1920) was more successful than the Mercantile Bank of China (1924) in sidestepping the constraint of narrow Chinese business interests. To be sure, a number of the China Banking Corporation's organizers had textile interests. But the bank achieved some diversification in that

its 11 Chinese foundation directors both united the older and younger generations of Manila's family businesses and were involved in 'a wide spectrum of activities' (Wong, 1999:133). Deo C. Chuan, known as the 'lumber king' and among the few Philippine Chinese substantially involved in primary production, was the driving force in founding the bank, and its president until 1940. Additionally, the Bank gained considerable financial support from Oei Tjoe, who had become wealthy as a Java sugar merchant (Dee, 1980). By 1923 the China Banking Corporation had attracted 7.1m pesos in deposits, equivalent to 6.4 per cent of Philippine base money supply, M0.

The Mercantile Bank of China had, by contrast to the China Banking Corporation, a less illustrious board of directors. More important, their interests centred predominantly on the textile trade. Several of the bank's directors, including the Bank's president Khu Yek Chiong, were major textile dealers in Manila (Wong, 1999: 143, 146). The Mercantile Bank of China remained substantially the smaller of the two banks, and in 1929, when deposits with Chinese banks reached a pre-World War II peak of 12.4 m pesos, accounted for 4.2 m of these (table 2).

A feature of pre-World War II Southeast Asia was the markedly oligopolistic structure of European banking. Two British banks, the Hongkong and Shanghai Banking Corporation and the Chartered Bank of India, Australia and China, dominated banking in Malaya. Similarly, as late as 1917 in the Philippines 'American banking capital has never taken any deep root ... the great English-oriented institutions — the Hongkong & Shanghai and the Chartered Bank of India, Australia and China — have long exerted a dominating influence in the local banking field' (Willis, 1917: 420). Even in the inter-war period the main interest of European banks in Malaya and the Philippines remained the financing of foreign trade. Beyond this activity and some mortgage lending on high quality property, European banks tended to remit funds to their metropolitan (or Hong Kong for the Hongkong and Shanghai Bank) head office. Until the 1950s European banks, P. J. Drake (1972: 101) observes, 'presided over a substantial transfer of

funds from the colonies to the London capital market'. Unlike Japan or a developed economy like the United States, the banking system in Malaya and the Philippines did not have an important money creation function, as the fact of MO as the main component of money supply indicates.

No doubt Malaya's Chinese banks were only a fraction of the size of European banks. And in the Philippines, for which figures exist, Chinese banking accounted for at most about 8 per cent of total bank total deposits and assets (Wong, 1999: 137). Despite this, in both countries Chinese banks had a potentially major contribution to make to economic development: because they were rooted in the local economy; because of a willingness to lend beyond the foreign trade and real estate sectors; and because of European banks' orientation mainly towards European business. But constraints imposed by the currency board system prevented Chinese banking from attaining its full developmental potential by limiting the extent to which these banks could safely act as financial intermediaries.

The role of financial intermediaries and so the relationship between finance and development is usefully thought of in terms of mobilization and allocation. In regard to the former, Malayan and Philippine Chinese banks tapped a new, much wider market than the European banking system. In Malaya, Chinese banks encouraged the 'banking habit' and attracted additional finance, since even in the inter-war period 'the European banks had an air about them which intimidated many local people ... [and] would not accept small accounts' (Yap, 1982: 28). Likewise, the importance of Manila's two banks was that 'not many Chinese could avail themselves of the services of [European] commercial banks in the Philippines' (Wong, 1999: 131).

Just as Chinese banks almost certainly mobilized additional finance, so too they improved allocative efficiency within a community hitherto dependent either on a few major businessmen being able to borrow through European bank compradores or constrained to self-

finance and loans from relatives. Chinese banks lent to Chinese and, consistent with that group's leading entrepreneurial role, especially in Malaya, financed a wide range of activities, including manufacturing.

