Banking and Financial Reforms in the Philippines

By *Mercedes B. Suleik*

INTRODUCTION

The main function of a financial system in an economy is to facilitate the mobilization of savings and to channel them into productive investment. The financial system provides the principal means of transferring savings from individuals, businesses and government entities to individuals, private enterprises, and government. An efficient financial system channels resources to activities that will provide the highest returns for the use of these funds. In turn, the resources stimulate economic growth, as more goods and services are produced and jobs are generated.

Efficient financial systems, however, do not just happen, nor can they be legislated into being. Moreover, in most instances, the financial system of an economy at any given time may be what is most appropriate or possible at the moment, and may be seen to be an evolving system in transition from one stage to another. The Philippine financial system may be considered to have progressed from a simple trade- and credit-oriented system under colonial rule to a formally established financial structure consisting of a central bank and other banks and financial institutions under its supervision and regulation, which over the last four decades has undergone a number of reforms that have made it what it is today.

HISTORICAL BACKGROUND

With the recognition of Philippine political independence in 1946, a joint Philippine-American Commission was created to study the Philippine currency and banking system, which recommended the reform of the monetary system, the establishment of a central bank, and the regulation of money and credit within the system. These recommendations were implemented by a Central Bank Council which was tasked to draft a charter for a central bank, see the bill through Congress, and establish it.

In February 1948, a bill was submitted by President Manuel Roxas "establishing the Central Bank of the Philippines, defining its powers on the administration of the monetary and banking system, amending pertinent provisions of the Administrative Code with respect to the currency and the Bureau of Banking and for other purposes." This bill subsequently became Republic Act No. 265, The Central Bank Act, which was signed into law by President Elpidio Quirino on June 15, 1948. The Central Bank opened its doors (at the old PNB site in Escolta), with Hon. Miguel Cuaderno, who headed the council which drafted the charter, as its first Governor.

Under R. A. 265, the broad policy objectives spelled out the Central Bank's duties and responsibilities as including the promotion of economic development in addition to the maintenance of internal and external monetary stability. Thus, as the country rose out of the ruins of the second world war, the Central Bank was also tasked to formulate strategies and implement programs that would lead to a "rising level of production, employment, and real income in the Philippines," in effect assigning to the Bank a planning and development function in addition to its stabilization objectives. Most "beginner" central banks which were established by statute in fact had these objectives. Consonant with these objectives was the responsibility and duty to prudentially supervise banks (micro-economic supervision) and to manage and control money supply and the direction of bank lending with a view to obtaining price and exchange rate stability, balance of payments equilibrium and providing employment (macro-economic supervision).

On July 24, 1948, Republic Act No. 337, otherwise known as the General Banking Act, was also passed, to take effect on the same day that the Central Bank commenced

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operations. This Act authorized the Monetary Board of the Central Bank to define the entities that may engage in the lending of funds obtained from the public through receipt of deposits of any kind as banking institutions, and specifically included commercial banks, savings banks, mortgage banks, development banks, rural banks, stock savings and loan associations, and branches and agencies of foreign banks in the Philippines. As per provisions of R.A. 265, the Central Bank was charged with the responsibility of supervising and examining these banking institutions.

Under the Charter, the Central Bank occupies a pivotal position in the monetary and banking structure of the Philippines. The first Governor considered as an imperative the rehabilitation of a war-ravaged economy—the Central Bank was endowed with monetary authority and responsibility and was equipped with instruments of policy that would enable it to encourage a financial climate that would "abet and stimulate the vigorous prosecution of a well-balanced development plan."

Over the years, Central Bank has tried to fulfill that mandate by espousing monetary, credit, and exchange policies that were appropriate to the prevailing conditions. Thus, it has relaxed credit policy in times of financial dearth or in areas starved for credit, and conversely, tightened it in times of excess liquidity marked by inflationary pressures. The Central Bank has used the various instruments it has at hand to deal with these ebbs and flows, generally suiting the instrument or the mix of instruments to the obtaining conditions. In its earliest years, the establishment of a credit priority system was deemed necessary for the promotion of the country's economic development. The banking system maximized the use of the Central Bank's rediscounting window, allowing banks to avail of cheap credit to finance their credit extensions, particularly for agriculture and other "priority" sectors or industries.

