

DEVELOPMENT FINANCE AND STATE BANKING:  
A SURVEY OF EXPERIENCE\*

by

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## TABLE OF CONTENTS

	<u>Page</u>
1. Introduction	1
2. Theoretical Framework	3
3. Asian Experience with Selective Credit Control and Financial Development	19
4. Korea's Credit Policy	23
4.1. Korea's Financial System	23
4.2. Interest Rate Policy and Structure	24
5. Pakistan Experience	29
5.1. Interest Rate and Saving Mobilization	33
5.2. Loan Rate Ceilings and Loan Supply	36
5.3. Credit Allocation Strategy	40
5.4. Credit Flow to the Government	42
5.5. Summary	43
6. Thailand	45
6.1. Financial Structure	46
6.2. Interest Rate Policy	49
7. The Philippine Case	53
7.1. Rediscounting and Interest Rate Policy	56
7.2. The DBP Loan Performance	62
7.3. PNB's Performance	66
7.4. The Land Bank and the Philippine Amanah Bank	68
7.5. Liquidity Control and Management of Credit	71
8. Saving Rate and Financial Saving	74
9. Concluding Remarks	76

## LIST OF TABLES

<u>Table No.</u>	<u>Title</u>	<u>Page</u>
1	Selective Credit Instruments	81
2	Financial Structure of Korea, 1975 and 1982	82
3	Structure of Rates of Deposit Money Banks, 1980-1982	83
4	Sources of Funds of Banking Institutions of Korea, Average for 1975-1983	85
5	Selected Figures and Growth Rates of Some Economic Indicators; Korea, 1970-1982	86
6	Financial Structure of Pakistan, 1981	87
7	Structure of Interest Rates, Pakistan	88
8	Selected Figures and Growth Rates of Some Economic Indicators: Pakistan, 1970-1982	89
9	Selected Figures and Growth Rates of Some Economic Indicators: Thailand, 1970-1982	90
10	Financial Structure of Thailand, 1973 and 1980	91
11	Sources of Funds of Banking Institutions, Thailand, 1970-1983	92
12	Structure of Interest Rates in Thailand, 1975, 1980, 1982	93
13	Structure of Interest Rates, Philippines, 1980-1983	94
14	Selected Figures and Economic Indicators, Philippines, 1970-1982	97
15	Percentage Distribution of Domestic Credits of the Central Bank, 1970-1982	98

List of Tables  
(Continued)

<u>Table No.</u>	<u>Title</u>	<u>Page</u>
16	Structure of the Philippine Financial System, 1975, 1980, 1983	99
17	Sources of Funds of DBP, PNB and LBP, 1976-1982	100
18	Selected Cash Flow Amounts and Ratios of GFIs, 1980-1982	101
19	Cash Inflow Ratios of GFIs, Philippines, 1975-1982	102
20	Selected DBP Performance Ratios, 1975-1982	104
21	Selected Performance Ratios: PNB, 1975-1982	105
22	Selected Performance Ratios, LBP and PAB, 1976-1982	106
23	Ratio of Actual to Target Values of Liquidity and Credit by Institutional Grouping in the 1978-1982 Five-Year Development Plan	107
24	Regression Results	109

## 1. Introduction

The desire to accelerate the rate of economic development has led many LDC governments to establish state banks and other types of financial institutions. Government financial institutions (GFI) could be intended to expand an otherwise small private banking system and enhance the development of the financial market and its intermediary function. This change is expected to help in savings mobilization and therefore growth. In the majority of countries, GFIs were put up for the more specific task of implementing selective credit policy. This generally includes the provision of credit to priority sectors or activities usually at lower than market interest rate. The Philippines has adopted the second tack and its GFIs have been extensively used as a direct vehicle for implementing its financial program.

GFIs could be used for achieving both ends, i.e., savings mobilization and selective credit control. There are, however, some practical conflicts in trying to accomplish both. To be effective intermediaries, GFIs must compete for the funds of surplus units particularly savings. They have to offer attractive yield and other features on their financial claims. This they will be able to do if in turn they can relend the funds to the most productive and financially viable borrowers so that they can repay the surplus units with high rates of interest. Selective credit control (SCC)

tends to impinge on the relending decision of GFIs. As practiced in many LDCs, it usually involves the grant of credit incentives to selected sectors, activities or groups of borrowers that the economic planners want to promote and credit restrictions on lending to other categories of borrowers. SCC has taken the form of preferential loan rate, rediscounting facility and reserve requirement, and/or portfolio ceilings and floors. When the loan rate is artificially lowered to encourage investment in a particular category, the lending institution is not able to attract as much surplus funds as would maximize its profits rate. Likewise, a GFI which is created to lend at lower than market rate of interest to a favored group of borrowers is prevented from maximizing its intermediation function. It cannot borrow as much as the market would bear when the interest rate ceiling is below the equilibrium rate. Policy makers usually augment GFI funds from deposits and other intermediated sources with preferential discounted funds or budgetary support. These allow the GFI to increase its lending level but they weaken its intermediary role. Such support may even inculcate a habit of reliance on institutional borrowing to the neglect of intermediation. Many Asian GFIs have been managed this way.

## 2. Theoretical Framework

The rationale for SCC put forth by development finance economists (Bhatt, 1978; Johnson, 1974; Fry, 1982; Khatkate and Villanueva, 1978) is the presence of externalities, indivisibilities and imperfections in the capital market. The intent of SCC is to provide credit to private activities which have obvious externalities or to groups of borrowers who are unable to make investments in the best yielding projects because of lack of access to organized credit institutions.

