CENTRAL BANK OF THE PHILIPPINES

BANGKO SENTRAL NG PILIPINAS

JANUARY 3, 1949 - JANUARY 3, 1974

CENTRAL BANK OF THE PHILIPPINES

JANUARY 3, 1949 - JANUARY 3, 1974

Published by the
Central Bank of the Philippines
on the occasion of its 25th anniversary
on January 3, 1974

Printed in the Philippines

Tanggapan ng Pangulo ng Pilipinas
(OFFICE OF THE PRESIDENT OF THE PHILIPPINES)

Message

The story of the Central Bank of the Philippines is an essential and integral part of the national epic of building a better life for the Filipino people.

As our primary institution in formulating monetary and credit policies, the Central Bank has been a potent instrument for social progress and economic growth, in conjunction with the various developmental agencies of the Government.

In the years ahead – with the Government now adopting a total and systematic approach to the improvement of all aspects of Philippine society – it is envisioned that the Central Bank will play an increasingly greater role in the attainment of our national objectives.

I am pleased to note that this book, published on the occasion of the Central Bank's silver jubilee, provides valuable insights to Filipinos who wish to familiarize themselves with the policies and practices of central banking. In this respect, the new book is a signal contribution to our people's understanding of their stakes in the national economy.

I hope that past achievements will inspire the Central Bank to scale greater heights of achievements worthy of its position, power and personality as the nation's premier financing institution.

F. E. Marcos

President of the Philippines

1974

Foreword

The twenty-fifth anniversary of the Central Bank of the Philippines marks an important milestone and highlights the Bank's unique position not only in the country, but also among the central banks in the world.

The primary responsibility of a central bank is to maintain internal and external monetary stability. The Central Bank of the Philippines does this, and more. For it has involved itself in the very process of economic development in more direct ways than have most of its counterparts in other countries.

To fulfill its responsibilities, the Central Bank has utilized a number of policy tools intended to influence the availability and cost of credit and to preserve the international value and convertibility of the peso. For the expansion of money supply should parallel the economy's ability to produce goods and services; and the peso rate in terms of international reserves must be at a level most conducive to an equilibrium, if not a strong surplus, in the balance of payments.

Economic and social developments have necessitated adjustments along the way. Central Bank measures have stressed, at different points in time, the maintenance of stability, the reordering of priorities, the rechanneling of investments, the push for rapid growth. Still, the thread and purpose of Central Bank policy have always been in the national interest – more so now considering its role in the building of a New Society for the Philippines.

The history of the Central Bank is, indeed, a chronicle of the Philippine economic performance during the last 25 years. Many of us may not have realized it, but the following observations cannot be denied:

1) The Philippine economy is intrinsically strong, resilient and responsive to policy changes and management aimed at correcting imbalances, achieving stability and sustaining growth; and

2) The Philippines – its people, institutions and leadership – is capable of meeting serious problems and instituting corrective measures on time.

The verdict on the Central Bank's performance, of course, must be made by the Filipino people themselves. But it is a fact that only a small segment of the populace knows what the Central Bank stands for, what it has done in its 25 years of existence and what is expected of it in the years to come.

This book has, therefore, been prepared with that consideration in mind. It is a record of the Bank's conventional activities in monetary and credit policy, as well as its involvement in and impact on international trade, banking reforms, government securities, regionalization, relations with international agencies and service to the common man.

Though the Central Bank's presence and role in the national economy have directly affected the day-to-day life of the Filipino citizen, he is probably little aware of it. This book is an attempt to bridge that gap, to build toward a two-way flow and full public awareness of the meaning of the Central Bank in the context of our national life.