The currency board system meant, however, that each Chinese bank had to rely exclusively on its own resources (Grove and Exter, 1948: 939). A central bank, if present, would have served as a lender of last resort and reduced banks' need for loan contraction in a downturn. By contrast, under a currency board, a worsening of the terms of trade and accompanying adverse balance of payments current account could also lead to a bank liquidity crisis. Balance of payments deficits were financed by converting local into metropolitan currency and, as this occurred and base money supply fell, banks lost reserves and had to contract loans to safeguard their liquidity. Moreover, the large falls in money supply characteristic of Malaya and the Philippines, along with banks' uncertainty as to the eventual extent of monetary contractions and therefore what constituted a 'safe' reserve ratio, made it prudent to maintain large liquid reserves. Chinese banks in both Malaya and the Philippines normally kept 50 per cent of their deposits liquid and in Malaya deposited these with European banks (Straits Settlements, 1934, vol. 3: 416; Bank of England Archives 1956; Wong, 1999: 138). The latter, unlike Chinese banks, had access to an external wholesale credit market and their metropolitan head offices could, if necessary, act as a central bank. Thus, the currency board system, together with European banks' minimal allocative function, effectively limited the allocative impact of Chinese banks on the local economy. Although Malayan and Philippine Chinese banks successfully performed a financial intermediary's role of mobilizing finance, this could only be partially carried through into an allocative function. Something like half of the finance mobilized by Chinese banks ended up as no more than liquidity.

It is not unusual that in the early stages of banking development a large part of banks' portfolios consist of loans to their directors. The limited information available on the balance

sheets of Malayan Chinese banks does not confirm such lending, but its likelihood is more than a suspicion (Short, 1971: 73). Certainly a high proportion of loans made by the two Philippine banks were to directors (Wong, 1999). This was especially true of the Mercantile Bank, with the further result of a rather narrow allocative function since much of the finance it mobilized went to the textile trade. In nineteenth-century New England, the practice of making loans primarily to bank directors, which N. Lamoreaux (1994) terms insider lending, implied that individuals purchasing shares in these banks in effect acquired a diversified portfolio of the business interests of the directors to whom loans went. In reality, the banks functioned like investment clubs and insider lending overcame the problem of unequal or asymmetric information, since shareholders knew the identity of bank directors and could judge the health of their businesses.

Each of the Philippine banks issued shares, which were traded on the Manila Stock Exchange. But the Philippine banks differed from New England insider lending in that in addition to functioning as portfolio managers they provided transactions services and deposits comprised a large part of their liabilities. Unlike equity capital, these constituted a fixed nominal claim and, furthermore, one of increasing real value in times of depression and deflation. An additional source of risk, common to banks in both Malaya and the Philippines was the establishment of branches abroad. The China Banking Corporation set up two overseas branches in the 1920s, in Xiamen and Shanghai, while Malayan Chinese banks, as well as establishing branches in Malaya and elsewhere in Southeast Asia, also opened in China. Although the gold standard, of which the currency board system was an aspect, gave Chinese banks stability in their dealings with countries on gold — at least until the competitive devaluations of the 1930s — the currencies of Hong Kong and China remained on silver and operations there carried significant exchange-rate risk.

THE 1930s DEPRESSION AND CHINESE BANKS

By the time the depression in Southeast Asia, beginning in late 1929, had started to lift Malaya's three main Chinese banks had been forced into amalgamation and one of the Philippine banks had failed. This section examines the difficulties Chinese banks faced. It asks to what extent problems might have been avoided if there had existed a central bank or other institution, including a modified version of a colonial currency board, performing some central bank-like functions.