It matters very much how SCC is used. The best package is one where savings mobilization is combined with selective incentive for investments with clear externality or with high social return. This is illustrated in Figure 1 below which draws simple supply and demand curves for funds. The supply of funds is assumed to be

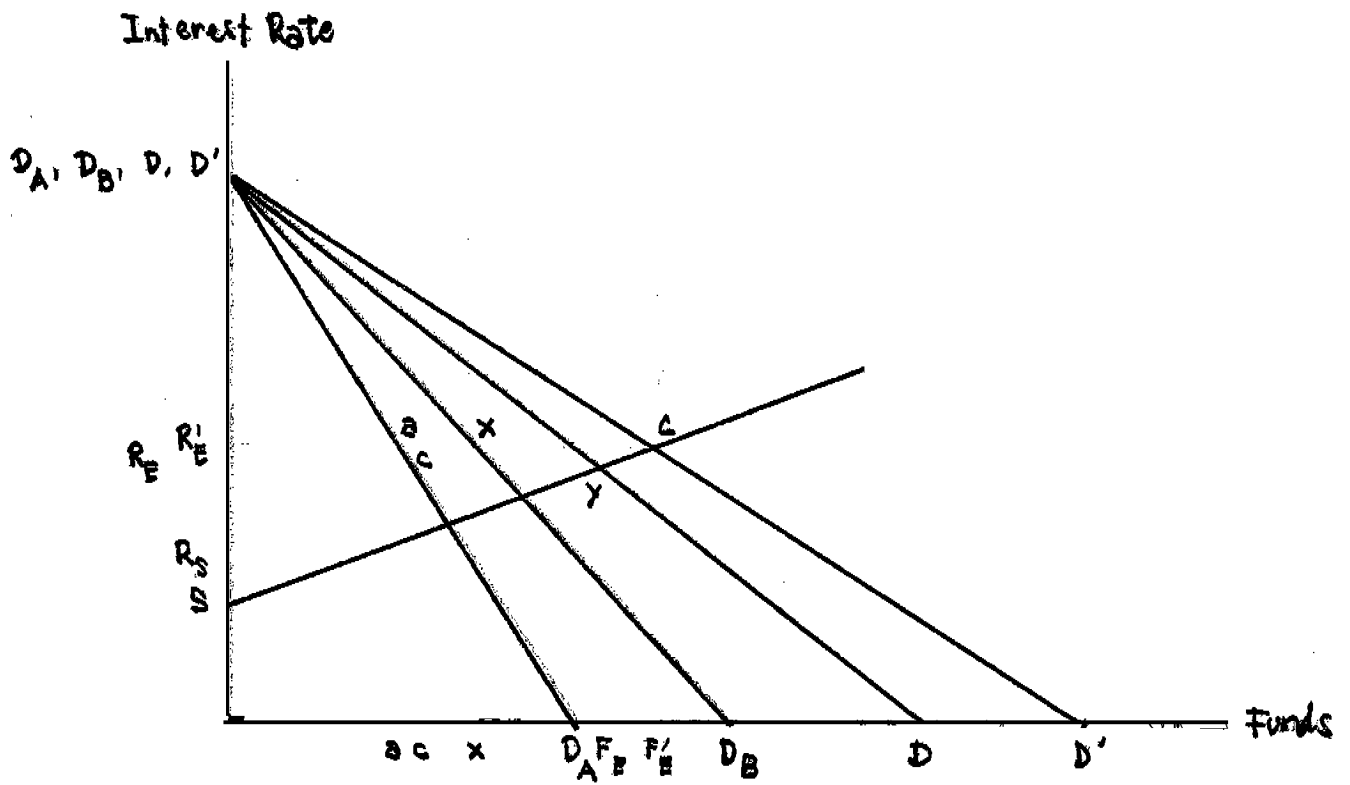


Figure 1

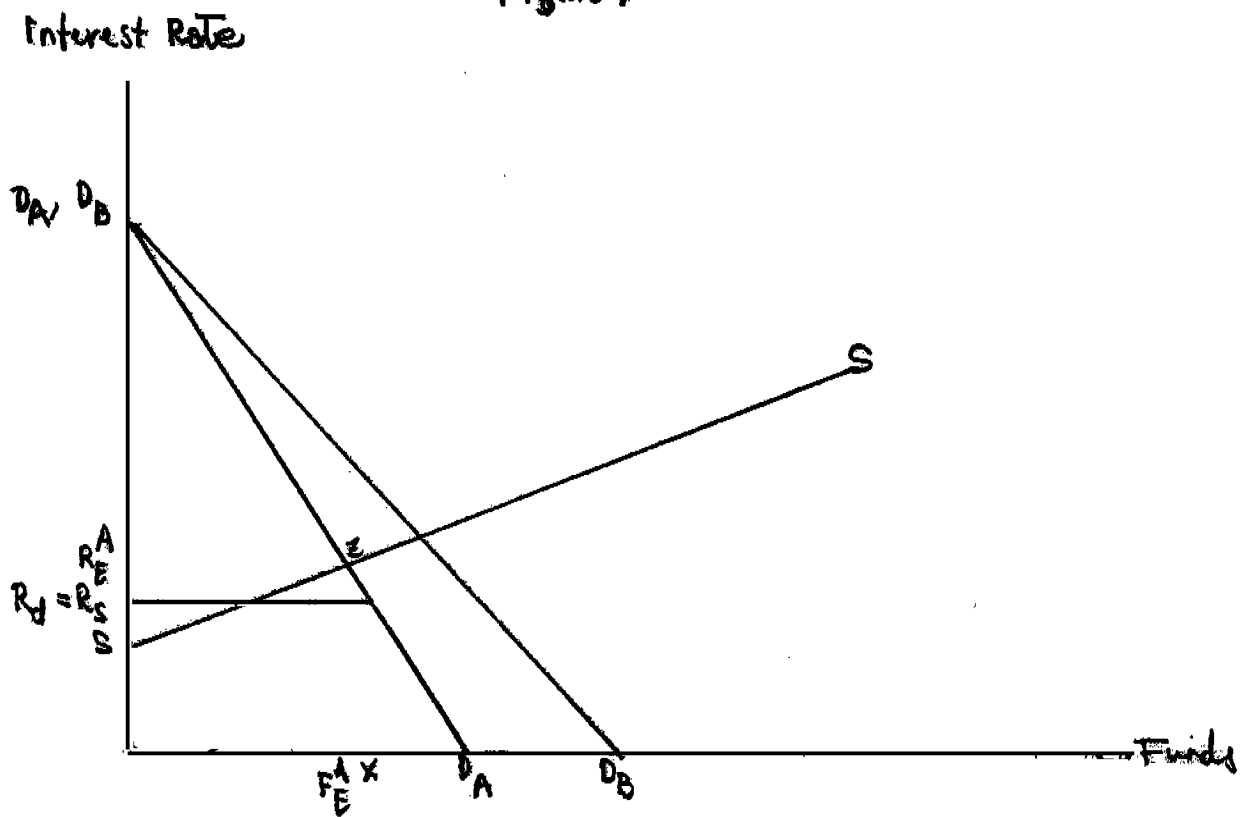


Figure 2.



positively responsive to interest rate. Two demand curves are drawn,  $D_A D_A$  is for activities without externalities and  $D_B D_B$  for those with externalities and other reasons for high social value. The purely private marginal rate of return for B activities is assumed equal to A so that their purely marginal private rate of return curve is  $D_A D_A$ .

Taking account of externalities shift upward the marginal rate of return to  $D_B D_B$ . The aggregate demand curve shifts from DD to  $D'D'$ . Without intervention the equilibrium is at Y with  $R_E$  interest rate and  $F_E$  intermediated funds. Cognizant of the externality, policy makers should intervene so as to be at C. Optimal rate is  $R_E'$  and intermediated funds is  $F_E'$ , both are larger than at Y. At the new equilibrium, funds allocated to A is smaller while that for B is larger than previously, i.e., a versus c, and c versus x. SOC must be used so as to bring the level of investment for A and B activities to the socially desirable levels. First is that the policy maker will have to choose an equilibrium rate,  $R_E'$ . Note that this is higher than what the market would choose. Second is that the financial institutions will have to be motivated to lend  $F_E'$  instead of  $F_E$  by compensating them with some subsidy equal to  $R_E' R_S$ . The subsidy may come from budgetary allocation or noninflationary seigniorage. This is the best strategy for it achieves maximum savings mobilization and optimum

resource allocation. Alternatively the subsidy may be directly given to the borrowers in the form of tax exemption or outright transfer that would shift their demand curve for funds to  $D_B D_B$ .

An alternative strategy which is the more popularly used in LDC including Asia, is for the central bank to give special rediscounting and or budget allocation for lending at lower than market rate to activities favored for their externalities, development impact, etc.. This strategy differs from the above in two respects --one is that it results in lowering the rate of interest below market and below the optimal level pointed out in strategy 1. Savings mobilization is diminished as refinancing and/or budget allocation supplements savings mobilized at lower deposit rates. It also tends to segment the market into the favored and unfavored one. If GFIs are used mainly to implement the selective strategy, the segmentation takes the form of private and public sector division. It involves a selection of priority activities and a choice of central bank refinancing conditions and lending rates. Oftentimes, the decision to lower the loan rate for selected sectors or activities leads to a decision to repress all rates. There are many variations to this strategy. The extent and complexity of the selective control differ from country to country. GFIs tend to play an important role in implementing SCC. The more extensive and complex the SCC strategy, the greater the

need for GFIs which could assure their implementation. The private financial sector are prone to evade SCC rules.