GREGORIO S. LICAROS
Governor
Central Bank of the Philippines

January 3, 1974

RESPONSIBILITIES AND OBJECTIVES OF THE CENTRAL BANK OF THE PHILIPPINES

To enable the Central Bank of the Philippines to perform effectively and efficiently in a developing economy, its responsibilities and objectives are restated and its priorities in objectives indicated in Section 2 of Republic Act No. 265, as amended by Presidential Decree No. 72 dated November 29, 1972, to wit:

> *"Sec. 2.* Responsibilities and objectives. — *It shall be the responsibility of the Central Bank of the Philippines to administer the monetary, banking, and credit system of the Republic.*
>
> *It shall be the duty of the Central Bank to use the powers granted to it under this Act to achieve the following objectives:*
>
> *(a) Primarily to maintain internal and external monetary stability in the Philippines, and to preserve the international value of the peso and the convertibility of the peso into other freely convertible currencies; and*
>
> *(b) To foster monetary, credit and exchange conditions conducive to a balanced and sustainable growth of the economy."*

The objectives of the Central Bank as restated are more in keeping with a central bank's primary role to bring about monetary, credit and exchange conditions conducive to sustainable economic growth. The Central Bank is also given authority over the entire credit system in addition to the banking system.

Contents

TABLES

1 THE CENTRAL BANK'S 25-YEAR ROLE IN THE PHILIPPINE ECONOMY

The establishment of the Central Bank a quarter of a century ago marked the beginning of a new and challenging era in the struggle for national advancement. After laboring long and rather helplessly under the constraints of the dollar exchange standard, Filipinos at last found in the Central Bank and in the adoption of a managed currency system the means with which to exercise greater self-determination in the conduct of their economic affairs.

UNIQUENESS OF CENTRAL BANK FUNCTIONS

Since its inauguration, the Central Bank has been one of the most talked about but perhaps least understood institutions in the country. This paradox may be explained partly by the unique role it plays in the economy and partly by the confidential nature of its functions.

Functionally, the Central Bank differs from the operations of ordinary banking institutions. Unlike other banks, it does not accept deposits from the public or extend loans directly to individuals but serves mainly as a "bankers' bank," aside from acting as fiscal agent and adviser to the Government. Consequently, it should not be judged in terms of the development projects it has financed directly or deposits it has accumulated. Profit is not an objective; rather its Charter-defined goals are of national import with far-reaching but not readily identifiable consequences.

Central bankers all over the world are generally reputed to be tight-lipped about their activities. In the Philippines, the need for keeping in strict confidence certain information related to money and banking is often determined by the nature and timing of Central Bank policy decisions. Thus, any premature disclosure of changes in monetary or exchange policy could trigger off speculative activities which could disrupt or affect adversely the entire economy. On the other hand, the Central Bank is also a reliable source of economic information and data considered useful in decision-making activities.

To the general public, the effects of central banking activities may be difficult to pinpoint or assess. The Central Bank's existence is most tangibly evidenced by the peso notes and coins in circulation. Philippine peso notes and coins, which are liabilities of the Central Bank, emanate from the institution's function as a bank of issue. The legend, "Ang salaping papel na ito ay isang bayarin ng Bangko Sentral," appears on every issue. This serves as a constant reminder of the Central Bank's responsibility to preserve the value and integrity of the peso.

Essence of Central Banking

The real thrust of the Central Bank's functions lies in its influence over money and credit flows and the country's external payments position to promote growth under stable conditions. The Central Bank's performance is primarily anchored on how well and how effectively it has used its powers and influence to attain its objectives.

Under its original Charter, the general objectives of the Central Bank consisted of: maintenance of monetary stability; preservation of the international value and convertibility of the peso into other freely convertible currencies; and promotion of a rising level of production, employment and real income.