Beginning in 1926 in Malaya and 1928 in the Philippines, export prices fell substantially and the terms of trade deteriorated (table 1). Decline in Malaya was dramatic. The terms of trade more than halved between 1925 and 1929 and by 1932 had more than halved again. In the Philippines the terms of trade reached an inter-war peak of 113.3 in 1927 but worsened continuously to 90.4 in 1930. Unlike Malaya, the Philippines' terms of trade then stabilized and by 1932 began to recover. Nominal money supply, M0, and money supply divided by foreign prices (a measure of deflationary pressure) tell a similar story. Again contraction and deflation was much less severe in the Philippines than Malaya. A rise in the multilateral or effective real exchange rate of a country indicates a real devaluation. Between 1929 and 1932 Malaya's real exchange rate more than doubled. The Philippines experienced some real devaluation in the late 1920s. But just as the other macroeconomic indicators suggest that by 1931 the worst of the depression was over for the Philippines, so too by then its real exchange rate began to appreciate. Compared to Malaya, depression in the Philippines appears to have been comparatively mild and short-lived. In contrast to Malaya, the Philippines had favoured access to the United States market until 1935, and the value of Philippine sugar exports rose during the early 1930s (Larkin, 1993:150). Furthermore, unlike Malaya's large rubber estate sector, organization in the Philippines of most primary commodity production into small or relatively small units gave a flexibility which facilitated adjustment to depressed economic conditions.

Terms of trade decline and real exchange rate depreciation may improve long-term competitiveness. But in the short- to medium-term they can leave firms and the banks lending to them in difficulty. When there is a large real depreciation, this difficulty tends to become extreme and may be associated with overall economic contraction which more than offsets any possible competitiveness gain (Krugman, 1999, 2001). Many bank borrowers are in the export and nontradeables sectors. These borrowers, having contracted loans in nominal terms and now, due to deflation, with increased real liabilities, find repayment hard. At markedly unfavourable real exchange rates, the balance sheet problems of borrowers constrain investment by them and also translate into bank balance sheet problems. Nor can a currency board, unlike a central bank, re-liquidize banks. As cash flows from banks — when loans cease to be repaid and since a declining terms of trade implies relatively dearer imports paid for by converting local into foreign currency — they must reduce lending. This almost certainly leaves borrowers credit constrained and contributes, through the balance sheet problems of banks and consequent credit contraction, to declining investment and falling aggregate demand. As depositors' uncertainty over the viability of banks' balance sheets increases, bank runs become correspondingly more likely and the solvency of banks is threatened.

Malayan and Philippine Chinese banks could not avoid being affected by the macroeconomic downturn that began in the later 1920s and continued in the 1930s, and for them the currency board system multiplied the depression's adverse impact. In the Philippines, balance sheet contraction for the banking sector as a whole was confined to 1930 when, reflecting bad debts, total bank assets fell by something over 10 per cent (Philippines, Annual Report 1931: 6 and 1932: 8-9). Chinese banks were, however, more severely affected. The Mercantile Bank of China collapsed in September 1931 and its liquidation began at the end of the year. Deposits in the China Banking Corporation decreased from 8.2m pesos in 1929 to 6.1m in 1933 but recovered to 7.3m in 1935 (Wong, 1999: 138). In Malaya between the end of

1929 and 1932 Chinese bank assets declined by fully 22 per cent (Short, 1971: 62). Almost certainly due to the greater severity of macroeconomic shock in Malaya, contraction across the entire Malayan banking sector appears to have been more extensive than in the Philippines: 'practically all the local Chinese banks as well as some overseas banks were in financial difficulty' (Lee, 1966: 89).

A main argument against central banks is that in their absence commercial banks, unable to perpetrate moral hazard, would hold large reserves and capital and such prudence would render systemic stability the rule (Goodhart, 1994). The large reserves kept by Chinese banks indeed suggest such a response in the absence of a central bank. Furthermore, this central bank substitute (ignoring its effect in constraining banks' allocation of finance) was not altogether unsuccessful. In the 1930s depression only one of the Malayan and Philippines Chinese banks failed entirely and the China Banking Corporation, despite the fall in deposits, emerged intact. But depression in the 1930s was so severe, especially in Malaya, that without a central bank serious bank-specific problems emerged.

These problems perhaps chiefly reflected inexperience and imperfect information rather than moral hazard. The difficulties of Chinese banks might well have been obviated by an effective regulatory system performing central bank-like functions, such as the colonial authorities could have established. To the extent that one accepts this argument, the depression need not have had so severe an effect on Malaya and the Philippines as it did.

