The growth of offshore banking in the 1970s

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The figures

The growth of the market in its first decade was extraordinary. The official figures collected by the Monetary Authority of Singapore and reproduced by Bernauer show total ACU assets of 30.5 million US dollars at the end of 1968, 123.0 million in 1969 and 389.8 million in 1970. They reached 2,976.1 million in 1972, 6,277.1 million in 1973 and 12,597.4 million in 1975. By 1979 they stood at 38,162.7 million and by the end of 1981 at 85,852.0 million US dollars. The market more than doubled in size every year until 1973. Growth then slowed, but remained high by any standard.[1]

The number of participants grew with the volume. There was one ACU in 1968, 16 in 1970, 46 in 1973, 66 in 1975, 101 in 1979 and 108 by March 1980. By the end of 1982 there were 120 institutions with Asian dollar accounts, of which 74 were banks. Between the end of 1969 and February 1980 the number of foreign banks in Singapore rose from 7 to 48, while the number in Hong Kong rose from 52 to 115. Seen against the global offshore market, Singapore's share rose from 0.35 per cent in 1970 to 4.77 per cent at the end of 1981.[2]

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Gross figures overstate the size of any offshore market because they count deposits that banks place with one another. Chia estimated the net size of the Singapore market, excluding redeposits between ACUs, at 14.4 billion US dollars at the end of 1976, or about six per cent of the estimated net size of the Eurocurrency market. The gross size at the end of June 1977 was 18.8 billion dollars, held by 74 ACUs. Daily dealing volume was estimated at 150 to 200 million dollars.[3]

From conduit to intermediary

The character of the market changed as it grew. In its early years it served mainly as a conduit through which funds from Asia flowed to Europe and North America, where interest rates and investment opportunities were greater. In 1970 deposits of non-banks made up 62.5 per cent of ACU liabilities, while loans to non-banks accounted for only 3.6 per cent of assets. Interbank claims formed 95.0 per cent of the assets.[4] Singapore collected the savings of Asian companies, central banks and wealthy individuals and passed them on to London.

The oil price increases of 1973 and 1974 reversed the direction of the flow. As petrodollars were recycled to developing countries, funds moved from Europe and the United States to Asia through the Singapore market. In its Annual Report for 1980 the Monetary Authority of Singapore stated that 76 per cent of ACU funds were taken up in Asia in early 1979. By 1981 the non-bank share of deposits had fallen to 15.9 per cent, while loans to non-banks had risen to 22.7 per cent of assets.[5] The market had become an intermediary that brought international funds to the growing economies of the region.

The borrowers reflected the industrialisation of Southeast Asia. In 1971 more than half of ACU loans went to manufacturing. By 1978 the share had fallen to about 28 per cent, as financial institutions, governments and trading companies took a larger part.[6] Chia lists the depositors of the mid-1970s as central banks, commercial corporations, affluent individuals and commercial banks outside Singapore, including Eurodollar banks that brought funds from Europe because of Singapore's low political risk.[7] The wealthy individuals in this list are an early sign of the private banking business that Singapore would develop on a much larger scale after 2000.

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By the end of 1981 the structure of the Singapore market closely resembled that of London. Interbank deposits represented 77 per cent of foreign currency deposits in Singapore and 76 per cent in London, while the maturity profiles of assets and liabilities were almost identical.[8] The offshoot had become a mature offshore market in its own right.

Asian dollar bonds and certificates of deposit

The authorities also tried to develop a capital market alongside the deposit market. The Asian dollar bond market began in 1971 with an issue of 10 million US dollars by the Development Bank of Singapore. According to Chia, interest earned by non-residents on Asian dollar bonds had been exempt from tax since August 1973, together with the stamp duty. Ngiam dates the abolition of stamp duty on Asian dollar bonds to April 1980, so the two accounts diverge on the stamp duty.[9] Issuance remained irregular. Ngiam counts one issue in 1971, none in 1974, nine in 1976, eighteen in 1980 and 222 issues in total between 1971 and 1992. Bonds raised in the market amounted to 266 million dollars in 1976, against 47 million in 1975.[10]

The bond market never matched the deposit market in importance. One critical article of 1976 in *Euromoney* went so far as to call it a "charade".[11] The weakness of local capital markets in foreign currencies is a recurring theme in Singapore's financial history. Chapter D.II shows how the futures exchange SIMEX later created a different kind of market depth, while Chapter D.IV describes the efforts after 1998 to develop the bond market.