Consider the case where SCC rules are applied to GFIs only leaving the private sector to service freely. Policy makers will have to choose the amount of funds to be given to GFIs and the rate of interest they may charge. In order to get  $x$  activities going, the interest rate must be set at  $R_S$ . The private sector catering to  $A$  is now faced with the aggregate supply. The new equilibrium is at a lower rate,  $R_E^A$ ; lower intermediation level at  $F_E^A$ . This strategy is definitely inferior to that described above. The level of  $B$  investment will depend on the rate of interest chosen. The level of  $A$  investments will be larger than optimal,  $F_E^A$  versus  $a$  in Figure 1. Total investment in  $A$  and  $B$  activities will tend to exceed the optimal level. On the other hand, surplus units are indirectly taxed to the extent of the interest surplus they are made to forego, i.e., the triangle  $SR_E^A C$ -triangle  $SR_E^A Z$ .

### 3. Selective Credit Control

Many governments adopted rather complicated rediscounting and lending rules that are differentiated according to some arbitrarily chosen priority ordering investments. Such a strategy complicates not just the SCC's allocative problem but also its implementation. The issue of credit fungibility arises more frequently under such SCCs. SCC has also been used to accelerate financial development and to solve dualism or market segmentation. The observed dualism of the economy tends to include dualism of the financial market. In such a market, a relatively well developed financial system operates in the industrial/government center while its branches thin out to zero in the remote agricultural areas. Secondary cities and towns may warrant the establishment of a bank branch. Commercial banks which offer simple low-risk financial assets to savers usually predominate in the beginning stages of development. Somehow many underdeveloped financial systems contain a stock exchange that characteristically remains small. The low level of per capita income and the underdevelopment and discontinuous state of transport and communication facilities affect barriers to the flow of goods and factors as well as funds and savings. The economy is segmented into smaller markets including at one extreme barter economies and at another, the well developed center. Each submarket would have its own price and interest rate structure. The between market price/interest rate differentials could be quite substantial. The

market opportunities could likewise differ significantly. The financial alternatives in the center may form a continuous portfolio frontier while that in the remote areas a few points of generally higher risk and transactions cost. The problem of indivisibilities can be very serious. Other underdeveloped woes may be present. Many areas and industrial sectors are palpably inaccessible to organized credit, agriculture and small scale enterprises being the obvious ones. At the same time the development strategy being pursued may call for a financial complement whereby credit is to be made available for the sectors/activities to be promoted. The need to institute SOC appear obvious. They should help solve problems of externalities, indivisibilities and market imperfections which prevail in greater degree in underdeveloped situations. Practical considerations of cases of externalities and indivisibilities are however replete with difficulties. The identification of sectors or activities where they are present and the estimation of the incidence or value of externality or the break-up of indivisibility require no mean task. The capability of LDC governments to undertake these tasks is limited. In many instances, governments are impatient in solving development problems or in accelerating growth and they have been impatient in developing their respective selective credit program. In many cases, the program is haphazardly developed and its component rules and incentive structure decided arbitrarily. This may account for the

mixed performance of SCC and the many criticisms that could be heaped on them.

