STRIKING A BALANCE IN GOVERNMENT REGULATION OF PRIVATE AND PUBLIC CREDIT

Contemporary historians recall that as President Manuel Roxas stood to deliver his address on July 4, 1946, his eyes were misty with tears as he surveyed the milling throng around him and saw their heads held high on that first day of our political freedom but with their bodies barely protected against the setting of the ruins of liberation, which, to him, could have only suggested the beginning of the far more difficult fight for economic liberty. Tonight, ladies and gentlemen, I shall discuss one aspect of the government's role in this struggle and lay down suggestions for striking a working balance in its regulation of private and public credit.

In the United States, the power of the Federal Government over money, banking, and credit is as great in economic scope and significance as any of the powers granted to Congress by the Federal Constitution. The development of this broad power has been largely due to the statesmanlike interpretations of the United States Supreme Court. *McCulloch v. Maryland*[1] is a leading example of the wise influence exercised by the Court over banking and commercial questions.[2]

Similarly, the broad power conferred upon the Philippine Congress by Article VI, section 1 of the Constitution which provides that "the legislative power shall be vested in such Congress" lays ample basis for its regulation of private credit.

Regulation of private credit by Congress has not, however, followed a regular pattern during these last years. It has gone with the fluctuations in the economic growth of the country. During the months of 1953, for instance, the monetary and credit policy moved from qualitative restraint in midyear 1953 to positive ease in the later part of the same year. Consequently, domestic lending operations of banks expanded considerably, registering a total of new loans, discounts and overdrafts, including renewals granted by commercial banks which amounts to ₱79.9 million in 1954, as compared to ₱606.0 million in 1953. Undoubtedly, this credit expansion was largely due to the liberal exchange and partly to the reduced discount rate of the Central Bank.[3] This liberal credit operation continued until 1955 and late 1956.[4]

In the following months, climaxing in 1958, a return to the earlier pattern of restricted credit operation has been and shall be felt.[5] This has been brought about by the considerable flotation of

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1 4 Wheat. 316 (1819).

2 CHARLES C. ROHLING, *et al.*, BUSINESS AND GOVERNMENT 469 (4th ed.).

3 CENTRAL BANK SIXTH ANNUAL REPORT 106 (1954).

4 Fanny Garcia, *et al.*, *Public Borrowing Policy for 1954* in THE FIVE-YEAR ECONOMIC AND SOCIAL DEVELOPMENT PROGRAM FOR FISCAL YEAR 1957-1961 224.

5 *Ibid.*

government bonds and the consequent injection of additional currency into the monetary stream of the country. To continue with the liberal policy hitherto followed would have increased further the monetary supply such that inflationary pressures would have become a real threat.[6] Not only has the policy been one of restriction in granting the amount of loans but also one which follows a selective basis, that is, a requirement is made respecting the use of the loans to highly productive enterprises.[7]

The 1957-1961 fiscal program of the administration contemplates a relaxation of this stringent credit policy in the following years.[8] The government has realized the need for relaxing the policy on credit operations with the private sector. The late President Magsaysay pointed out the problem in this wise:

> "The orientation and rigidity of present credit facilities is one of the principal handicaps to private entrepreneurial activities. In our present situation, the total supply of credit available to the private sector is inadequate owing largely to our low rate of savings. ...The medium and long-term credit requirements of bona fide prospective entrepreneurs are inadequately covered. This is the central financing problem of the private sector.
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> "It is obvious that the financial structure of the banking community needs to become much more flexible to make medium and long-term credit available on a more selective basis, in large amounts, and on more reasonable terms to deserving borrowers wishing to undertake new productive enterprises...."[9]

To accelerate the expansion of private credit resource, the administration plans to support private credit directly with public funds. This plan is contemplated to be put into operation beginning with fiscal year 1959. It involves granting direct loan funds from government resources and providing a larger base for credit expansion.[10] Thus far, we have a broad picture of the government's regulation of private credit. Let us next consider how far it has exercised any similar restraint in its use of the public credit.

On the question of public indebtedness, the Constitution lays down this provision:

> "Art. VI, sec. 18. All appropriations, revenue or tariff bills, authorizing increase of the public debt, x x x shall originate exclusively in the House of Representatives, but the Senate may propose or concur with amendments."