To amplify these objectives, Presidential Decree No. 72, upon recommendation of the Joint IMF-CBP Banking Survey Commission, amended the Central Bank Charter with more clearly-defined goals:

"x x x

a) Primarily to maintain internal and external monetary stability in the Philippines, and to preserve the international value of the peso and the convertibility of the peso into other freely convertible currencies; and

b) To foster monetary, credit and exchange conditions conducive to a balanced and sustainable growth of the economy x x x" [1]

To achieve these objectives, the Monetary Board has been granted broad powers and functions. Besides credit control and monopoly of currency issue and custody and management of foreign exchange reserves, the Central Bank regulates and supervises the operations of the banking system and exercises regulatory powers over non-bank financial institutions.[2] It performs clearing functions and has custody of reserves of commercial banks. It acts as fiscal agent and financial adviser to the Government. The Central Bank has also been authorized to collect through the banking system national revenue taxes, customs duties and other levies including the stabilization tax.[3]

Over the 25-year period, Central Bank strategy in pursuing its objectives took the form of exchange and trade controls in the 1950's; monetary and credit regulation in a "free" economy with an adjusted but fixed exchange rate in the 1960's; and in the 1970's, monetary and credit management, external debt management and regulation of certain exchange transactions under a basically "floating" currency.

CENTRAL BANK PARTICIPATION IN PHILIPPINE ECONOMIC HISTORY, 1949-1974

During the past 25 years, the Central Bank's participation in pursuing the national economic goals of growth and stability has been under three major areas of activity, namely:

1) promoting the development and growth of the financial structure;

2) influencing the level and pattern of money and credit flows; and

3) managing the country's external accounts.

Development and Growth of the Financial System

The effectiveness of a central bank generally depends on the stage of development of the economy where it operates, particularly its financial system. In countries where large segments of the population belong to the low-income, subsistence level group with little or no cash holdings and where market transactions are conducted more on a barter basis rather than with money or credit, monetary policy would be ineffectual and a central bank, or any bank for that matter, may not be useful or needed at all. In contrast, central banking plays a pivotal and indispensable role in developed countries like the United States, England or Germany which are serviced by sophisticated and efficient financial systems.

Between these two extremes are the developing countries like the Philippines. Although at varying stages of economic growth, most developing countries share a dualistic nature – the existence of progressive, relatively industrialized and sophisticated societies (usually in urban areas) alongside relatively backward, non-money or non-credit-using societies (often in rural areas).

In many of the countries where the banking or financial system exists in rudimentary form, central banking is concerned with the development of the financial sector not only to service the growing needs of a developing economy but also to create an environment which will enhance the effectiveness of monetary management.

Need for Developing the Financial Structure

In the Philippines, there still exist non-monetized sectors which were dominant during the earlier years. As a result, the effectiveness of monetary measures has been limited. Moreover, a significant number of income earners with surplus funds need to develop banking habits that place more funds and resources within the influence of monetary policy. Efforts are still being constantly exerted to foster the sound and orderly development, growth and geographical diffusion of banking institutions to service the banking needs of a wider area and to extend the monetized sector and enhance the effectiveness of monetary policy.

Growth of the Banking System

During the first two decades of its existence, the Central Bank endeavored to encourage the growth of the banking system. With liberal minimum capital requirements and other incentives for the establishment of banks, the banking community grew phenomenally during the 1950's through 1960's.

From 11 banks with total assets of ₱1,009 million in December, 1949, the commercial banking system expanded to 18 banks with resources totaling ₱2,224 million in December, 1959. By December, 1960, their number reached 40 with ₱12,-050 million in resources and by June, 1973, 39 commercial banks with assets valued at ₱23,480 million were operating after one new commercial bank was opened in July, 1971 while two banks were in the process of liquidation.

Financial Development Problems

The proliferation of banks gave rise to such problems as overcrowding in the metropolitan areas and uneconomic fragmentation and weaknesses in the capital structure. By the mid-1960's, Central Bank policies were directed toward strengthening the capital structure by raising the required minimum capitalization and by encouraging mergers and large-scale or branch commercial banking.[4] These moves were taken not only in response to the growing needs of development but also to protect bank creditors, particularly bank depositors.

The policy of strengthening the financial structure of commercial banks continued and was emphasized anew in April, 1973, when the Central Bank launched a program to encourage existing private domestic commercial banks to increase their paid-in capital to at least ₱100 million. The overall objective was to build the private sector's paid-up capital base of the commercial banking system to ₱3 billion within the next three years.