Selective credit control has some inherent contradictions. While it is intended to be selective it can only be so at a highly aggregative level. SCC has been applied to relatively broad categories such as export industries, food production, small-scale enterprises, long-term or investment expenditures versus consumption, low cost housing, etc.. Within each category, the social rate of return taking account of externalities, indivisibilities, and such, are likely to differ between projects. Some may have negative returns. The enforcement of a common SCC say, subsidized interest rate or subsidized rediscounting facility for broad categories would fail to discriminate among projects within each category. They would all be subsidized whether or not their social rate of return exceeds their opportunity cost.

The objective set for the adoption of SCC is not always efficiency. Special rediscount facilities and GLs have been created for different objectives. These objectives may work at cross-purposes and against overall efficiency. It is argued here that SCC must be based on efficiency criteria or more specifically on the investment criterion. This should be the unifying standard by which projects could qualify for subsidy. Otherwise, SCC would not solve the problems of market failure. It may just become a bottleneck to intermediation and lead to intervention syndrome.

SCC involving the grant of subsidized credit tend to work against the growth of intermediation activity of the financial institutions involved. For the intermediaries to be able to lend at below market rate, it must ration and/or obtain funds at also low rate. The rediscounting window has been a popular source of funds for this purpose. Financial institutions particularly the GFIs are made to rely on the central bank for funding their loan portfolio for it is unprofitable for them to borrow funds in the market. The habit of borrowing from the central bank is fostered. The SCC may be accompanied by interest rate ceiling on deposits which further discourages financial saving. The intermediation function is inevitably weakened and the development of the financial market retarded. The tendency for financial underdevelopment, in turn, reestablishes the basis for specialized institutions and SCC as a whole.

Our analysis shows that SCC is not an easy development tool to use. Its optimal application requires of the policy maker good information about the demand for and supply of funds functions and especially of the marginal social value schedule of investments with externalities or indivisibilities and those that the existing financial institutions neglect to accommodate. The analysis further shows that among SCC tools, the only one that does not impair savings mobilization and allocation is interest compensation such as discussed in Figure 1. The most popular SCC rediscount

tool tends to shift the supply curve of funds, lower the rate of interest for ordinary projects and tax financial asset holders. The figure shows that whenever there are investments whose social returns exceed the market rate, the correct policy is to raise the interest rate from its private equilibrium level. Yet the tendency of many governments is to lower the rate. This is done by legis-lating ceilings or rediscounting.

SCC are sometimes applied to specific projects but in general they are granted to selected sectoral or borrowing categories. Countries which adopted the export substituting strategy, for instance, use SCC as a component of the strategy. It is possible to evaluate the social rate of return on specific projects but it is near to impossible to obtain full information on the marginal social rate of return for a broad sectoral grouping such as export promotion or agricultural development. It is expected that the information on externality will be more imperfect the broader the category. A broad category by definition will contain many more projects over which no government, however competent, can possess adequate information. Without such information there will be no basis for choosing the subsidy rate and the interest rate on deposits and on loans to non-favored industries. Choosing the wrong rate of subsidy will lead to malallocation and disintermediation. If the subsidy to favored sector is too high, it will result in a crowding out of good non-favored projects; if too little,



it will lead to smaller equilibrium supply of funds, lower interest rate and smaller overall level of investment.

In the absence of good information should policy makers intervene in the market? If the externality does not appear to be substantial it will be better to leave the market to decide on the basis of private return. The cost of market failure will also be small. In the opposite case, intervention is called for and the problem is more in weighing the relative cost of overestimating or underestimating the externality or correspondingly the subsidy rate. If on top of this a wrong SCC tool is used, the negative impact could reach very serious proportions. The above analysis shows that the only truly safe tool is the direct subsidy to identifiable socially desirable projects in the form of interest rate subsidy or direct subsidy paid the project or in interest subsidy paid to the financial institution. Refinancing incentives given to banks tend, in general, to reduce intermediation or saving mobilization and frustrate the desired credit allocation. When an overall interest rate ceiling is imposed in addition to selective rediscounting and reserve requirements, these negative impacts are worsened.

Recent literature on development finance and SCC discuss these problems in a somewhat loose manner. There is general agreement about the rationale for SCC. There is a big debate,

however, about the effectiveness of using SCC in achieving the desired objective. Johnson (1974) points to the distortions and the problems of credit rationing that result from SCC; or more specifically from the SCC that are popularly used by LDCs.

Khatkate and Villanueva (1978) argue in turn that LDC conditions are imperfect to begin with and SCC can be used to minimize the imperfections. They give a guideline on which economic group to apply SCC control, whether on the borrower or on the lender.