BANKING REFORMS

It may even be said that the first set of Philippine banking reforms actually took place in 1948 with the establishment of the Central Bank. Recall that the terms of reference of the Joint Philippine-American Commission included the "reform of the monetary system." This was the case since the Philippines did not exactly start from zero, it having had a history of banking that spanned a period of nearly four centuries. Under Spanish rule, banks were governed by their respective royal charters and the Spanish Code of Commerce. Under American rule, in 1900, under Act No. 52 of the First Philippine Commission, all banks were placed under the supervision and examination of the Bureau of Treasury. This function was later transferred in 1929 to the Bureau of Banking in the Department of Finance until its repose in the Central Bank in 1949.

One of the first acts of the newly established Central Bank was to arrest the rapid decline of the country's international reserves as the pressure on foreign exchange built up with the growing import requirements for reconstruction and rehabilitation as well as from the pent-up demand for consumer goods following the end of the second world war. This was done through the issuance on December 9, 1949 of Circular No. 20, which mandated the surrender of all export proceeds through authorized agent banks, established a system of controls on sales of foreign exchange for imports, and restricted the sales of foreign exchange for non-trade or invisible transactions. Stringent controls were in place for most of the decade of the fifties, relaxing only briefly in 1951 to ease inflationary pressures arising from import bottlenecks caused by the outbreak of the Korean war, and in 1954, with the objective of spurring economic development.

The 1960s saw the beginnings of a return to the free market by means of a gradual decontrol program which was to be implemented in four stages. This program was initiated by the issuance of Circular No. 105 and 106 in April 1960, which was effective up to September 1960, and was followed by Circular No. 133 in September 1969, which was in effect up to November 27 of that year. Under this program, an increasing proportion of foreign exchange transactions were allowed in a "free market" where the exchange rate was administratively set. The system, however, introduced a multi-tier exchange rate system, until November 8, 1965 when full decontrol was achieved and a new par value of ₱3.90 per U. S. dollar (devaluing from ₱2.00 in 1949) was established. This period of complete liberalization, however, lasted only briefly as import requirements continued to impinge on the country's reserves, leading the Central Bank to once again issued directives that more or less resulted in the reimposition of foreign exchange controls.

Meanwhile, on the domestic front, the CB rediscount window became the major source of financial system requirements, as a system of priorities continued to operate with varying degrees of subsidy given to different industries considered vital and essential in the process of economic development.

The banking system expanded rapidly in the sixties, with branching networks encouraged throughout the country, and rural banks established with full CB support (counterpart funds were provided to match owner's equity) with the objective of putting up one rural bank for every municipality over the length and breadth of the Philippines.

REFORMS "PART I"

Two decades after its establishment, and amidst a backdrop of international and domestic economic expansion, a joint International Monetary Fund-Central Bank of the Philippines Commission was created in November 1971 to undertake a survey and study of the Philippine banking system. Among its terms of reference was the formulation of a program to ensure the banking system's sound and healthy growth and to make it more responsive to the needs of an expanding economy. It was also felt that it was time to review and overhaul the infrastructure, as the conditions existing in the financial system were such that intermediation activities within the defined banking infrastructure were insufficient and/or inconsistent with the needs of the economy. The financial system was highly fragmented with too many types of units operating under their own special purpose charters, thus impeding effective competition. Moreover, pockets of intermediation outside the Central Bank's domain of supervision such as the money market operations of certain types of financial institutions which were not within the General Banking Act's definition of banks had effectively diminished the efficacy of monetary regulations such as the interest rate ceilings and reserves on funds sourced from the depositing public, thus placing banks at a competitive disadvantage. Intermediation on both the sourcing and lending sides was generally short-term oriented.

Thus the recommendations included a number of items pertaining to the banking and non-banking systems as well as the coverage of Central Bank authority. More specifically, the recommendations were addressed to the alignment of the legal provisions and regulations by functional areas rather than by types of banks, the consolidation of CB authority over banks as well as non-banks, and the redirection of finance towards long-term maturities.