In Malaya depression-induced merger between the three Hokkien banks created the Oversea-Chinese Banking Corporation (OCBC). Although the banks' public statement referred to merger and the 'mutual desire of directors and shareholders', in fact two of the three banks were in considerable distress. Between the end of 1931 and mid-1932 deposits in the Ho Hong Bank halved and in the Oversea-Chinese Bank fell by 30 per cent. Public confidence in both banks suffered because of their foreign exchange position. In September 1931, when Britain left

the gold standard, so too, under the currency board system, did Malaya. But Indonesia, linked to the guilder, and Hong Kong, on the silver standard, did not devalue along with Britain. Because branches of the two Malayan Chinese banks had taken deposits in Hong Kong and Indonesian currency but apparently converted these mostly into Straits dollars, departure from the gold standard left them with greater liabilities than assets. Additionally, the Oversea-Chinese Bank experienced a run on its Rangoon office (Short, 1971).

Moreover, all three Chinese banks had lent heavily to a single borrower, Tan Kah Kee. Tan was a rubber magnate who during the 1920s also moved into manufacturing to an extent sufficient to be called the 'Henry Ford of Malaya'. By 1931 the contraction in demand both in Malaya and the Asian markets to which Tan's companies exported made it clear that his manufacturing empire was in serious trouble. At the same time the fall in Malaya's terms of trade, due chiefly to low rubber prices, greatly contracted the value of Tan's rubber holdings and so the assets side of his balance sheet (Huff, 1994).

The Chinese banks' unhedged foreign exchange portfolios were an elementary mistake. Almost certainly it was one which, in terms of its impact on the banks, was much compounded because of the effect it had in leading to depositors' withdrawals. The banks' large loans to Tan Kah Kee were explained by the asymmetry of information available to Tan, who knew his true circumstances, and those lending to him, who did not. It was not until 1931, as a leading Chinese banker of the time later reflected, that 'The local [Chinese] banks found that collectively, they had lent him [Tan] too much' (Yap, 1982: 31). In Malaya a central bank providing lender of last resort facilities might have been able to stem the frantic withdrawal of deposits from the two Chinese banks. Perhaps more to the point, a regulator would have been able to monitor the banks' foreign exchange positions and have had a knowledge of their loan portfolios as a whole. Effective regulatory powers are absent under a colonial currency board system but could exist under a modified currency board and certainly comprise part of a central

bank. Enforceable regulation would have increased the compatibility of boards and banks. It could probably have headed off at an early stage what turned out a near systemic collapse in Malaya's Chinese banking sector.

In the Philippines the Mercantile Bank of China weathered one run, beginning 6 August 1931, after support from Manila's clearing-house banks, but a second run, sparked off by news of the bank president's resignation, proved fatal. A subsequent move by some prominent members of the Chinese community to provide finance and re-organize the bank lacked sufficient backing (Philippines, Annual Report 1931: 9-10). The runs followed rumours of foreign exchange losses and concern over the bank's considerable lending to textile traders, many of whom were directors of the bank or closely connected to it. A high proportion of these bank loans were unsecured (Wong, 1999). After World War I Philippine textile dealers first began to import large quantities of cotton and silk goods direct from the United States. The facility of easy credit, available from the Mercantile Bank after 1924, encouraged this practice and in the boom year of 1927 many dealers accumulated big stocks. Subsequent worsening in the Philippines terms of trade and economic contraction made textiles hard to sell and reduced prices. Furthermore, Japan's partial loss of the China market in 1929 and consequent re-direction of exports to the Philippines led to a sharp increase in competition and further drove down textile prices (Straits Settlements 1934, vol. 1: 59). This conjunction of circumstances left Manila's Chinese textile dealers with stocks considerably depreciated in value (Doeppers, 1991).

There is no doubt that, as in Malaya, Philippine banks suffered from a lack of regulation. Leo Martin, Bank Commissioner for the Philippine, stressed that 'The present laws relating to banks ... are deficient and unsatisfactory' (Philippines, Annual Report 1931: 7). Bureau of Banking officials in the Philippines periodically examined individual banks and their reports and recommendations were passed on to the management. But 'government authorities did not

normally take strong actions even if [official] recommendations were unheeded by the directors of the bank' (Wong, 1999: 139).