The flotation of bonds and other forms of obligation is a legislative function. Such obligations are paid from proceeds of taxation. Because they create public indebtedness, bills authorizing their issue must originate from the House of Representatives.[11]

The Jones Law and the Independence Act contained fixed limits on bonded indebtedness. On the other hand, the Constitution has no

6 *Ibid.*

7 Pres. Ramon Magsaysay, *Budget Message to Congress* in 1 BUDGET FOR THE FISCAL YEAR 1958 14-A *et seq.*

8 *Op. cit. supra*, at 7A-8A.

9 Note 7 *supra.*

10 Note 7 *supra.*

11 SINCO, PHILIPPINE POLITICAL LAW 204 (10th ed.).

such limitation because it is assumed that the Philippines, being now an independent country, should take care that it does not exhaust its public credit. The question of determining the necessity of issuing bonds is a political one which lies within the domain of Congress.[12]

Resort to public borrowing is brought about by the insufficiency of government funds to be used for economic development. The late President Magsaysay declared "that even with the increase in revenue by 43.7 million pesos, the ordinary income of the government is not sufficient to provide for all essential services ..... Our principal difficulty, today, as at the beginning of our administration, is still lack of funds." [13]

To raise these needed funds, the government has only three choices, namely, (a) postpone the execution of developmental projects and limit development expenditures to the meagre amounts from government revenues, (b) borrow money from abroad, and (c) sell bonds to the banks. Of the three, the last is the easiest to resort to. This method of resorting to the national credit has been called in some countries as "deficit spending".[14] While the government has partly realized the funds it needs, its indebtedness, however, has also skyrocketed. Excluding a direct issue of four million pesos, total public bonded indebtedness (including local governments and the Metropolitan Water District), as of June 30, 1955, for instance, amounted to ₱105,765,080.90, or an increase of ₱78,077,765.00 over that of June 30, 1954.[15]

All are in perfect accord that the Philippines should expand economically. In fact, if I may digress for a moment, the national election we just had revealed the truth of this statement. Candidates who had no chance before to be casually acquainted with economics turned, for once, to peddling their pet nostrums of economic expansion, and slogans which used to be identified with the crusade for political independence were expertly dressed up in the trappings of economics. Thus, it must be admitted that for lack of ready funds, the government may resort to the use of the public credit.[16] And because of the fact that the stability of the currency is directly related to the sum of the money supply flowing from the use of public and private credit, any emphasis on the former calls for a corresponding restriction on the latter if the stability of the currency is to be maintained.

The considerable use of the public credit of late has, consequently, resulted in the marked limitation of private credit. This is, obviously, not conducive to sound economic growth. Any such restriction ought to be brought down to the minimum.

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[12] *Ibid.*

[13] Pres. Ramon Magsaysay, *State of the Nation Message to Congress*, January 24, 1955.

[14] Miguel Cuaderno, Sr., *Bond Issue for Economic Development*, Central Bank News Digest, June 17, 1955, p. 14.

[15] CENTRAL BANK SIXTH ANNUAL REPORT 37 (1954).

[16] Note 7 *supra*, at 3A-38A; see also Domingo, *Practical Approach to Our Industrial Problems* in 1955 PHILIPPINE YEARBOOK OF COMMERCE AND INDUSTRY 30.

In order to effect the liberalization of private credit, public borrowing should first be reduced. Furthermore, the restrictive provisions of the Central Bank Act should be made to conform with the objective set forth.[17] Finally, the terms of loans should be relaxed by providing for long-term loans and amortization payments scheduled so as to conform with the individual nature of each industry.[18] As a corrolary, the granting of loans should be conditioned on the use of the same for productive enterprises by following strictly what is known as the "selective basis" of loan grants.[19]

Both private and public indebtedness increase the money supply and are, therefore, directly connected with inflationary pressures. Of the two, however, public credit is the more delicate, immediate in effect, and extensive in consequences because while private indebtedness does not involve any addition to the total amount of currency but only adds to the money in circulation, public indebtedness increases not only the money supply but also the total amount of currency itself without any provision on gold reserves.