Equity participation by foreign banks in local banking institutions was also encouraged and a team of consultants was organized to help and advise interested parties on bank mergers. All these measures prepare the commercial banking system for the growing requirements and the expanded role which commercial banks are to assume in development financing under the New Society and ensure the safety of bank deposits, strengthen public confidence in the banking system and help encourage savings.

As a vital determinant to economic growth, savings must be encouraged as an integral part of the development effort. Thus, early in 1973, a national savings campaign was initiated by the Central Bank to educate people to deposit in banks and encourage them to save in forms consistent with development requirements.

Credit Dispersal

The dispersal of commercial bank credit outside the Greater Manila area was sought to be encouraged by a policy adopted in August, 1969 and clarified in June, 1970 and in January, 1973 which required commercial banks to invest a portion of their deposits in the particular region where such deposits have been accumulated.

To broaden the money sector and to diffuse banks particularly in the rural areas, the Rural Banks Act (Republic Act No. 720)[5] was enacted on June 6, 1952. As a result, the network of rural banks grew from 18 banks in 1953 to 135 in 1959 to 452 in 1969. The total resources of rural banks likewise rose from ₱2.4 million in 1953 to ₱61.2 million in 1959 and ₱562.8 million in 1969.

The Central Bank, in the 1970's, decided to expand the rural banking network at the rate of 100 new banks yearly from 1971 to 1975 in addition to some 500 rural banks already operating by end-1970. By August, 1973, there were already 613 rural banks. Besides providing banking facilities and services needed in outlying sectors, rural banks have helped rechannel loanable funds from urban centers and external sources to farmers and producers in rural communities.

The establishment of Central Bank regional offices in strategic areas may also be considered an integral part of the effort to widen the monetized sector and diffuse banking facilities. By performing regional clearing functions, the Central Bank hastens wider public acceptance of banking services and facilities.

Growth of Other Credit Institutions

Along with the growth of commercial and rural banks, the specialization and diversification of banking services were enhanced as savings banks, private development banks and savings and loan associations expanded appreciably. Other institutions such as investment houses, finance companies and other entities engaged in specialized credit were also established without Central Bank authorization.

The Central Bank's authority, however, was extended to non-bank financial institutions under P. D. Nos. 71 and 72 which instituted financial reforms recommended by the Joint IMF-CBP Banking Survey Commission.

Development of Government Securities Market

The Central Bank, in the mid-1960's, also figured prominently in creating and developing a government securities market. A significant development in May, 1966 was the flotation of treasury bills to the public at market rates without Central Bank support.[6] Since then, trading in treasury bills, tax certificates, treasury notes, bonds and more recently, Central Bank Certificates of Indebtedness (CBCI's), has been sustained.

The development of this market will not only provide the Government with an alternative means of financing which is relatively less inflationary and which promotes a more efficient use of funds but will also help enhance the effectiveness of open market operations as a measure of monetary control.

Control over Liquidity Flows

The essence of central banking lies in its efforts to influence the level and pattern of liquidity flows. Mostly by controlling the availability and cost of credit, the Central Bank tries to maintain liquidity at levels which will ensure monetary stability as the economy develops and grows.

The importance of maintaining liquidity at adequate levels has time and again been demonstrated. Too little or too much of money and credit both bring dire consequences to the economy. Inadequate resources may slow down growth while excessive expansion of credit can generate destabilizing pressures which push up domestic prices, create balance of payments difficulties and erode the external value of the currency. The events which led to exchange reforms or the "floating rate" in February, 1970[7] dramatized this point. For this reason, the Central Bank kept a close watch over prices, domestic credit, monetary and balance of payments movements and other economic indicators.

During the 1950's, monetary management took a backseat to exchange and trade controls which the Central Bank then administered. At that time, with the financial system still in the initial stages of development, monetary policy was less effective than in the succeeding years.

Moreover, the stimulation of import demand and the destabilizing pressures exerted on the balance of payments as a result of excessive expansion in liquidity were dealt with by exchange and trade restrictions. It was in the 1970's after controls were lifted and thereafter that monetary management was faced with the challenge of a "free" market, which was met by the Central Bank primarily with monetary measures.

