granted by private banks. Private banks are also encouraged [illegible] grant loans to these activities at lower rates by allowing them a more lenient discount privilege and portfolio ceiling on [illegible] loans.

The loan rates reported by a selected number of banks [illegible] are given below:

Bank	Loan Rate in 1970
B	12 - 14% discounted + 2% service fee [illegible]
A	12 - 14%
C	12 - 13%
D	12 - 13%
E	12 - 14%
F	11-1/2 - 14%
G	11 - 14%

The loan rate reported by some government and government-supported financial intermediaries are as follows:

Development Bank of the Philippines	12%
Philippine National Bank for all loans except for "clean" loans at 14%	12%

It is thought that the actual rates of interest charged by private banks are higher than the usury ceiling rates, though what they report are the rates within the usury ceiling. With the exception of Bank B, the banks sampled did not give any [illegible] cription of the conditions of the loan. No service charges were specified. If these banks behaved as Bank B, the actual rate of interest would be as follows:

a) on 12% loans discounted, + 2% service charge, the actual rate is $\frac{.14}{(1-.12)} = .159$

b) on 14% loans discounted, + 2% service charge, the actual rate is $\frac{.16}{(1-.14)} = .186$

We would expect to find variation in interest rates on loans arise from three sources: the lower rate chosen for government financial institution, the rate charged by banks which follow the Usury Law, and the rate charged by banks which try to subvert the Usury Law.

3. Yield on Government Securities

Government debt in the Philippines consists of Treasury Bills, and intermediate and long-term bonds. The latter have maturities from 1 year to 40 years. Treasury Bills are sold at "competitive" prices (as expressly provided by Law) while intermediate and long-term bonds are sold at par only. Selling these bonds at par means fixing the yield at their stated rates. [We find in Table 4 that these rates range from 2% to 8%, though only a very small portion of the debt, issued in 1969 yields 8%. Majority of the outstanding bonds have rates between 4% and 6%.] On the other hand, Treasury Bills which were marketed competitively gave yields which were much higher than the yields on the longer-term government issues. On government issues, we observe a ~~perverse~~ contrary term structure where yield is negatively related to maturity. A logical consequence of fixing the yield on longer-term issues below the market rate is to make them non-competitive in the market. Table 6 however, shows that there is a normal term structure of interest rate on the competitively marketted Treasury Bills.

However we still find private holdings of government bonds. This may be explained by other credit measures. The Monetary Board permits commercial banks to hold a very large proportion of their reserves in government bonds. Secondly the Securities Act allows stock brokers to file their bond in the form of government securities. Hence we find in Table 8 that the Central Bank and commercial banks hold more than 70 per cent of outstanding government securities. Other financial institutions hold the balance. Private holding is of negligible proportion.

perhaps they haven't noticed — they don't need this figure!

With respect to non-bank financial intermediaries there is no implicit or explicit policy to help them develop. They have not received any assistance from either Monetary or Fiscal Authority. (Government debt Management has not been conducive *contributing* to the expansion of the securities market since long-term government debts are virtually non-marketed securities. The exclusion of long-term government debts from the market naturally narrows down the already small securities market. At the same time, the low loan rates obtained in banking institutions, in particular, in government or government-supported institutions, make loan-financing more attractive than equity financing.

Theoretically, however, the Usury loan ceiling and the Central Bank deposit ceiling are favorable to the development of non-bank financial intermediaries, since in contrast to banks, they are free to issue or place financial assets at rates above these ceiling rates. But as long as banks are able to maintain their relative position, *in expansion w/* vis-a-vis the non-bank financial intermediaries through direct assistance from the Monetary Authority the advantage resulting from the imposition of the ceiling rates on the latter institutions is voided. *ineffective*

In the money market the behavior of three important financial assets is studied - saving and time deposits, Treasury Bills and Bancom papers. This market is dominated by deposit liabilities of the banking sys[illegible] However holdings of

Treasury Bills and Bancom papers have been
rapidly than deposits as shown in Table 7.
deposit liabilities, on the contrary, showe
decline from 1960-1965 period to 1965-1969

This behavior may be explained by the competitiveness of these instruments with respect to bank deposits. The yield on Treasury Bills and Bancom papers in 1966 to 1970 showed an upward trend and averaged about 11% with a range of 5.6-16.7 and 10.9-16.% respectively. On the other hand, deposit rates rose from 5-3/4 to 7 per cent over the same period. The differential yield to suppliers of funds offered by the Treasury and Bancom bills would tend to attract funds to these instruments. The slowing down of the growth on bank deposits during the later half of the 1960's is probably explained by the this rate differential.

(15

A On the other hand, the long-term market is discriminated against by the availability of cheap credit in banking institutions, in particular in government or government-supported banks and by the management of long-term debts of the government. Large borrowers which could otherwise avail of the securities market go to banks which offer relatively lower rates on long-term loans. Hence we find in Table 8 below that a large
portion of gross domestic investment is finance
by long-term loans. Equity financing is
in proportion to total financi

do not augment this market since they are sold at non-competitive rates.

As already discussed previously, Philippine debt management did not encourage the development of the stock and bond market. A small market is vulnerable to wide price fluctuation. Table 9 shows the price changes of the 10 largest issues over the past four years.

