

M R Chatu Mongol Sonakul: National Central Bank and building world peace

Speech by Mr M R Chatu Mongol Sonakul, Governor of the Bank of Thailand, at the 27th International Conference on World Peace “Building a Culture of Peace in the New Millennium”, held in Bangkok on 1 December 2000.

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Members of the Professors World Peace Academy, Participants of the 27th International Conference on World Peace, Ladies and gentlemen.

The history of central banking is normally agreed to have begun around four thousand years ago in the Greece, Roman and other empires up to the middle ages when banks were put up primarily for the purpose of getting finance for governments to wage war. So the first period of central banking cannot very well be said to have been in conformity with the topic I've been asked to talk about here today, which is entitled “National Central Bank and Building World Peace”.

But in the sixteenth and seventeenth centuries and especially later on when industrialisation began in earnest, there were great needs for finance for the many various industries that sprang up around that time. Commercial banks and great finance houses became common but the limitations of the technology of that period of using precious metals as currency became quickly apparent.

Commercial banks began issuing their own paper notes, for the amount of the valuable metals that they had in stock being much more transportable. But human nature being what it is, they also began issuing paper notes equivalent to the value of precious metal which they don't have in the vaults and the various currencies issued by the various banks became devalued very quickly.

Another aspect to the whole thing is that people do cash in paper notes at times and banks have to hold large reserves sometimes up to 30% of their liabilities in order to make sure that they have adequate liquidity that may be used in case of unforeseen events.

The first central banks in its relatively modern form were therefore established to provide the function of being the sole issuer of currencies and the single keeper of reserves as defined by law, notably the Bank of England in 1694 and epitomised in a tome in 1873, Lombard Street by Bagehot, Editor at the time of the Economist, where the concept of the Banking Department and the Note Issuing Department was so clearly explained.

This gave credibility and value to paper currency and it was also a very much more efficient system in that the single reserves at the central bank could be used by the many commercial banks who thereupon kept much smaller contingencies, historically sometimes as low as 4 % of liabilities and accessed the joint “reserves” at the central bank whenever necessary enabling a much more efficient use of financial reserves than each bank having its own large reserves. Thus was born the term “banker to the bankers” and “lenders of last resort”.

Thus, in this way central banking for the first time really became a cornerstone of the building of world prosperity and world peace.

Of course the single reserves might be sufficient under normal circumstances but when things get out of hand, it may not be sufficient, and banks do shut down. The government and the central banks thereupon undertook that most important function of building world peace, which is looking after the poor and the disadvantaged, by putting up deposit insurance schemes, the first being in New York in 1829 but the first nationwide schemes being in Czechoslovakia in 1920 whereby at least the smallest and the least knowledgeable depositors are protected.

Of course, a better alternative would be to try and make banks less liable to failure. Since banks are often in an oligopolistic system or at the very least, they are leveraged by the ratio of debt to equity of around 12:1, being the inverse of the capital adequacy ratio now defined by the Bank for International Settlements to be at least 8%, and using other people's money in a way that normal companies cannot

do - the central bank then underpins the viability of commercial banks by supervising and examining them so that sensible decisions are made and fraudulent activities are minimised.

Surprisingly, that may not even be the biggest way central banks contribute to world peace. For nations taken individually, the biggest function deemed to be of the central banking is monetary policy. By trading in foreign exchange, in local currencies, by credit extension, by rule making, and by setting interest rates, the general level of economic activity can normally be influenced by the central bank.

In so doing, central banks used to try to contribute to peace and prosperity by making sure that the less advantaged or the more useful activities or social class and such like have better access to funds in general or to the funds of the central bank, and in the extreme case even go so far as financing projects and infrastructure.

In the modern world, it is now normally agreed that each national economy is so vast and complex that central banks could be considered to have done very well if it just keeps the country stable and let government build infrastructure and help the poor and private sector trade and invest to economically develop the nation.

The recent trend is that, central banks are now given the sole task of keeping price stability, and is given the independence to do that since if they have no independence, government will, at time ask it to do things that are in conflict to that sole function.

Thus the modern central bank is really akin to keeping peace in the nation through enhancing stability and it's other people's jobs to create wealth or turmoil as the case may be, the turmoil being a necessary instrument in coming to the right policies or at time the wrong ones or in an ever worse ending turmoil without apparent purpose as is so often the case in emerging markets.

But it certainly is not now deemed the function of the central bank to be doing this sort of thing. So central bankers can now claim that they are basically trying to create peace and hopefully in a peaceful economy, there will be better prosperity than a wildly gyrating one.