In regulating money and credit flows, the Central Bank has been impeded not only by structural imperfections of the financial system but also by the limitations of the instruments of monetary control and the scope of monetary policy.

Although the Central Bank has been empowered to resort to techniques available to most central banks (e.g., changes in reserve requirement, rediscount rates, portfolio ceilings, open market operations, moral suasion, etc.), local conditions have limited the range of choice to the traditional monetary instruments. Measures better suited to Philippine conditions, such as variable reserve ratios, rediscount, ceilings, cash margins and/or time deposits against import letters of credit and other selective credit measures, have been tried with some effectiveness.

To adopt itself and respond promptly and appropriately to changing conditions and the exigencies of the times, the Central Bank resorted to other and improved tools of monetary action. In the 1960's, the management of government deposits in commercial banks was used although, this too had its failings. In 1969, the imposition of ceilings on bank credit was tried with more satisfactory results.

More recently, in 1972, two potent devices for influencing liquidity levels in the economy were found in the management of Central Bank Certificates of Indebtedness (CBCI's) and swap transactions in foreign exchange.[8] By pacing the issuance of CBCI's and the disposition of CBCI proceeds, the Bank was able to influence not only liquidity levels but also the industrial, sectoral and geographical direction of money and credit flows. Similarly effective was the control of swap transactions in foreign exchange emanating largely from foreign currency deposits and foreign borrowings.

Conflict in Pursuing Growth and Stability

One difficulty of monetary management in developing economies is the conflict which may arise in the pursuance of growth and stability objectives, particularly in the short run. At times, measures to accelerate growth may also generate destabilizing pressures. Conversely, stabilization efforts may tend to slow down or even stifle growth. In the long run, however, it is generally conceded that economic development and growth are best achieved under stable conditions. Monetary stability is essential to the development effort in promoting savings, encouraging investments and efficient utilization of resources.

To reconcile the contradictory nature of these measures, the Central Bank relies on selective credit measures. Most notable is the use of cash margins and/or special time deposits against import letters of credit. Another selective instrument is the establishment of rediscount quotas or ceilings for commercial banks.

Other qualitative instruments tried at one time or another were the ceilings set on the portfolios of commercial banks for certain types of loan assets. In April, 1957, the Central Bank adopted a system of credit priorities which was first applied on the portfolio ceilings imposed on bank credit.[9] The system was revised in June, 1966,[10] and served as a criterion in the rediscounting operations of the Central Bank.

Policy Coordination

The scope of monetary policy has been limited because it can influence only the cost and availability of credit. Monetary policy applies mostly to the regulation of credit transactions of the banking sector, one of the three major sectors (along with the Government and the external sector), which have the power to expand or reduce money supply.

Despite its limitations, however, monetary policy rather than fiscal policy has been relied upon heavily for stabilization purposes, notably during the latter half of the 1960's. Credit restraint during this period contributed to the shift in the flow of resources to the public sector which enabled the Government to continue implementing development projects, including the infrastructures undertaken at that time.

Efforts to promote policy coordination and cooperation at various levels not only within the government sector itself but between government and private sectors were reflected in the membership composition of government policy-making bodies and the various inter-agency committees organized for specific purposes.

The composition of the Monetary Board, which used to be chaired by the Secretary of Finance, is intended to insure the coordination of monetary and fiscal policy. Under the amended Charter, significant changes in the Board's composition have been made.

The Governor has been designated Chairman while the Secretary of Finance continues to sit as member. The membership of the Chairman of the National Economic and Development Authority and the Chairman of the Board of Investments vice the President of the Philippine National Bank and the Chairman of the Development Bank of the Philippines is expected to enhance the coordination of monetary and fiscal policy with the overall economic policy. At the same time, the Governor is a member of the highest economic policy-making body, the National Economic and Development Authority.[11] Better coordination is also pursued at lower and working levels with the formation of various inter-agency committees formed for work in specified areas such as price control, rice and corn policy and development budgeting.