On November 29, 1972, based on these recommendations, Presidential Decree No. 72 and Presidential Decree No. 71 were promulgated, amending certain sections of R.A. 265 and R. A. 337. An important change was the restatement of the CB's objectives, emphasizing the maintenance of domestic and international stability as its primary objective, and secondarily, that of fostering monetary, credit, and exchange conditions conducive to a balanced and sustainable growth of the economy. Thus, the thrust veered away from direct involvement in the economic development planning process, which was more the concern of the national planning body, the National Economic and Development Authority NEDA), but placed greater concern over the Bank's providing policy direction in the areas of money, banking and credits. Apropos to this responsibility, the scope of the CB's authority was expanded to include not just the banking system, but the entire financial and credit system. The decrees reiterated the CB's supervisory power over banks and gave the Bank regulatory authority over non-bank financial intermediaries.

The reforms included several important programs of action. Among these programs was the institution of minimum capitalization requirements: ₱100 million for commercial banks and ₱10 million for savings banks. For private development banks, the minimum capitalization requirement was raised from ₱1 million to a range of ₱2 to ₱4 million, depending on location classifications. These minimum levels were later further increased during the 1980 reforms. The principal beneficiaries of these reforms, i.e., the dismantling of functional differences among financial institutions, were commercial and thrift banks. The implementing circulars were 492 to 498 of 1976 and 584 to 589 of 1977. Quasi-banking operations of commercial banks were put in place. Thrift banks were allowed to service demand deposit accounts and to pioneer into negotiable order of withdrawal (NOW) accounts. Authority to conduct trust operations and access to the CB rediscount window was also granted to thrift banks. Moreover, banks were enabled to go long-term through various channels: through equity investments in allied undertakings, increased investment ceilings on bank premises and other fixed assets, lowering of net-worth-to-fixed asset ratio to 10 percent, among others. On the sourcing of funds, entry by new stockholders was facilitated by the policy of diffusion of bank stockholdings through the 20 percent individual ceiling and 30 percent corporate ceiling. It was also during this period that a major review of the law on interest rate ceilings under the Usury Law of 1916 was conducted, and so, with the relaxation of the interest rate ceilings on maturities of 730 days or over, alternative instruments such as commercial papers and certificates of mortgage and chattel morgage provided facilities for long-term funding. Likewise, the reforms of the seventies spilled over to the functional areas of bank supervision and examination. There were changes in the "10 meter rule" of the 1960s regarding the chartering of banks and establishment of branches, which was amended to the more rational "economic service area" criterion. Traditional methods of balance validation and statement analysis were replaced with techniques and policies which emphasized systems and management. Moreover, bank monitoring was subjected to a more refined set of statistical indicators such as: (1) the interim bank rating system on **solvency, liquidity, income and management** (SLIM); (2) the **capital and reserve system** (CARE); the **financial statistics system** (FINSTAT); and the **computerized interbank loan system** (IBL).

Further to the reforms in the area of interest rate policy, Presidential Decree No. 858 of December 31, 1975, gave the Monetary Board of the Central Bank the authority to "eliminate, exempt from, or suspend the effectivity of interest rate ceilings on certain types of loans or forbearances." The issuance of this decree was followed by CB implementing circulars on interest rates on January 2, 1976. In addition to raising interest rate ceilings on time deposits with less than two-year maturities by 1/2 per cent and on savings deposits by l percent, the Central Bank removed the ceilings on time deposits with maturities of two years and over. Loans were categorized into short and long-term, with ceilings on short-term loans set at 12 and 14 percent, and on long term loans, at 19 percent. Furthermore, the framework of interest rate ceilings was extended to deposit substitutes. The absence of ceilings on yields of deposit substitutes and other short-term money placements made them so popular that the CB felt constrained to help stem the inordinate flow of funds away from regular bank deposits. The ceilings on short-term deposit substitutes and short-term purchases of receivables were both set at 17 percent, which in any case remained higher than interest on savings and time deposits. No ceilings were placed on instruments with remaining maturities of over two years. The interest rate reforms of the 1970s were but a prelude to further reforms in the 1980s.

Meanwhile, in the area of foreign exchange policy, the start of the 70s saw the Central Bank take the bold step of "floating" the exchange rate. The peso, which was increasingly considered overvalued at its par value of P 3.90, was released to the market with the issuance of Circular No. 289 on February 21, 1970. Within a week, the peso depreciated to its market value of close to ₱6.00 per U.S. dollar. This system of "floating rates" was to prevail for the succeeding two decades, albeit at times the CB intervened in the market to prevent undue fluctuations, particularly those which were the result of speculative activities. By the end of the 80s, the peso's value in the free market had depreciated to an average of ₱21.74 per U.S. dollar.