In a peaceful economy, growing stably at a high but sustainable rate, one cannot expect that there will be no criminals hidden deep down somewhere inside the society. A new instrument has therefore been added to the arsenal of monetary policy and financial supervision in the anti-money laundering legislations.

The first anti-money laundering legislation was issued in 1970 by the US government. The mechanism is generally that cash deposit of more than the minimum stipulated amount would be examined.

In the case of Thailand, this legislation was issued in April and became effective in August 1999. The central bank participated fully in the draft and cooperates with its implementation.

We have taken the option though that central banks should be trying to put up a good system for people to operate in rather than having another prime function of catching thieves and criminals, and in this legislation therefore a new independent government office has been put up dedicated solely to the pursuit of the articles of the legislation.

We sit on the committee under the legislation as I have just said, and cooperate wherever we can to make sure its execution is effected and effective. This is another occasion where central banks contribute directly to peace in that criminal activities which by nature are not peaceful is kept to a minimum.

Speaking of criminal activities, vote buying in an election is also a criminal activity and although legislation makes it difficult for us to tackle this problem, we cooperate with the Neutral National Election Commission in tracking down movement of funds and we have assigned an assistant governor to directly coordinate with this Commission.

The banking laws in Thailand at present though is that banking activity is secret and this inhibits us from doing as much as we could to help in curbing this criminal activity. New legislations, both in the central bank act and financial institution act will empower the central bank to have much more ability to manage the nature of commercial banks and will follow the principle of transparency when we shall

be able to do much more for such an important event as a national election and hopefully then commercial banks would be much less inclined to cooperate in less than virtuous activities.

Whilst it is probably true central banks of the modern era spend so much time in trying to stabilise national events, the biggest single cause of untold misery, poverty, death and famine in the modern economy is probably neither disease nor natural events, but it is the ever more frequent financial and currency crises and many central banks in many economies have been helpless in this prevention.

There are now many international fora to tackle these problems, but all of them now are bent on making emerging markets behave themselves better with a better system, monitor themselves better and monitor what's going on in the rest of the world, the latter is actually an impossibility.

All financial transaction of significance is now computerised. A central bank with any kind of competence will have good access within the nation and understand and manage their own destiny. Given a reasonable government and even minimal legal system, each nation should be able to keep peace and stability.

But international transaction is something else. No amount of computer capability will enable you to access the computers of the money centers of other countries, and of the off-shore center of the world. These are vast sum that we are talking about, directed at an opportune moment on markets which are not yet sophisticated, deep or varied and for political or financial reasons are at the time vulnerable somehow.

In Thailand, for instance in 1997, the amount of non-resident baht moved in that year was 900 billion dollars when our total GNP was only 140 billion dollars.

When that kind of money moves against a nation, there is really no way a reasonable defence could be made. Of course, the important powers of the world say that the country should behave itself better, but one has to ask a question why important powers of the world try to make sure that each country behaves itself, yet allows the international monetary system to behave totally as it wishes without due regard to responsibility or the misery and famine that such events could cost.

The obvious answer is that all the major important money centers and funds are in the advanced countries and the major countries systems being much more diverse is less liable to collapse when there are large movements of funds in any particular sector.

Banking in Thailand for instance provides 77% of all credit available in the country at this moment while in the US it is only 26%.

Before you ask, we are of course trying to rectify this, trying to get banking down to 55% of total credit by the year 2010, and in the last three years, somehow we have got the debt market which was before then nonexistent to be double the size of the stock market.

But it takes life times and generations to change people's habits and the nature of the country. The world monetary system could in fact be monitored quite easily if the superpowers of the world would only wish it to be done. It sends forces to keep peace in other countries, so it could quite just as well impose a system, a world monetary system that would significantly reduce this kind of crisis. But the only crisis which might have affected the superpowers were the LTCM crisis of the 1998 and the Asian crisis of 1997 and it soon became apparent that the suffering could mainly be kept to the poor nations and so it looks as though nothing good is going to happen in the international arena.

Let me end my statement therefore by saying that before coming here I looked at the list of speakers and participants and was truly impressed by the diversity and excellence. I have therefore tried to put some interesting thoughts in the area of national central banking for your perusal.

All of us here wish for peace and prosperity in the world. Each of us a little bit or a lot depending on the occasion can contribute to peace. So I truly hope that whenever the opportunity arise we will do our part to try and put up a better world monetary system at which tasks the emerging countries are so powerless.