The Philippine government is run on the basis of deficit spending or the absence of reserves to back up the additional currency issued.[20] It is said, however, that our government will not be in a position to solve the financing problems effectively without using our national credit and accepting deficit spending.[21] It is, therefore, suggested by responsible resources that while recognizing the danger of inflation, twin-brother of public borrowing, we must forge ahead, with open eyes because inflationary tendencies are necessarily entailed by accelerated economic development.[22]

But the danger of inflation and its awesome consequences remain. No less than the Chief Executive made this point clear in his budget message to Congress. Inflationary pressures are expected to be most acute in fiscal years 1957 and 1958.[23] "The aggregate outstanding public debt of the Philippines, as of June 30, 1956, amounted to ₱1,514.9 million. It is estimated that the outstanding debt will rise to approximately ₱2,088.0 million by June 30, 1961." [24] Yet, in almost the same breath, the late President Magsaysay declared that the "fiscal program is founded on a declining rate of public borrowing!" What are the prospects of warding off the danger of inflation?

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17 Speech of PNB Pres. A. J. Jison at the Association of Agriculturists Convention, May 5, 1955.

18 Domingo, *op. cit. supra*, at 15; see THE FIVE-YEAR ECONOMIC AND SOCIAL DEVELOPMENT PROGRAM FOR FISCAL YEAR 1957-1961 13.

19 THE FIVE-YEAR ECONOMIC AND SOCIAL DEVELOPMENT PROGRAM FOR FISCAL YEAR 1957-1961 73 *et seq.*

20 The Manila Chronicle, March 6, 1957, p. 1, cols. 4-5.

21 SALVADOR ARANETA, ECONOMIC RE-EXAMINATION OF THE PHILIPPINES 80 (1953).

22 ALFREDO MONTELIBANO, *Planning for Greater Economic Growth* in PHILIPPINE INDUSTRY AND TRADE 9 (1955); see also VERNON A. MUND, GOVERNMENT AND BUSINESS 77 (2nd ed.).

23 1 BUDGET FOR THE FISCAL YEAR 1958 3A-38A.

24 Note 13 *supra*.

We are told that there is no fixed formula for determining the amount of deficit financing that may be safely undertaken.[25] Accordingly, bond issues, particularly the one billion pesos authorized under Republic Act No. 1000, should be carefully watched and coordinated with various economic policies.[26] "Thus, in 1956, price levels on domestically-produced goods increased by approximately 4.3 per cent. It must be recognized that the net injection of ₱230 million from the sale of government securities into the income stream in 1956 undoubtedly was a major and stimulating factor. This will perhaps be augmented even more in the future months as the full impact of increased purchasing power is felt." [27]

A committee composed of technical assistants from the Central Bank and the National Economic Council had, therefore, unanimously recommended the adoption of ₱250 million as the maximum expenditures which might be effected from public borrowings for all purposes during the fiscal year 1957. Under bond authorizations for that year, however, a total cash expenditure of ₱396.4 million was scheduled or exceeding by ₱146 million what was considered by the committee as safe borrowing limits under the prevailing economic situation. It, therefore, offered the stern warning that "failure to revise present program authorizations and expenditure trends within this limitation may well bring serious consequences in terms of spiralling prices." [28] In this connection, it should be understood that the mere sale of bonds does not of itself create inflation. It is only when the proceeds from such sale are used in public expenditures that an addition is made to the money supply, tending to stir alive the forces of inflation. The limit of ₱250 million set by the committee is, therefore, intended as a ceiling to this public expenditure.[29] We cannot close this discussion on the public credit without touching on the question of sinking funds.

Sinking fund has been defined as "that fund credited with receipts transferred from the general fund through periodic installments to meet obligations maturing in the future or to carry out certain operations." [30]

A number of public debts are, unfortunately, without sinking funds. Thus, no statute provides for the servicing of debts contracted under Republic Act No. 266.[31] PNB, BPI, guerrilla, and treasury notes of the government have not been provided with proper sinking funds. Neither was there any fund set aside, until lately, for the Rehabilitation and Development bonds. Payment of these debts on their dates of maturity must have to be effected by increased taxation, where otherwise no such increase in taxes would have been necessary if sinking funds have been adequately provided with. The

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25 Cuaderno, *op. cit. supra* note 14, at 15.

26 CENTRAL BANK SIXTH ANNUAL REPORT 4.

27 Fanny Garcia, *et al.*, *op. cit. supra* note 4, at 221.

28 *Op. cit. supra* at 222-223.