REFORMS "PART II"

The decade of the eighties was marked by a growing restiveness in the population, which in terms of the financial system, was reflected in increasing anxiety and mistrust in financial institutions. The flight of a Chinese businessman who was heavily indebted to a number of institutions triggered a "crisis of confidence" which shook the very foundations of the system. The Central Bank took immediate steps which included the grant of emergency advances to institutions performing quasi-banking functions which were the hardest hit by the financial panic, and financial assistance to affected vital industries. The inflationary impact of these advances was neutralized by the issuance of Central Bank Certificates of Indebtedness (CBCI's). These are monetary policy instruments which in fact had been introduced early in the seventies as an effective tool for mopping up excess liquidity in urban centers for rechannelling to credit-starved areas. The rescue operation was achieved through the establishment of the Industrial Rehabilitation Fund. Further, new regulations on the issuance of commercial papers were issued, and for the first time an attempt to rate borrowers was made with the establishment of the Credit Information Bureau, Inc. (CIBI), a joint undertaking of the Central Bank and the private sector, to provide information on total borrowings and the credit standing of would be borrowers.

From a macroeconomic point of view, the start of the eighties was affected by the spill-over effects of the second round of oil price increases in 1979, the unexpectedly prolonged global recession, and the unabated rise in interest rates. These considerations largely influenced the direction of monetary policy as the decade began. While still geared towards maintaining the growth momentum and containing inflation within manageable levels, greater focus was turned towards private sector demand to compensate for the slowdown in the external sector. Thus, from 1980 to 1982, the Central Bank generally pursued a supportive and moderately expansionary policy through demand-stimulating measures and the adoption of institutional as well as policy changes designed to increase domestic savings mobilization, encourage long-term financing, and enhance efficiency in financial intermediation.

Since the mid-seventies, the continuing alignments and adjustments in interest rates and policy measures taken had been designed to move the economy towards establishing a long-term fund base and developing the capital market. By 1980, the stage was set for the adoption of a policy whereby interest rates would be governed by market forces, which meant that the demand for and supply of financial flows would determine the price paid for them. At the end of 1982, the deregulation of interest rates was finally completed with the removal of the remaining interest rate ceilings on short term-loans. This final step which would give financial institutions greater flexibility in mobilizing funds was in tandem with the reform of the financial system in 1980. Reforms "Part II" introduced the concept of modified univeral banking, which was intended to lead the system to bigger and more diversified and competitive intermediaries, premised on the existence of a stable core of deposits which could be made available to fund users at the right price. Modified universal banking in the Philippines was legislated under Batas Pambansa Blg. 61 to 67 dated April 1, 1980 and implemented under Circulars 739 to 742 dated July 10, 1980. Through these multi-purpose banks (or expanded commercial banks), competition in the system was expected to be more vibrant, and credit-orientation, more long-term. The other banks would also be energized with the removal of their legislated areas of specialization, and the capability to "graduate" to the next higher ranking financial institutions was an added incentive. Increased minimum bank capitalization would determine this capability, as the Central Bank raised the minimum level of capitalization for new commercial banks to ₱300 million, ₱20 million for thrift banks located in Metro Manila and ₱0.5 million for rural banks.

The Central Bank likewise increased its capitalization from ₱10 million to ₱10 billion as provided for by an additional revision to R.A. 265 by means of P.D. 1771 dated January 4, 1981. A significant feature of this decree was the grant to the Monetary Board the power to authorize special examination of affiliates and subsidiaries of banks and affiliates of non-bank financial intermediaries with QB functions, and the empowerment of the Monetary Board to allow examination of deposits during bank examination to determine bank fraud or serious irregularity.