The past decade and a half showed quite a rapid growth in banking institutions. Assistance granted for the capitalization of government or government-supported banks such as branches of the PNB, private development banks and rural banks encouraged the growth in their number as shown in Table 10. Additional assistance in the form of advances for current operation helped in increasing the level of their activities as shown in Table 11. Private commercial and savings banks grew faster than government banks inspite of the subsidy to the latter banks. Bank assets grew as follows:

Table 11

FINANCIAL ASSETS OF BANKING INSTITUTIONS
1950, 1955, 1960, 1965, 1969

(In Million Pesos)

YEAR	GOVERNMENT SUPPORTED				PRIVATE				Grand Total
	Philippine National Bank	Rural Banks	Development Banks	Total	Commercial Banks	Savings Bank	Philippine Veterans Bank	Total	
1950	399	-	-	399	526	7	-	533	932
1955	673	8	547	1,228	782	24	-	806	2,034
1960	782	73	603	1,458	1,499	68	-	1,567	3,025
1965	2,298	239	1,327	3,864	4,151	196	29	4,376	8,240
1969	3,876	472	2,768	7,116	7,822	554	198	8,574	15,690
Growth Rate (%)									
1950-55	68.7	-	-	207.8	48.7	242.8	-	51.2	118.2
1955-60	16.2	812.5	10.2	18.7	91.9	183.3	-	94.4	48.7
1960-65	193.9	227.4	120.1	165.0	176.9	188.2	-	79.2	172.4
1965-69	68.7	102.6	99.0	84.2	88.4	182.6	582.8	95.9	90.4

SOURCE: Philippine National Bank Accounts for corresponding years.
Rural Banking Systems Annual Reports
Central Bank Statistical Bulletin

We looked into the activities of the more important non-bank financial intermediaries. These are the two largest investment banks - PDCP and Bancom; and the GSIS and the SSS. These intermediaries grew very rapidly also as shown by the growth of their total assets. The assets of Bancom and PDCP grew from ₱101.6 million to ₱387.7 over the 1965-69 period gaving a growth rate of 282 per cent. SSS assets grew from ₱159 million to ₱363.4 from 1960 to 1965, reaching a level of ₱944 million in 1969, a growth rate of 182 per cent and 160 per cent, respectively. GSIS assets grew from ₱571 million in 1960 to ₱1705 million in 1965, a growth rate of 200 per cent.

In the earlier period, the growth rate of the assets of banking institutions compared well with that of the two insurance agencies. However, between 1965 and 1969, the growth in banking activities slowed down substantially.

Concluding Remark

We have seen how the Usury Law and the various credit measures of the Monetary Authority have affected the development of the financial structure: the types of intermediaries established; the portfolio of financial assets evolved; and the structure of interest rate. The next question to ask is what is the economic cost of these measures? There might be some cost due to interference with financial intermediation and some cost due to poor allocation of funds.

The role of the financial market is to channel the nation's savings into investment. The market, in trying to meet the varied financing requirements of the users of funds and the also varied liquidity requirement and taste of savers and wealth owners, is able to reduce the average cost of funds. For example the intermediaries borrow short and lend long thus being able to provide funds at less than the long rate suppliers of long-term funds would otherwise demand. We have seen that credit measures obstruct the normal functioning of the financial market. When this occurs, intermediaries are not able to diversify the supply of financial assets to meet the varied liquidity and other requirements of the suppliers of funds. This would make the rate of interest higher than in a case of more diversified market, everything else equal.

However, the more important cost of financial interference is in the allocation of investment. Casual observation would point to poor allocation of funds. It is not constructive at this point to mention newspaper accounts which need a more thorough study. It is quite likely that should the Usury Law be repealed and credit measures changed to reflect market rates of interest, (except for clearly socially desirable projects), the problem of allocation will be diminished. We can not over emphasize the danger of having an extensive government banking system given our political tradition.

TABLE 1

Schedule of Changes in Central Bank Rediscount Rates to Commercial Banks
1949 to present (Dec. 7, 1970)

B or M. B. Pesolution	RATES (PERCENT)						
		Preferential Rate					
Date	Basic Rate (1)	Agricultural Crop Loan (2)	Agricultural Packing Credits & Export Bill (3)	Agricultural Papers (4)	Industrial Papers (5)	Export Financing (6)	Rice and Corn Financing (7)
1949 - Aug. 4	1.50	-	-	-	-	-	-
Dec. 29	3.00	-	-	-	-	-	-
1952 - Aug. 7	2.00	-	-	-	-	-	-
1954 - Jan. 19	1.50	-	-	-	-	-	-
1957 - Apr. 1	2.00	-	-	-	-	-	-
Aug. 29	4.50	-	-	-	-	-	-
1959 - Feb. 5	6.50	4.50	5.00	-	-	-	4.50
1960 - June 7	6.00	4.50	5.00	-	-	-	4.50
Sept. 8	5.75	4.50	5.00	4.50	4.50	-	4.50
Nov. 21	5.00	4.00	4.00	4.00	4.00	-	4.00
1961 - May 5	5.00	3.00	3.00	3.00	3.00	-	3.00
1962 - Jan. 8	6.00	6.00	6.00	6.00	6.00	-	6.00
Aug. 21	6.00	3.00	3.00	3.00	3.00	-	3.00
1966 - Jan. 10	4.75	3.00	3.00	3.00	3.00	-	3.00
1967 - June 23	6.00	-	-	-	-	4.75	3.00
1968 - Feb. 27	7.50	-	-	-	-	5.75	4.00
1969 - Apr. 16	8.00	-	-	-	-	5.75	4.00
1969 to present - June 17	8.00	-	-	-	-	5.75	4.00

o February 2, 1969, there was no preferential rate granted by the Central Bank other than the basic rate.