It is unclear if the Mercantile Bank of China, already in difficulty due to its largely undiversified textile portfolio and an uncovered foreign exchange position in Shanghai taels, could have been rescued by a central bank acting as lender of last resort (Wong, 1994). The failure of two separate non-government rescue attempts suggests that this may not have been possible. Textile stocks against which the bank had loaned money, although devalued by deflation and low Japanese textile prices, were still far from worthless. Work by the liquidator, which continued through the 1930s, indicated that substantial asset recovery was possible, the unsecured nature of many of the bank's loans notwithstanding. But after Britain left gold, and with Japan's sharp devaluation of the yen beginning in November 1931, textiles became much harder to liquidate advantageously. Devaluation of the yen, as those attempting to rescue and re-organize the Mercantile Bank may well have concluded at the time, probably put the bank finally beyond rescue. Nor did Japanese competition in the Philippines lessen until the late 1930s. In the case of the Mercantile Bank, there is a serious argument for moral hazard. But it is reasonable to suppose that for the Mercantile Bank effective regulation in the 1920s would have prevented the problems which occurred in the 1930s.

CONCLUSION AND 1990s COMPARISONS

The elements of history tend to repeat themselves but historical events, in their chronology and relative importance of different components, do not. Most of the elements and issues of the 1930s surfaced in the 1990s. Again commentators talked of exchange-rate risk, real exchange rate depreciation, debt deflation, balance sheet crises, lenders of last resort, moral hazard and prudential regulation.

But the configuration of these elements was different. The 1990s crisis originated in Thailand's borrowing short term to finance long-term investment and a sudden loss of

confidence in the Thai baht. Real exchange depreciation and balance sheet crises were common to both the 1930s and 1990s. In the 1930s crisis, however, currency boards ensured stable nominal exchange rates and the decline in local relative to foreign prices led to real exchange rate depreciation, while in the 1990s this occurred because of a collapse in nominal exchange rates once international financial markets lost confidence in Southeast Asian currencies. A domino effect of financial crises — and in contrast to the 1930s one can speak of contagion in 1990s Southeast Asia — exposed numerous country-specific complications, notably in Indonesia (Hill, 1999). Moral hazard, effective regulation and a lender of last resort all became 1990s issues, although many now considered these as an IMF remit (Fischer, 1999).

Such a judgment highlights a fundamental difference between pre- and post-World War II globalization as it affected Southeast Asia and so between the region's two main twentieth-century crises. The 1930s was a crisis originating in the real economy consequent on global integration of goods markets and collapse in export prices due to a downturn in demand in the United States and Europe for the products Southeast Asia exported. Conversely, in the 1990s Southeast Asia's greater integration into world financial markets became the basis for a crisis the origins of which were financial. By the 1990s Southeast Asia had developed well beyond its 1930s primary-commodity dependent, export-economy stage and a crisis in banking and finance translated into sharp contractions in real output. Because in the 1930s Malayan and Philippine Chinese banks did not yet have a central role in the two country's economies, although banking crises seriously affected some specific economic sectors, it had less of an impact on the economy as a whole. This localized effect probably helped Chinese banking in Malaya and the Philippines to survive the 1930s crisis, learn from past mistakes and emerge as a much-stronger force in post-World War II Southeast Asia.

After the war the Philippines established a central bank at almost the first opportunity, in 1948. Malaya followed a more cautious, and probably ultimately more advantageous, policy of

reforms in the 1950s to the currency board system and introduction of effective regulatory measures (Drake, 1969:69-72). These latter were much along the lines of the bank regulation that this article has suggested would have significantly enhanced the pre-World War II compatibility of boards and banks and thereby promoted economic development in both Malaya and the Philippines.