On January 16, 1981, P.D. 1801 implemented the section under the 1973 Constitution which provided for the establishment of a Central Monetary Authority which would give policy direction on money, banking and credit. This Decree established the Central Bank of the Philippines as the Central Monetary Authority. *(When the Aquino administration ended, there were two bills in the restored Congress—one in the House and another in the Senate—converting the Central Bank to a CMA, the one in the lower House already having passed its third reading. The new Congress under the newly-elected Ramos administration has reintroduced the bill creating a Central Monetary Authority, and is considered a priority in the legislative agenda.)*

Also part of the continuing thrust towards improvement of the CB's supervisory function were actions delimiting the issuance of commercial papers to prime papers and prime issuers. Support from banks were to be made in the form of commited credit lines and from the CB in the form of committed credit lines to such banks should the need arise. Moreover, regulations on trust operations and fund management were intended to differentiate these activities. Also, pertinent to the re-orientation of resources towards the longer end of the maturity spectrum, regulations on the issuance of bonds and/or negotiable CTD's by banks were laid down. The rationalization and review of existing regulations continued. The alignment of regulations among financial institutions including non-banks with quasi-banking functions, was carried out, thus placing NBQB's under counterpart regulations to those applied to banks, for the same functional or situational circumstances.

For the enhancement of prudential supervision, in 1983, central liability files and central information files were initiated to assist field examiners in the classification of loans to big borrowers of the system and the identification of DOSRI loans and loans to linked corporations. In 1986, a pilot group to audit the computer system of banks was established. A new rating system—the CAMEL (acronym for Capital Adequacy, Management, Earnings, and Liquidity) rating system—which was introduced in 1983, incorporated into a single numerical rating all the qualitative and quantitative factors considered in the evaluation of a bank.

In the area of problem bank management, the concept of comptrollership as a conditionality to the grant by the Central Bank of emergency loans and advances to meet an actual or threatened bank run was approved under M.B. Resolution No. 1049 on August 21, 1984.

The 1980s will be remembered as a period marked by the greatest number of bank closures. Some of the big bank closures resulted in the filing of court cases against the Central Bank. Meanwhile, a number of rural banks which found themselves saddled with an unusually high percentage of delinquent accounts in their loan portfolios in turn incurred arrearages with the Central Bank. Towards the latter half of the eighties, the CB issued circulars which provided for the implementation of rural bank rehabilitation program. This program would assist the rural banks through a capital build-up scheme encouraging the infusion of fresh capital from old and new stockholders and conversion of arrearages with the CB into equity in the Land Bank of the Philippines, and also through gradual liquidation of arrearages through a plan of payment and condonation of liquidated damages.

THE 1980s: PROBLEMATIC YEARS FOR THE BANKING SYTEM

The 1960s and the 1970s were halcyon years for the Philippine banking system. But by the 1980s emerging signs of financial distress had begun to surface, mainly rooted in the international shocks that began with the quadrupling of oil prices in the mid-seventies, and their recessionary impact on industrial economies which were transmitted to developing countries, including the Philippines.

Worldwide, the inability of many firms to service their debts resulted in serious difficulties for many banks and financial institutions. Distressed banking systems were not confined to small, developing economies. In fact, in the United States over a thousand savings and loans associations were closed or merged with sounder institutions between 1980 and 1988, the cost of the restructuring estimated at $80 billion. Moreover, about 10 percent of the commercial banks were on the "watch list" of the regulators. In Spain, between 1978 and 1983, 51 institutions holding one-fifth of all deposits had to be rescued. A similar story was told in Norway where commercial and savings banks suffered heavy losses due to the dive in oil prices as well as imprudent lending. More familiar to many were the serious financial problems experienced by Latin American countries. Middle Eastern, African, and countries in Asia were not spared from the global banking malaise.

Widespread financial distress increases the demand for credit, puts pressure on interest rates, and thereby stokes inflation. Other costs of financial system failures are the misallocation of resources, an unfortunate consequence being that a growing share of credit goes to debt service instead of investment. The pressure on governments to come to the rescue of floundering banks has also resulted in central banks themselves incurring huge financial losses (particularly where the foreign currency risk on banks' foreign exchange liabilities are absorbed by the central bank). Other serious problems include fiscal imbalances which have to be funded by additional government borrowing, thus straining interest rates and prices that are further exacerbated by stresses on the exchange rate.

The financial system's reduced ability to direct credit towards productive borrowers tends to undermine efforts at structural adjustment. The need to shore up huge investments in non-performing companies has impeded the flow of resources to more profitable enterprises, thus delaying recovery in the short run, and in the long run, slowing down economic growth.