Funding centre and booking centre: the division of labour with Hong Kong

Hong Kong did not stand still. Its banks, many of them branches of the same international groups that operated ACUs in Singapore, arranged the largest share of the syndicated loans to Asian borrowers. In 1979 institutions in Hong Kong arranged 53 syndicated loans to Asian countries, against 10 for institutions in Singapore. The two centres complemented one another. Singapore gathered

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deposits from many outside sources, while Hong Kong deployed them. At the end of 1981 the liabilities of Hong Kong participants to Singapore counterparts amounted to 42.6 billion dollars, against claims of 28.4 billion.[12]

Tax law explains much of this division. Singapore did not tax the interest paid to non-resident depositors, whereas Hong Kong applied a 15 per cent tax to such interest. Hong Kong, however, taxed profits at a lower rate and did not tax offshore income. American banks with excess foreign tax credits therefore booked their loans in Hong Kong and funded them in Singapore, so that Hong Kong became known as the booking centre and Singapore as the funding centre.[13] Chia predicted in 1977 that Hong Kong might displace Singapore as a funding centre once it reduced its tax on interest to zero.

The prediction was tested in February 1982, when Hong Kong abolished its tax on interest earned by non-residents on foreign currency deposits. Its Asian dollar deposit liabilities then grew by more than 50 per cent.[14] Hong Kong had already relaxed its moratorium on bank licences in 1978.[15] The rivalry between the two centres, which began with the decision of 1968, has continued in every decade since and is examined in Chapter K.III.

Monetary control and the speculative inflows of 1972–1973

The offshore market brought risks to the domestic economy as well as income. The clearest test came in 1972 and 1973, when speculative capital poured into Singapore. Because domestic interest rates were higher than Eurocurrency rates, banks swapped foreign currency into Singapore dollars through local banks and lent the proceeds to residents. Between January 1972 and March 1973 ACU interbank deposits with Singapore banks increased by 259 per cent, which created excess liquidity at home.[16] The episode showed that the ring fence around the ACUs could be crossed whenever the interest differential was large enough.

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Experiences of this kind help to explain a policy that shaped Singapore's monetary framework for a generation. The authorities held that a small open economy with a large offshore market could not afford to let its own currency become an international currency. They restricted lending in Singapore dollars to non-residents and borrowing by non-residents in Singapore dollars, a policy known as the non-internationalisation of the Singapore dollar. Ngiam described this policy in 1996 as perhaps the most controversial of the regulations still enforced by MAS, defended on the ground that internationalisation would make monetary policy more difficult.[17] Its gradual relaxation after 1998 belongs to Chapter D.IV.

What Singapore gained

The benefits for Singapore were substantial. Before 1968 financial and business services accounted for about 8 per cent of gross national product. By 1980 the share exceeded 18 per cent, while the economy as a whole grew at an average of about 8 per cent a year. The surplus on services helped to finance a persistent trade deficit. In 1981 the trade deficit amounted to 6.3 billion dollars, of which 60 per cent was offset by the net surplus on the service account.[18]

Employment and skills mattered as much as income. Employment in financial services grew faster than in manufacturing or in the economy as a whole between 1970 and 1979. The share of skilled workers in the sector was nearly twice the national average. The market trained a generation of Singapore dealers, credit officers and lawyers in international finance. By 1993 ACUs held 66.2 per cent of the total assets of Singapore's financial sector, against 0.1 per cent in 1968.[19] The financial sector of Singapore had been transformed from a domestic system centred on commercial banks into a market for international funds.