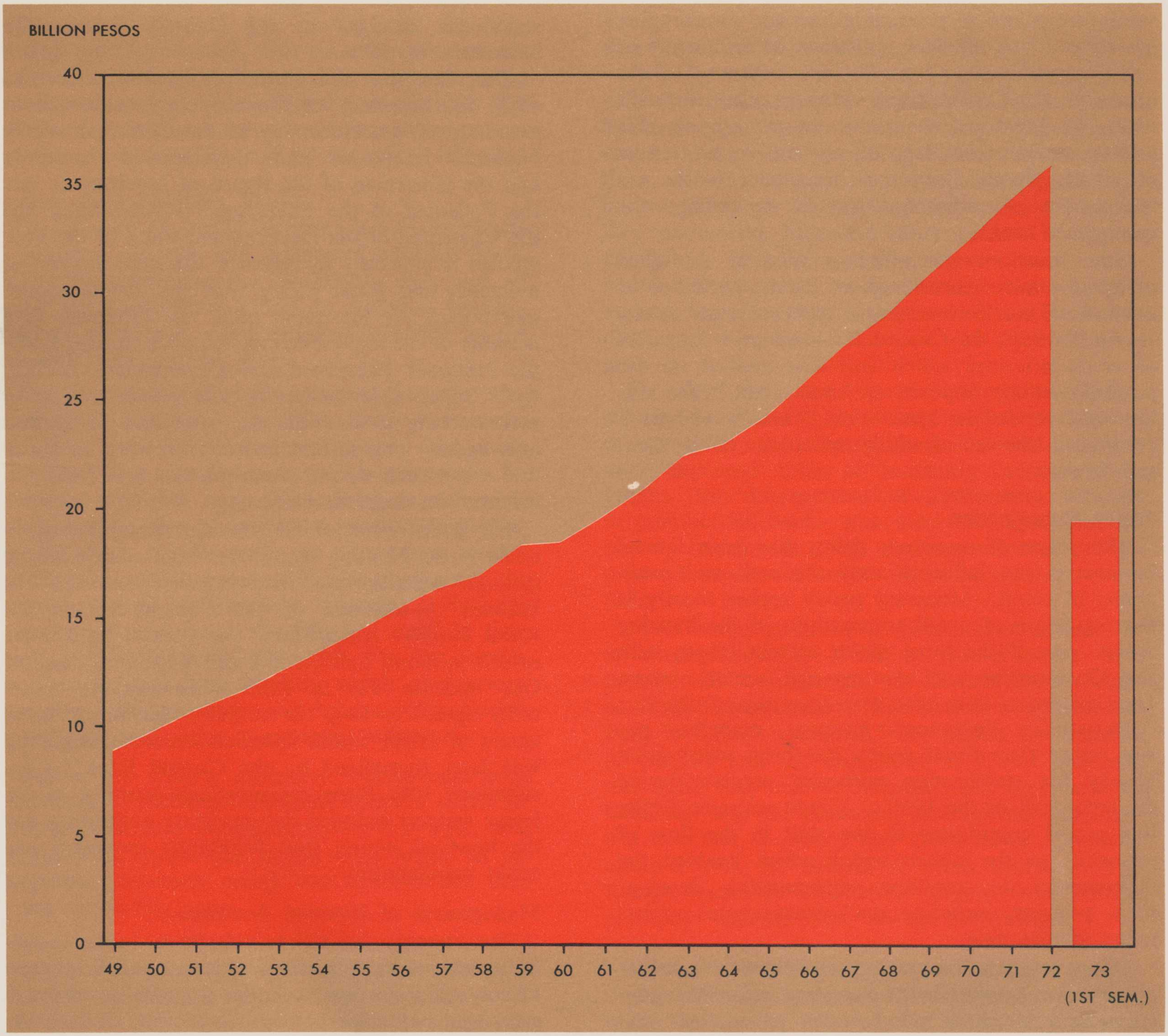
The cooperation of the financial community, particularly the banking sector, has been sought mostly through consultations with organizations like the Bankers Association of the Philippines and the Rural Bankers Association. The Central Bank often resorts to moral suasion as a tool of monetary action. One instance was in 1969 when bankers voluntarily agreed to keep the monthly volume of import letters of credit within specified limits although this was later formalized by the Central Bank.[12] Consultations with these organizations continue to enhance rapport between the monetary authorities and the financial sector, thus facilitating monetary and credit management.