29 *Op. cit. supra* at 224; *see also* note 7 *supra*, at 21A.

30 CENTRAL BANK STATISTICAL BULLETIN 4.

31 REPORT OF THE AUDITOR GENERAL FOR THE FISCAL PERIOD FROM JULY 1, 1954 TO JUNE 30, 1955 xxxi.

President correctly said that the "existence of this floating debt impairs sound financial operations and is a reflection on the financial integrity of the government." [32]

The following suggestions are, therefore, offered in the light of the foregoing observations:

1. Private credit should be liberalized by granting better loan terms;

2. Public borrowing must be held at the minimum in order to avoid the danger of inflation and to render possible the liberalization of private credit;

3. In granting private loans and in using proceeds from bond issues, priority should be given to productive projects; and

4. Sinking funds should be established to cushion the impact of maturing public debts.

Economic stagnation is not the fate of the Filipino people, nor national bankruptcy and ruin their destiny.

Our country, by all fair and legal means, should respond to the need for economic development. It can ill afford to trail behind, much less to drop out from, that restless march which seeks for the nations "flowering time of bread and honey." Our economic sinews should be flexed so that we may yet see in our day, or at least expect our children with some reasonable degree of certainty to see during their day, the meaning of that timeless vision of economic abundance.

Towards that end, the government may use the public credit. There is nothing inherently wrong in public borrowing. It is demanded by the requirements of nation building. In the process, private credit may be reasonably restricted in order to maintain the stability of the currency. It should be observed, however, that such restriction is not normally favored because it strikes against private enterprise. It should, therefore, be resorted to as a necessary remedial measure, not as an economic way of life, and only when the predominant good of the nation overrides the freedom of private credit. Economic development should not be achieved at the expense of private credit, nor national economic sufficiency realized by stifling private initiative. Thus, if the government has to adopt any austerity program, as in fact it has lately, let that program be a cardinal rule not only for the private sector to observe with uncomplaining discipline but also for the government, itself, to live by with religious faith and sustained dedication.

We detest the thought of economic stagnation. But our dread of national bankruptcy is no less. For this reason, while admitting the necessity of floating government bonds and engaging in deficit spending, it should never be forgotten that this is not the end of the story.

Government securities are long-term indebtedness which pass on to the succeeding generation the obligation of the debts incurred

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[32] Note 7 *supra*, at 24A.

in the form of higher taxes.[33] With this thought in mind, it is earnestly suggested that our policy-makers should gear the flotation of bonds to these two basic requirements:

First, a most careful investigation must be made before any bond issue is attempted to ascertain that the injection of currency into the standing money supply would not bring about inflation. This matter is of immediate concern to our people of today because the direct effects of inflation would be felt by them, and

Second, every centavo proceeding from the flotation of bonds must be used for productive, self-liquidating projects. Although we may be burdened and harshly affected by such issues, we find consolation in the thought that those coming after us shall be benefited by the good result of the burden we have assumed. For, indeed, how much burden is shifted on to our children shall be directly proportional to the productivity of the projects for which the bonds are issued.

The President might have had this problem in mind when he said thus in his budget message to Congress:

> "While our fiscal policies must be bold and forward-looking they must at the same time be prudent. We will not be attracted by transitory schemes with utopian appeals of prosperity through a policy of unlimited spending. Nor will we be deterred by a policy of excessive caution." [34]

Just where the line shall be drawn between "utopian appeals" and "excessive caution" is addressed to the policy-making organs of our government.

Let it be said, however, as a passing reminder, that the government exists for the security of those yet to come no less than it stands for the welfare of our people of today. Statesmanship and policy-making dictated only by the noblest of purposes on the highest plenitude of wisdom and transcending, as it were, the inordinate urge for name or glory and the importunities of power should be the constant measure in authorizing any increase of the public indebtedness, lest by some innocent mistake or unpardonable negligence we may unwittingly pass on to those yet unborn, not the security that they expect and to which they are justly entitled, but the heavy cost of the government of the living.

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[33] CHARLES C. ROHLING, *op. cit. supra* note 2, at 469.
[34] 1 BUDGET FOR THE FISCAL YEAR 1958 3A-38A.

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