Taking the fungibility into consideration, they argue for applying SCC control on borrowers when there is fair competition among financial assets, i.e., they are close substitutes. Control will be ineffective if fund suppliers can move from one asset to another. SCC control is more effective if applied to lenders when financing sources for investment are not close substitutes. Intervention in bank deposits will affect the cost and supply of funds to borrowers from banks but not the users of the securities market when these two sources are not close substitutes. The institutional problems emanating from SCC led some economists to argue for fiscal incentives instead of SCC. (Friedman 1974 and Cuaderno 1952). Tax incentives or direct transfers to activities with positive externality may be preferable to credit incentives. There is likely to be a more careful decision making and monitoring of tax or transfer than of central bank credit subsidy. The taxpayers have a better appreciation or information of the burden of fiscal measures than

CB subsidy. The adoption of such measures has to undergo parliamentary debate while a CB has almost autonomous power over the change and use of credit. LDCs' CBs are particularly vulnerable to government pressure to assist various groups of borrowers including the government itself and the GFIs. Its money printing power may not be limited to noninflationary optimal uses. Credit can be an important political tool.

Some writers are concerned with the effectiveness of SCC. Cohen (1968) suggests monitoring credit flows to the selected targets. SCC is judged effective if credit is allocated according to plan or targets. Khatkate and Villanueva are similarly interested in the effectiveness question. This is reflected in the criteria they suggest for selecting SCC tool, whether it directs to lenders or to borrowers.

The literature has been concerned with the broad rationale for SCC and some guidelines for effective implementation. It has not addressed itself to the allocative and intermediation issues.

The success of SCC in improving allocative efficiency and therefore in promoting growth may in fact depend on its scope rather than on the tools used. Very good information is required for developing an SCC program. The policy maker has to study and identify sectors or projects deserving of SCC. The economic rationale for SCC must be stated in empirical terms. In other

words, the value of externalities needs to be approximated, the imperfections and their solutions specified. Governments' capability to produce this information is limited. It should therefore desist from adopting an overambitious SCC program, i.e., one which extends to activities/sectors in which it has little or no information. A poorly selected SCC program will prove counterproductive while an extensive one will tend to cancel out its selectivity and bring with it allocative problems of the kind ensuing from financial repression policy.

How selective is the policy to be? Should it be applied to individual cases or to groups or categories of activities or projects? It will not be difficult to find a number of projects which can be shown to exhibit some externalities and granting them subsidy or imposing on them a tax would not be a problem. It is another matter to find a broad group of activities in which all the components meet the criteria for SCC. Let us take the case of export promotion strategy adopted by many LDCs and which grants favorable credit and tax treatment to all export industries. Within the industry, the firms will likely differ as to the degree and value of their externality; some may not even have any externality. The same problem applies to other SCC rationale, say the solution of some market imperfections. For instance GFIs are established in rural areas to cater to agricultural borrowers who have no access to financial intermediaries. Oftentimes credit is

granted to the sector at uniform subsidized rate. Not all agricultural activities deserve subsidy and yet they qualify for the subsidy by virtue of their belonging to the favored category.

As the number of categories covered by SCC increases, the allocative and financing problem multiplies. Financing a larger subsidy and loan demand may be found difficult and may lead policy makers to resort to monetary expansion.

The above discussion tried to put together some of the critical issues in selective credit control. There is no disagreement about the need for SCC when the market is incomplete or imperfect. There are however serious difficulties in arriving at a correct SCC strategy. First is the tremendous information requirement for selecting the target activities/sectors and valuation of the incentive or disincentive to be applied. Second is the choice of SCC tool. It is shown that the existence of positive externalities should raise the equilibrium interest rate. Private demand for the activities/sectors with externalities is to be increased by some subsidy. The credit tool to use is interest subsidy to the borrower to be fully borne by the society either through a tax or central bank seigniorage. SCC tools geared to increase the supply of funds directly through rediscounting and other central bank borrowing is expected to result in poor allocation and disintermediation. Third is the question of the degree of aggregation at which SCC is to be

applied. Should it be on individual project basis or should it apply to categories of activities? In the former case, SCC's coverage will be limited to projects in which the extra social value is shown to be positive and therefore requiring of incentive. But the SCC program in this case will remain modest. Applying SCC to groups or categories of activities is necessarily fraught with information problems. The planners will have to come up with marginal social valuation for groups of activities so that the group or groups deserving of incentives can be identified. This task is near impossibility. One cannot discriminate within each category on the basis of social return.

The other practical problems discussed are the fungibility of credit and the substitutability of financial claims through which funds are supplied to lending institutions. It is felt that these are of minor importance as compared to the three issues discussed above.

Finally, Bhatt suggests that beneficiary projects of SCC should be financially viable, otherwise the lending institution will exhaust its supply of funds.

### 3. Asian Experience with Selective Credit Control and Financial Development

The above analysis distinguishes two types of SCC tools. Type I are those that work on the demand for funds and type II are those that affect the supply of funds. Included in type I are interest rebate given to the borrower or the lending institution which lowers the effective interest rate for favored borrowers. This SCC is equivalent to tax incentives, transfers and development support like infrastructure build-up and technical assistance. They lead to cost reduction or market expansion and therefore to an outward shift in the demand for credit. Type I SCC, by itself would not interfere with intermediation. Type II SCC includes all sorts of supply intervening controls such as interest rate control on loans and deposits, differentiated rediscounting and reserve requirement, and loan targets and ceilings. All these tend to inhibit financial intermediation or saving mobilization and therefore financial market development. They also tend to result in market segmentation. By definition, selective control is more effectively implemented by government financial institutions (GFIs) than by private intermediaries. It is therefore relevant to see the relative importance of GFIs in the financial market. It is to be expected that the more extensive are the GFIs, the greater will be the disintermediation impact of any set of SCC.

The experience with SCC of some of the less advanced countries of Asia, that is, excluding Japan, Hongkong and Singapore, is reviewed for lessons they may offer, referring to the recent ADB study of saving mobilization in six countries. Fry's (1982) work entitled "Interest Rate in Asia" and the writer's survey of Pakistan's Financial System and Credit Policy are also referred to. Ten countries---Taiwan, South Korea, Thailand, Malaysia, Pakistan, Bangladesh, Sri Lanka, Nepal, Indonesia, the Philippines---are covered by these studies. Without exception these countries use type II SCC; all have state-owned or state-controlled specialized DFIs. They vary, however, in the nature and extent of the SCC used, and in the relative importance of the GFIs. Not one of the countries chose type I SCC.