Management of External Accounts

The strategy to maintain balance in the country's external accounts has undergone three phases: 1) controlling foreign exchange expenditures through exchange and trade restrictions at levels which the

GROSS NATIONAL PRODUCT AT 1967 PRICES

1949-1973



economy could afford; 2) decontrol and the operation of the free market; and 3) the institution of currency reforms under the Stabilization Program of 1970, strengthened by major economic, political and administrative reforms under Martial Law.

Although the time boundaries which distinguish one phase from another may overlap, the first phase may be considered as corresponding to the decade of the 1950's and the second and third phases as occurring during the decades of the 1960's and 1970's, respectively.

The Decade of Controls

During the first decade of the Central Bank, the country was involved in rehabilitating and reconstructing the economy, particularly in the earlier years, and in the development effort later on. The balance of payments problems confronting the country emanated mostly from the rising import bill coupled with insufficient and unstable export earnings. Exchange expenditures were inflated by the rising import requirements of reconstruction and development and the buying spree for imported goods following the end of World War II. At first, the trade deficit was financed largely by U.S. Government expenditures which included war damage payments and veterans' backpay outlays. When receipts from this source tapered off, the international reserves dropped to a level which required drastic remedial action in the form of controls.

Originally intended as a stopgap measure, exchange and trade restrictions remained enforced until the end of the decade. Despite the defects of controls – which included difficulty of implementation, the negative nature of the measure itself and the blackmarket, graft and corruption and the over-protection of inefficient industries – exchange and trade restrictions nevertheless contributed to the establishment of industries engaged in the manufacture of import substitutes.

In a way, controls spurred what may be considered the beginning of Philippine industrialization. With the protection and built-in subsidy afforded by controls and the exchange rate system at that time, the share of the manufacturing sector to the Net Domestic Product (at factor cost) rose from 12.6% in 1949 to 19.0% in 1960 (based on 1967 prices.)[13]

Notwithstanding the establishment of light industries, many of which were merely assembling and repacking plants, the import bill continued to grow as the demand for imported goods did not decline but instead shifted from finished consumer goods to raw, semi-processed and other materials needed as inputs for existing plants. Moreover, notwithstanding the 17% exchange tax and the other measures adopted to close the gap between the official exchange rate and the blackmarket, the external value of the peso continued to deteriorate at the expense of the export sector, a situation which called for a change in strategy.

Decontrol and the 1960's

With the view to lifting quantitative restrictions on foreign transactions and restoring the free market or free enterprise economy, a gradual decontrol program was launched on April 25, 1960. The program was originally conceived to consist of four stages lasting four years, but was subsequently accelerated due to favorable initial results. Initially, 25% of foreign transactions were thrown on a free market to be governed by an administratively set free market rate at least in the opening stages. Later in the year, about one-half of foreign exchange transactions was placed on a free market status.[14] On January 21, 1962, all remaining restrictions on foreign exchange transactions were removed except that 20% of export receipts were to be sold to the Central Bank at two pesos per U.S. dollar.[15] It was not until 1965, however, that the official parity of the peso vis-a-vis the U.S. dollar (for the first time since 1903) was changed to the level (₱3.90 to U.S. $1) prevailing in the free market since the middle of 1962.[16] The economy thus continued to operate "freely" until recurring balance of payments deficits again required restrictions on certain foreign exchange transactions.

With controls lifted, the Central Bank had to resort mainly to monetary measures to maintain stability. At this time, any excessive build-up of liquidity almost inevitably pushed up domestic prices, stimulated import demand and caused external