The problems which emerged in the 1980s struck deeply in the heart of the global financial system. The Philippines was hit doubly. The resulting distress in the domestic financial scene of the Dewey Dee scandal in the early eighties was of such proportions that a major rescue operation had to be launched, in order to stabilize the fragile infrastructure. Continued difficulties in the external sector exacerbated the inability of banks to strengthen their positions. The borrowing spree that began in the mid-seventies when the international financial markets were awash with petro-dollars for countries eager to embark on ambitious development plans was too difficult a temptation to resist. Thus did the banking system find itself saddled with huge external debts that could not possibly be paid by the non-performing companies in which they were lodged. Thus did the shoring up of distressed institutions put pressure on the government's financial position, and budget deficits began to balloon, inflation come short of incendiary levels, and interest rates hit unprecedented heights, followed by an exchange rate which rapidly began its downward spin.

The net result of the strains placed on the Philippine financial system by the convergence of both international and domestic destabilizing factors was to find, between 1981 and 1987, 161 smaller financial institutions, holding 3.5 percent of total financial system assets, closed. Moreover, the authorities had to intervene in two large government and five private banks. The government banks were liquidated in 1986, and their largest bad assets (approximately 30 percent of the banking system's assets) were transferred to the national government. The private banks which were government-owned or -controlled, are in varying stages of Central Bank supervision, and are up for privatization.

Resolving the financial system's problems has been the Central Bank's main task in the last decade. Among the important steps that have been taken and continue to be implemented include the resolution of the external debt problem, the strengthening of the country's financial infrastructure, and the containment of inflation. Unpalatable measures which included strict rationing of foreign exchange, a substantial depreciation in the exchange rate, and credit tightening policies were unleashed. The measures, aided by moderate fiscal policies, while inflicting hardships achieved their major goals of improving the balance of payments and curbing the runaway inflation rates. External debt restructuring was pursued, focusing beyond mere reprieves and borrowed time. The financial system's rehabilitation efforts were focused on two major government banks and on the rural banking system, the objective being to put them in a more viable position—for the former, by transferring non-performing assets to the national government, and for the latter, through a program of capital build-up and conversion/ repayment plan.

REFORMS "PART III"

The Philippine financial system has gone through its crucible. What remains is to consolidate the gains made through the bank reforms of the seventies and eighties. The thrust for the nineties is liberalization. Allowing the market to set the pace and determine the direction that the system will take is still considered to be the best option. Improving the efficiency and competitiveness of the financial system is the agenda of what may be considered as "Reforms-Part III."

Among the more important steps taken have been the liberalization of rules and regulations on the establishment of banks, the objective being the improvement of financial intermediation in order to effectively mobilize savings and allocate necessary funds to the appropriate sectors of the economy. These measures in fact are as follows:

1. The moratorium on the establishment of new banks was lifted on May 16, 1989, with the issuance of CB Circular 1200.
2. This was followed by the easing up on branch banking under Circular 1281 dated April 15, 1991. An auction system was instituted for the awarding of franchises to eligible commercial and thrift banks wishing to open more branches in Metro Manila, in the cities of Cebu and Davao, and in first class cities and municipalities. Minimum bids for a franchise are priced depending on the service area. Bids for franchises in the National Capital Region, i.e., Metro Manila as well as those considered as "overbanked" areas are priced twice as much as those in first class cities and first class municipalities. Banks are in addition provided with incentives to open more branches in other areas, particularly those which continue to be "underbanked" in relation to economic activities and population. Hence, franchises in these other areas do not require minimum bids.
3. To improve credit delivery in the countryside, mobilize savings for productive investments in rural areas. Rural banks were given the privilege of nationwide branching under Circular 1280 dated April 15, 1991.
4. To facilitate the delivery of banking services to a greater number of clientele, the operation of ATM's in off-site or off-premises areas was allowed, subject to certain CB regulations specified in Circular 1286 dated May 23, 1991.
5. By law, foreign banks are not authorized to operate in the Philippines with the exception of four foreign bank branches already operating when the General Banking Act took effect in 1949. The law also provides that at least 70 percent of the voting equity of banks organized under Philippine law should be owned by Filipino citizens. In 1977, foreign banks were allowed to operate offshore banking units. Recently, the Monetary Board approved the request of these banks to be allowed to negotiate inward export letters of credit. They are also now allowed to provide full foreign exchange services for all foreign currency non-trade remittances. The most recent development is that the Central Bank is reviewing the restrictive policy on the entry of foreign banks in the Philippines with a view to recommending to Congress liberalization of these statutory restrictions in line with the overall policy of encouraging foreign investments.