Table 1 below gives a summary picture of the various SCC tools used by each country. All countries use subsidized loan rates and preferential rediscounting facility for priority sectors. The majority or six out of ten impose credit floors and/or ceilings and maintain at the same time a multiplicity of state-owned or state-controlled financial institutions including development or specialized financial institutions (DFIs). In effect, they apply all the popularly used SCC tools. Four countries---Sri Lanka,



Taiwan, Malaysia and Thailand---chose to have very limited SOC. In the latter three countries subsidized credit is granted to a very narrow group of borrowers including the export sector. Sri Lanka gives subsidized credit to more sectors, but they in no way compare with the number of sectors given priority rationing in the other countries.

The countries differ in the sourcing of the credit available for selective allocation. Taiwan and Korea follow a high deposit rate policy as a strategy for mobilizing savings, i.e., attracting them into the financial system. They have succeeded so far in sourcing a large part of their institutional credit from deposits. Malaysia follows a free market system except for the limited control on credit for export. It faced no problem with sourcing loans. The Thai government, on the other hand, has imposed deposit and loan rate ceilings which are found to be ineffectively implemented through its essentially private banking system. The country's inflation was, moreover, generally modest resulting in positive deposit rates. Pakistan has tried to mobilize saving also through a high interest rate policy. But the overall low loan rate ceiling has discouraged financial institutions from raising deposit rates, thus disabling the totally state-owned/controlled financial system from achieving a high intermediation rate. Saving mobilization was effectively restricted by low loan and deposit interest ceilings in Bangladesh, Nepal and the Philippines despite their extensive network of government-owned/controlled financial institutions. The DFIs in these countries, Pakistan included, had relied on central bank credit and other non-intermediated sources for financing their loans.

Three countries are studied in some detail--South Korea, Thailand and Pakistan. The choice of these countries is made on the basis of the writer's familiarity with their economics, availability of data and the relevance of their experience to the Philippines. The three countries represent the full range of income in Asia and show important similarities as well as differences in the SCC package used. Korea and Pakistan have many common SCC features. In both countries, the government owns/controls all domestic financial institution and it pursues saving mobilization via high deposit rates. The manner of implementing interest rate and credit allocation policy, however, differ explaining in part the differences in their success in promoting intermediation and growth. Thailand is a contrast to most Asian LDCs since its DFIs form a small segment of the market and play only a minor selective credit control role. SCC is geared to only two sectors--export and agriculture.

Korea and Thailand have experienced sustained high growth rates over the last two decades while Pakistan began to develop rapidly over the last five years. It would seem that whatever might have been the inhibiting effects of SCC, they were not strong enough to seriously obstruct growth. Fry (1982) argued that Korea performed miraculously "inspite, not because" of its credit policy. We may argue that Pakistan and Thailand might have grown faster under a more reasonable credit policy. In a

later section where we compare the Philippine's conduct of SCC to its three neighbors, we will find that its SCC was obstructive to growth especially since the mid-70s when inflation rate reached two-digit level and the government directly intervened in the credit decisions of the GFIs.

#### 4. Korea's Credit Policy

Korea's credit policy is characterized by (a) total ownership/control of financial institutions, (b) fixing of high nominal interest rate of interest on deposits, (c) differentiated loan and discount rates for a wide variety of borrowers and close monitoring of credit allocation by the various financial institutions including credit targets for certain groups of borrowers/activities. The Bankers' Association sets the deposit rate structure at fairly high level following the policy of saving mobilization. The Ministry of Finance which has authority over the specialized DFI and the Bank of Korea (BOK), its central bank which governs commercial and other banks decide on loan and rediscount rates.

4.1. Korea's Financial System. The structure of Korea's financial system is best described in Table 2 which lists the component institutions and their relative importance measured by the value of their assets. It has a central bank called Bank of

Korea (BOK) with its standard development-oriented powers and role. Fry (1982) classifies Korea among countries with a proliferation of specialized institutions. There are a total of nine specialized banks with a market share of 35 percent in 1982. The institutions are classified into deposit money banks consisting of commercial and specialized banks. Their target clientele is indicated by their name including three development banks. Commercial banks have the largest share in the financial system's assets but their dominance in Korea is not as much as in other Asian countries. Their asset share was about 41 percent (1982) as compared to 76 for Pakistan, 67 for Thailand and 80 for the Philippines. The smaller share of commercial banks in Korea is partly explained by the relative success of the DFIs. They were able to compete in the intermediation business and to grow on the basis of intermediated rather than cheap central bank credit.

4.2. Interest Rate Policy and Structure. Up to the first quarter of 1982, the government set about seven loan rates covering about 74 loan categories including 16 categories for deposit money banks, 14 for Korea Housing Bank, 13 for the Agricultural Cooperatives, 7 for Small and Medium Industry Bank, 13 for Fisheries Cooperative and 8 for development banks. The list covers five finally-printed pages.