Notes

1. Bernauer, "The Asian Dollar Market", p. 50, Table 1, "Asian Dollar Market in Singapore", total assets/liabilities in millions of US dollars at the end of each year: 1968 30.5, 1969 123.0, 1970 389.8, 1971 1,062.8, 1972 2,976.1, 1973

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6,277.1, 1974 10,357.5, 1975 12,597.4, 1976 17,354.1, 1977 21,018.3, 1978 27,040.1, 1979 38,162.7, 1980 54,392.6, 1981 85,852.0 (source: Monetary Authority of Singapore). Bernauer, "The Asian Dollar Market", p. 50: "the Singapore market which more than doubled in size in each year through 1973. But although growth subsequently tapered off, it remains impressive.". ↩

2. Bernauer, "The Asian Dollar Market", p. 50, Table 1, number of ACUs: 1968 1, 1969 11, 1970 16, 1971 21, 1972 24, 1973 46, 1974 56, 1975 66, 1976 69, 1977 78, 1978 85, 1979 101, 1980 108 (end of March 1980). Bernauer, "The Asian Dollar Market", p. 51: the number of institutions taking Asian dollar accounts "increased to 120 by the end of 1982. Seventy-four of these institutions are banks"; foreign banks in Hong Kong increased from 52 to 115 and in Singapore "from 7 to 48, or nearly sevenfold" between the end of 1969 and February 1980. Bernauer, "The Asian Dollar Market", p. 52, Table 4: ACU liabilities as a percentage of the gross offshore dollar market, 0.35 in 1970 and 4.77 in 1981 (source of the gross market estimate: Morgan Guaranty Trust). ↩

3. Chia, "Tax Implications and the Asian Dollar Market", (1978) 20 *Mal LR* 16, at p. 16: gross size of US$18.8 billion at the end of June 1977 for 74 ACUs; net size of US$14.4 billion at the end of 1976, "equivalent to about 6 per cent of the estimated net size of the Euro-currency market". Chia, "Tax Implications and the Asian Dollar Market", (1978) 20 *Mal LR* 16, at p. 17: "The market daily volume is estimated to be US$150–200 million.". ↩

4. Bernauer, "The Asian Dollar Market", pp. 52–53 and Table 5: in its earlier years the market "served primarily as a conduit of funds from the Asian region to Europe and North America"; in 1970 deposits of non-bank customers 62.5 per cent of liabilities, loans to non-bank customers 3.6 per cent of assets, interbank funds 95.0 per cent of assets. ↩

5. Bernauer, "The Asian Dollar Market", p. 52: "In its 1980 Annual Report, the Monetary Authority of Singapore (MAS) said that '76 percent of ACU funds were taken up in Asia in early 1979.' … By 1981, the non-bank share of total deposits had fallen to 15.9 percent from 62.5 percent in 1970, while loans to non-bank customers had risen from 3.6 percent of assets in 1970 to 22.7 percent in 1981." ↩