Other reforms undertaken during this present period include changes in the minimum paid-in capital of commercial and thrift banks and investment houses to strengthen the system:

i. Expanded commercial banks from ₱1.0 to ₱1.5 billion
ii. Commercial banks, from ₱500 million to ₱ 750 million
iii. Thrift banks (Head Offices-National Capital Region)
from ₱10 to ₱20 million
iv. Thrift banks(Cebu and Davao)from ₱ 5 to ₱ 10 million
v. Investment Houses from ₱20 to ₱50 million for old, and ₱100 million for new, effective Sept. 1990

Likewise, the general policy governing weak banks was laid down under Circular 100 dated May 16, 1989, for the reason that the Central Bank does not wish to sustain the operation of weak banks for unduly long periods in order to foster financial stability in the system.

To reduce intermediation costs and improve financial efficiency, the gradual unification of reserve requirements across banks and deposit types was implemented starting 1989 under Circular 1209 (dated September 1, 1989) and Circular 1269, issued in December 1990. The series of adjustments on the reserve requirement ratios for demand deposits, short-term deposits and deposit substitutes over this period of time was made to equalize and rationalize the imposition of the reserve ratio across banks and non-banks.

The Central Bank has also undertaken the rationalization of its rediscounting window to enhance its role as a mechanism for liquidity control rather than for credit allocation. In other words, the CB has moved away from its early role as the "bank of first resort." This developmental function has been transferred to appropriate agencies such as the Land Bank and the Development Bank of the Philippines.

These measures include the phase out of the Central Bank's role in the credit allocation program by transferring the administration of the ALF, IGLF and APEX funds to the Land Bank of the Philippines and the Development Bank of the Philippines in 1990. The DBP has likewise been reoriented towards wholesale banking, after its restructuring, to improve fund mobilization and the delivery of long-term funds.

And only recently, additional policy thrusts have been taken towards the enhancement of the potential of the Philippine countryside. In October 1991, the activation of the Countryside Loan Fund (CLF) consisting of funds originally known as the Agricultural Loan Fund of (ALF) from the World Bank, and the establishment of the Countryside Financial Institution Enhancement Program (CFI Enhance) was launched, the objective of which is the maximization of the growth momentum of the rural sector.

In particular, CFI Enhance, of which the Central Bank is the lead institution, is designed to pave the way to a much improved capability on the part of countryside banks to mobilize savings and deliver funds to deserving users of credit. More specifically, the objectives of CFI Enhance have been spelled out to consist of: (1) raising the capital base of countryside financial institutions by encouraging existing and new investors to infuse fresh equity into said institutions; (2) reduce the debt burden of eligible CFI's; and (3) improve the long-term viability of these institutions and help them become more effective in mobilizing savings and delivering credit. CFI Enhance aims to build on the multiplier effects generated by new capital infusion. This way the deposits generated within the community can be effectively used to further develop rural economic opportunities, and thence provide greater scope for supporting countryside development.

As the year 1991 drew to a close, announcement of the liberalization of rules governing foreign exchange was made, implementation of which was scheduled to begin the following year. The primary objective of these reforms is to enable the Central Bank to discharge its statutory mandate to "foster monetary, credit and exchange conditions conducive to a balanced and sustainable growth of the economy." The move is likewise in keeping with the "more liberal exchange regulatory environment of competing countries in the ASEAN region such as Indonesia, Malaysia, and Thailand."

The liberalization measures embodied in Circular No. 1318, dated January 3, 1992 raised the allowable retention of export receipts by exporters to 40 percent (up from the previous ceiling of only 2 percent of export receipts), increased the access of exporters to foreign exchange resources from the foreign currency deposit units (FCDU's), allowed full and immediate repatriation privileges for all types of foreign investment—whether direct equity or in listed shares/securities, and liberalized non-trade foreign exchange regulations. Major changes in the non-trade foreign exchange system included the removal of the surrender requirement for all but a short list of 15 types of foreign exchange earners which must continue to sell their foreign exchange receipts to authorized agent banks. All others may freely buy and sell foreign exchange, and bring in or remit foreign exchange out of the country.