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Table 1
Malaya and Philippines Macroeconomic Measures 1917 - 1939
(1929 = 100)

| | Terms of trade | | Nominal money supply M0 | | Money supply M0/foreign prices | |
|------|----------------|-------------|----------------------------|-------------|-----------------------------------|-------------|
| | Malaya | Philippines | Malaya | Philippines | Malaya | Philippines |
| 1917 | 192.9 | 117.2 | 80.2 | 82.6 | 56.2 | 70.1 |
| 1919 | 125.8 | 82.7 | 123.5 | 118.0 | 73.2 | 68.5 |
| 1922 | 76.8 | 72.6 | 68.3 | 78.3 | 59.9 | 63.5 |
| 1925 | 244.2 | 108.4 | 124.9 | 107.0 | 106.1 | 93.4 |
| 1926 | 191.3 | 110.4 | 154.0 | 100.1 | 140.9 | 92.2 |
| 1927 | 161.9 | 113.3 | 117.2 | 103.1 | 111.5 | 99.5 |
| 1929 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 1930 | 71.3 | 90.4 | 81.8 | 87.9 | 95.8 | 91.7 |
| 1931 | 51.1 | 90.5 | 66.9 | 80.3 | 91.1 | 101.5 |
| 1932 | 47.1 | 92.6 | 64.5 | 71.7 | 90.1 | 103.7 |
| 1933 | 66.0 | 96.1 | 63.1 | 81.0 | 86.9 | 128.1 |
| 1935 | 92.9 | 83.8 | 72.7 | 94.5 | 94.0 | 133.5 |
| 1939 | 104.4 | 72.5 | 109.1 | 163.6 | 121.7 | 202.0 |

Notes: The multilateral real exchange rate is defined as defined as $MRER_t = \frac{\sum_{i=1}^k a_i E_{it} P_{it}^*}{P_{N_t}}$ where MRER_t is an index of the multilateral real exchange rate for Malaya or the Philippines in time t, 1917-39; E_{it} is an index of the nominal exchange rate between country i and Malaya or the Philippines in period t; i = 1, ..., k indicates the k partner countries used to construct the multilateral real rate index; **a_i** is the weight of partner i; **P_{it}^{*}** is the price index of the i partner in period t; and **P_{N_t}** is the price index of Malayan or Philippines nontradeables in period t. The weightings, based on 1929 import shares, used are Malaya: United Kingdom 0.723, United States 0.151 and Japan 0.126 and for the Philippines: United States 0.80; Japan 0.13 and United Kingdom 0.07. Nontradeable prices are for the Philippines wages of workmen and common labourers in Manila and for Malaya wages of Indian rubber estate workers in the Federated Malay States.

Sources: **Malaya and foreign prices:** Huff (2002) except Philippines foreign prices are from Birnberg and Resnick (1975): 306; **Philippines:** Philippines (1920, 1930, 1939); Philippines (1929, 1938); Birnberg and Resnick (1975): 306; Williamson (2002); Exchange rates: van der Eng (1993): 27-28.

Table 2
Malaya and Philippines Chinese Bank Deposits 1914 -1939
(1929 = 100)

| | Malaya | Philippines |
|------|---------------|--------------------|
| 1914 | 8.9 | |
| 1918 | 36.1 | |
| 1919 | 90.7 | |
| 1922 | 38.0 | |
| 1923 | 47.3 | 57.3 |
| 1924 | 50.6 | |
| 1925 | 115.8 | |
| 1927 | 107.4 | 94.4 |
| 1929 | 100.0 | 100.0 |
| 1930 | 92.6 | 83.1 |
| 1931 | 100.6 | 86.3 |
| 1932 | 81.6 | |
| 1933 | 92.5 | 49.2 |
| 1935 | 104.3 | 58.9 |
| 1939 | 160.4 | |

Notes: Figures for Malaya refer to banks incorporated in the Straits Settlements. In 1929 the value of deposits was Straits \$37.0m (US\$20.8m) in Malaya and Pesos 12.4 m (US\$6.2m) in the Philippines. For Malaya deposits are for 31 December, except for 1930 which is 30 June. Philippine deposits refer to various times within the year indicated and for 1927 use the 1926 figure for Mercantile Bank of China deposits.

Sources: Short, 1971:60-63; Wong, 1999: 138, 145.