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6. Bernauer, “The Asian Dollar Market”, p. 56: “In 1971, for example, over 50 percent of ACU’s loans were to the manufacturing sector”, declining “to about 28 percent of the total in 1978”. ↩
7. Chia, “Tax Implications and the Asian Dollar Market”, (1978) 20 *Mal LR* 16, at p. 17, listing the four categories of lenders, including “individuals – numerous affluent individuals seeking a more stable home for their cash than the situations in their countries permit” and commercial banks attracted by “Singapore’s low political risk”. ↩
8. Bernauer, “The Asian Dollar Market”, p. 53: “At the end of 1981, interbank deposits as a proportion of total foreign currency deposits stood at 77 percent in Singapore and 76 percent in London.” ↩
9. Ngiam, “Singapore as a Financial Center”, p. 364: “The Asian dollar bond market began in 1971 with the issue of U.S.$10 million by the Development Bank of Singapore. To encourage its development, the stamp duty on Asian dollar bonds was abolished in April 1980.”. Chia, “Tax Implications and the Asian Dollar Market”, (1978) 20 *Mal LR* 16, at p. 19: “Stamp duty, as well as non-resident interest earnings on Asian dollar bonds, has also since August 1973 been tax exempt.”. ↩
10. Ngiam, “Singapore as a Financial Center”, p. 365, Table 13.4, number of Asian dollar bond issues: 1971 1, 1974 0, 1976 9, 1980 18, total 1971–1992 222; new issues of US$47 million in 1975 and US$266 million in 1976. Chia, “Tax Implications and the Asian Dollar Market”, (1978) 20 *Mal LR* 16, at p. 17: “bonds raised in the Asian dollar bond market amounted to US$266 million as against US$47 million in 1975”. ↩
11. Bernauer, “The Asian Dollar Market”, p. 62, reference list: Ben Martin, “The Asian Dollar Bond Market is a Charade, Not a Reality”, *Euromoney*, November 1976, pp. 32–35. ↩
12. Bernauer, “The Asian Dollar Market”, p. 56, Table 9 (source: Bank of Japan): syndicated loans to Asian countries arranged in Hong Kong and Singapore, 53 and 10 respectively in 1979. Bernauer, “The Asian Dollar Market”, p. 56: “Put simply, Singapore gathers deposits from various outside sources while Hong

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Kong deploys them"; liabilities of Hong Kong participants to their Singapore counterparts of $42.6 billion at the end of 1981 against claims of $28.4 billion. ↩

13. Chia, "Tax Implications and the Asian Dollar Market", (1978) 20 *Mal LR* 16, at p. 20: "Hong Kong has an edge over Singapore in that there is no tax on offshore income"; "Hong Kong is known as the 'booking' centre and Singapore as the 'funding' centre because there is no tax on interest on deposits by non-residents"; at p. 24 the Hong Kong profits tax is given as 17.5 per cent. Bernauer, "The Asian Dollar Market", p. 57: Hong Kong "until recently, applied a 15-percent tax" to non-residents' interest earnings; p. 61, note 5, gives the corporate tax rate as 16.5 per cent in Hong Kong against 40 per cent in Singapore. ↩
14. Bernauer, "The Asian Dollar Market", p. 57: "since February 1982, when Hong Kong abolished its tax on non-resident interest earnings, its ADM deposit liabilities have grown by more than 50 percent." ↩
15. Ngiam, "Singapore as a Financial Center", p. 359: the transformation of Hong Kong "gained momentum after 1978 when the government lifted its moratorium on the issuance of new banking licenses". ↩
16. Bernauer, "The Asian Dollar Market", p. 60, quoting the MAS Annual Report for 1979: "Between January 1972 and March 1973, ACU interbank deposits with Singapore banks increased by an incredible 259 percent. The upshot was excess liquidity at home which threatened Singapore's exports." ↩
17. Ngiam, "Singapore as a Financial Center", p. 361: "The opposition of the Monetary Authority of Singapore (MAS) to the internationalization of the Singapore dollar (through limits on lending overseas and borrowing by nonresidents) is perhaps the most controversial." ↩
18. Bernauer, "The Asian Dollar Market", p. 60: "Prior to the inception of the Asian dollar market in 1968, the share of GNP that consisted of financial and business services amounted to 8 percent, but in 1980 this ratio stood at more than 18 percent.". Bernauer, "The Asian Dollar Market", p. 60: "In 1981, the

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balance of trade deficit amounted to $6.3 billion, of which 60 percent was offset by the net surplus on the service account.". ↩

19. Bernauer, "The Asian Dollar Market", p. 60, on employment growth in the financial sector between 1970 and 1979 and a proportion of skilled workers "nearly twice that for the economy as a whole". Ngiam, "Singapore as a Financial Center", pp. 362–363 and Table 13.1: ACUs accounted for 66.2 per cent of the total assets of the financial sector in 1993, compared with 0.1 per cent (S$60 million) in 1968. ↩

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