On August 24, 1992, the final step was taken with the issuance of Circular No. 1353. All foreign exchange controls, in existence for the last forty years, have been lifted. The components of this decontrol package complete the deregulation measures that were issued last January.

Thus, the inward remittance requirement for exports has now been totally lifted, and the 60 percent holdout regarding the retention of export receipts has been removed, so that exporters are now able to use their total export proceeds freely. Similarly, the mandatory foreign exchange surrender requirement imposed on service exporters have been removed. The amount of foreign currency loans that may be sourced from FCDUs of local commercial banks no longer requires prior Central Bank approval, and loans may be given up to 100 percent of the value of the L/Cs, purchase orders, or sales contracts in the case of merchandise exporters, and expected foreign exchange receipts, in the case of service exporters.

Authorized agent banks are now allowed to sell, without prior CB approval, foreign exchange to residents for use in the payment of invisible transaction. Likewise, anyone can now buy foreign exchange in amounts less than $1 million (or its equivalent in other foreign currencies) per year from the banking system without prior CB approval. Gold in any form may be exported except as required under R.A. 7076, and imports of gold are likewise allowed. Deposits abroad by residents are no longer prohibited, and any person may bring in or take out Philippine currency up to ₱ 5,000 without prior CB approval.

These new freedoms imply the recognition of the maturity that has been reached by the financial system. Simply put, Philippine financial transactions now operate in a market, where the invisible hand of market forces is the final arbiter. Keener competition among all participants will somehow force efficiency in production and distribution, drive costs and prices to their equilibrium levels, optimize the use of resources—both real and financial— and, in the long run, move the economy to leap to a higher growth curve.

The increased mobility of capital into and out of the country will enhance foreign investor confidence in the Philippine economy, thus encouraging foreign investments. Moreover, deregulation enhances greater linkages in an increasingly integrated international financial environment, where the trade and payments systems of individual economies are more interdependent.

IMPLICATIONS AND OUTLOOK

Over the last three decades, the reforms in the country's monetary and exchange rules and regulations have been undertaken with a view to enhancing the effectiveness and flexibility of monetary policy, while also helping make its financial system more efficient and in step with the international financial community. This is particularly true of the reforms that have been undertaken as the eighties drew to a close and the nineties began.

Policies governing the country's banking and financial system have completed a cycle, moving from an open policy which led to the rapid expansion in the 50s to the 60s of the banking system and the emergence of an unregulated sector which was subsequently encompassed by the CB's regulatory authority, to further reforms in the financial infrastructure (emergence of universal banking with resultant mergers and realignments), to the rehabilitation of problematic financial institutions, and to the adoption of further reforms with a view to strengthening the system through a more rationalized capital structure that could meet challenges posed by increasing globalization. Interest rate policy has likewise been reviewed to allow market forces to ascertain their determination, ending an era of legislated interest rate levels and Central Bank subsidization of interest rates, with the transfer of this function to more appropriate development institutions. And finally, in the area of foreign exchange policy, the cycle has been completed from restriction (controls in the 1950s), liberalization (decontrol in the 1960s), reimposition of controls on external transactions (1970s to 1980s), and a return to free market forces through the recent liberalization measures.

To be sure, the Central Bank and the financial system today face a stressful environment rooted in the traumatic changes and events that gripped the global milieu, particularly in the 80s. However, the shape of things to come in the 90s portend continuing regional, economic, and financial integration that will require ever-increasing convergence of economic policy and performance. Globalization will continue to impose demands for deregulation, liberalization, and privatization as it elicits forces that bring domestic and international money and capital markets together. Indeed, the rapid advance of technology, particularly in information systems, is integrating the many individual financial markets into just one huge marketplace in which transactions may be completed within the few seconds required to transmit a fax message. The Central Bank is poised to meet these exciting developments in banking and finance. Compared with the decades of the seventies and the eighties, the Philippines is now better placed to meet the challenges that would finally bring the country on par with its neighbors in Southeast Asia, now recognized as one of the most dynamic regions in the world. But more importantly, the achievement of this goal will have to mean its translation into "a rising level of production, employment, and real income in the Philippines." Simply stated, this must result in higher standards of living for the Filipino people; that is, any reforms in the financial system must mean, at the bottom line, that policy-makers shall have addressed the basic needs of food, shelter, clothing, as well as provide greater opportunities for most of the populace.

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