Unlike in other countries (Philippines, Pakistan, Thailand) the rates were varied from year to year. In 1980 when the interest rates were relatively high, loan rates ranged from 5.5 to 24.0 percent. There appear to be three tiers of loan rates: 20-24 percent, 17.0-18.5 percent, and 3.0-15.0 percent. The highest tier, 20-24 percent was applied to the non-preferred borrowers in all financial institutions except for three specialized banks—Korea Housing Bank, the Agricultural, and the Fisheries Cooperative Banks. Note that even the development banks and the three other specialized banks used these high tiers. Only the housing and cooperative banks charged the middle tier ranging from 17.0-18.5 percent. Preferred rates for specific sector or purpose were set for each financial institution such as export and shipbuilding at commercial banks (15%), "special loans" at development banks (13%), foreign-financed loans at the Small and Medium Industry Bank (8-9%), public housing at Korea Housing Bank (8%) and loans with government counterpart at the Agricultural Cooperative Bank (3-9%) and foreign-assisted loans at the Fishery Cooperative Bank (5.0-9%). This rate structure prevailed since Korea initiated a high interest rate policy in 1967. The interest rate structure had a wider range in the earlier years. In 1970 for instance, the range was 5.0 to 29.0. A new credit reform began in 1981 involving denationalization of commercial banks and reduction of SOC. The latter led to greater uniformity in the interest rate structure. In 1983, the loan rate on almost all categories was 10 percent. Fewer categories were granted loans at preferred rates,

i.e., only those that were financed by the government and foreign assistance in KHB, ACB, FCB and SMIB. Export ceased to be a favored sector by the end of 1982.

While the loan rate structure was quite complex that for deposits is simple and varied only by maturity from demand deposits which earned interest to time deposits of one year and longer. In 1980, these earned respectively, 1.0-1.8 and 22-24 percent. On the whole, Korea set fairly high nominal deposit rates though not high enough to offset the inflation rate in some years. The granting of low loan rates to favored sectors did not vitiate the thrust of the high rate policy since these sectors absorbed a relatively small share of total credit. The three specialized institutions--KHB, ACB and FLB which lent at the middle interest rate tiers--shared only 5.0 percent of total financial institution assets. The preferred sectors in the other intermediaries also comprised a small group of the total listed categories. The amount of credit going to these sectors is roughly indicated by the loanable funds supplied to the institutions from rediscounting at the central bank and the national budget. Table 4 shows that on the average for 1975-83, less than 15 percent of loanable funds of the banking system came from Bank of Korea and 3.0 percent from the government. We note here that even the specialized banks which granted subsidized credit relied on these sources for only 14 percent of the total.

The figures further indicate that the high nominal interest rate policy followed had a positive impact on intermediation and financial development. Deposits were the main source of loanable funds for all institutions except the Korean Exchange Bank which was created to finance international transactions and to intermediate foreign capital which was flowing to Korea in large volume. Foreign borrowing comprised 50 percent of its loanable funds. Foreign funds also contributed substantially to commercial banks or 10.4 percent and to the specialized banks, 15.3 percent. The large inflow of foreign exchange deposit must be partly explained by the high interest rate offered and the stability and strength of the won.

The average annual rate of growth of total deposits over the 1972-1982 period was about equal that of GNP or 10 percent. The ratio fluctuated quite widely around the average ratio of 34.9 percent. It declined from 36.0 percent in 1972 to 31.7 percent in 1976 after which it showed an upward trend reaching 41.2 in 1982. Dowling (1984) found a significant though not too strong a relation between  $M_2/\text{GNP}$  and the real rate of interest. A casual look at Table 5 shows that only the large drops or rises in the real rate made perceptible changes in the ratio. The first oil shock in 1973 and the consequent high inflation rates from 1974 to 1976 led to the decline of  $M_2/\text{GNP}$  ratio and the positive deposit rate beginning 1981 (due to the drop in inflation rate) must have

promoted deposits. Loan rate fell to 10.0 percent in late 1982 and has since remained at this level.

The level of intermediation is probably understated for the large curb market which is included in the informal sector. The curb market is of mixed nature. According to Park and Cole (1983), curb transactions are coursed through the banking system. They are undertaken to get around the rate fixed by the Bankers' Association. A large depositor places funds at a bank for loan to a specific borrower at rates much higher than the prevailing one. Park and Cole regard the curb market positively in that it allows for competition in the market. The widely reported scandal was seen by the authors as a very isolated case and account for a minimal share of total transactions.

The degree of government control over the financial market was total and the interest rate structure set was quite complex. That these did not hamper economic development could be due partly to the efficiency of bank managers. Apparently, state ownership/control of financial institutions did not lead to poor decisions or the financing of inefficient projects. In proof, Korean banks do not suffer from default problems and they have been able to source their loans from intermediated funds. The very high rate of growth of the economy is reflective of the allocative efficiency of its financial institutions.



Korea has started denationalization of the financial market beginning with the commercial banks and simplifying the interest rate structure. The economy has achieved such a high level of development that the need for market intervention is probably much lesser.

#### 5. Pakistan Experience

Like Korea, the state owns all of Pakistan's financial institutions except for one DFI, the Pakistan Industrial Credit and Investment and Investment Corporation (PICIC) but which the government nevertheless controls. Prior to 1974, the government owned only the DFIs but in 1974, it nationalized the commercial banks and the other intermediaries. There is also a proliferation of specialized financial institutions catering to similar set of clientele as the list in Table 6 indicates. These consist of agricultural cooperative banks, a housing bank, and a small and medium scale industrial bank and three development finance companies including PICIC.

Pakistan's credit policy has other similarities with that of Korea's. Appreciating the importance of saving mobilization policy makers have tried to attract savings into the organized market via high deposit rates. They have a complex loan rate structure and provided budgetary allocation to DFIs. Beyond these there are substantive differences in policy and in its implementation, and

possibly in the quality of management. For one, Korea follows a generally high loan rate policy while Pakistan set a generally low loan rate structure. Consequently, the performance of the financial system differed greatly.

Credit policy is aimed at "checking inflationary pressures through the containment of monetary expansion to desired limits," "ensuring an adequate supply of credit to productive and priority sectors," and "bringing about an equitable distribution of credit." These objectives are to be achieved by rules rather than by strategies that work through the intermediation activities of the financial system. Detailed rules on portfolio and interest rate have been set to govern the operation of the financial system. The interest rate policy for fund mobilization is distinct from that for fund use. Floor rates for bank deposits and relatively attractive yields on other financial assets like those under the National Saving Schemes (NSS) are set with the objective of drawing saving and other surplus funds into the organized market. The loan rate policy reflects the traditional view of stimulating loan demand through cheap credit. Lower ceiling rates are set for priority sectors and for long-term or fixed investment loans as compared to the rate for short-term or working capital loans. As a whole, the regulated interest rate structure is complex and perverse. The term structure for deposits and other financial assets is upward sloping starting at about 4.0 percent for 7-day deposit and rising to 14.6

percent for 10-year deposits while the term structure for fund use or loans is downward sloping starting at 14 percent for working capital to 11 percent long-term loans, reaching 8.0 percent for finance of small homes.

The National Credit Consultative Council (NCCC), a broad-based body<sup>1</sup> headed by the Governor of the State Bank of Pakistan (SBP) the central bank, plans the aggregate credit expansion ceiling and its allocation (as ceiling) to various institutions and to their various uses. The credit plan states the level of support for the government budgetary expenditures and commodity operation, SBP refinancing and other accommodations to DFIs and the credit ceilings and mandatory or minimum credit targets for commercial banks. Each bank is assigned a total credit ceiling and its allocation among various loan categories---private and public enterprises, fixed and working capital, small and large enterprises and broad industrial sectors. Mandatory targets are likewise assigned for high priority uses such as small-scale agriculture and business, and tobacco marketing. The aggregate credit ceiling is set as a means of controlling the rate of monetary expansion while its allocation is for directing the credit flow to desired uses.

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<sup>1</sup>Its membership includes the Planning and Finance Ministers, the Managing Directors of the DFIs and the Chairman of the Pakistan Banking Council for the nationalized banks. It is chaired by the State Bank Governor.

In addition to credit ceilings and floors, commercial banks are required to purchase government issues in order to meet a 30 percent liquid assets to deposit ratio. There is no secondary market for government securities. The State Bank and commercial banks are the major buyers of the issues which are floated to finance government deficits. The government has regularly incurred substantial deficits, 25 percent in FY 1981-1982.

The impact of the regulations on fund mobilization, the flow of credit to various uses and the interest rate structure is briefly analyzed in the following sections. Overall these policies are found to work at cross-purposes and have not, therefore, been very effective in achieving their set objectives. They have weakened the intermediation role of the financial system thus slowing down its development. Banks' intermediation function is very much constrained by the portfolio requirements and the interest rate ceiling since these directly intervene in their allocative and pricing decisions. The other financial institutions are adversely affected by the policy in a more indirect way. Equities as a source of finance and as alternative financial assets in savers' portfolio have to compete with low-cost loans from the banks and the DFI and with the high-yield NSS deposits and other financial assets. The DFIs, on the other hand, face their own interest rate restrictions. Their intermediary function has been preempted by the narrow role to which they were assigned. Consequently, these institutions experienced

minimal growth, less than 13 percent for the DFIs and -28.2 percent for the equity market over the period 1974 to 1981. Commercial banks have so far monopolized the intermediation function for the economy providing the bulk of organized credit for the various productive sectors, 72 percent in 1981.

5.1. Interest Rate and Saving Mobilization. The Government has adopted various strategies for fund or savings mobilization:

- (i) a rising term-structure of floor rates for bank deposits;
- (ii) National Saving Schemes (NSS) consisting of well-advertised high yield saving deposit accounts, deposit certificates and prize bonds accessed through the post office, special saving windows and the existing branches of commercial banks; (iii) guaranteed yield on mutual fund placement; and (iv) promotion by the NCBs (commercial banks) of profit and loss sharing (PLS) deposits with high yield support.

In general, the yield on each saving instrument rises with maturity but the yield structure is not made consistent with the features (liquidity, riskiness) of the instruments.

The National Savings Scheme was adopted in FY 1971-72. A total of nine NSS instruments have been successively marketed from FY 1971-72 to 1979-80. They are made accessible to all income classes by varying their denominations from very low to large sizes. The savings deposit accounts can be opened with a placement of Rs 2.0 (US15 cents) while the Defense Saving Certificates come in

$R_s$  10,  $R_s$  50 ...  $R_s$  5,000 and the Khas-Deposit<sup>2</sup> certificates size reach  $R_s$  10,000. The maturities range from call to 10 years though long-term placements are encashable anytime without penalty. The yield is made to appear higher than is actually. Some are advertised to earn compounded interest rates while others like the National Defense Certificates are promised average rates of profits which appear to be much higher than the actual yield. For example, 7-year savings certificates are advertised to earn 23 percent profit rate and 10-year certificates, 29 percent. Their equivalent compounded rates both equal 14.6 percent. This selling strategy is copied by the National Development Finance Corporation (NDFC). The strategy has succeeded to attract deposits but they resulted in unequal interest rates for otherwise homogeneous instruments. This inequality is shown in Table 7. NSS pays 12.0 percent to its one-year saving account and 11.0 percent to its one-year saving certificate pays. NDFC, on the other hand, pays its regular one-year deposit 11.0 percent and its one-year Golden certificate of deposit, 12.0 percent. The rate differs even more for the longer term deposits. For five-year deposits for instance, the rates range from 11.2 percent to 14.5 percent. The National Investment Trust guarantees a nominal return of  $R_s$  1.40 per share with a

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<sup>2</sup>Khas means special.

face value of Rs 10 giving an effective yield based on the market price of 11.95 percent in FY 1981-1982.

While the Government tries to attract savings through high yield, it also imposes Zakat tax of 2.5 percent on the value of all these saving instruments. At the same time it exempts from income tax earnings from NSS and NIT placements. The Zakat drastically reduces the effective rate of financial assets.

Contrast the deposit rate structure to Korea's and Thailand's simple and uniform structure. In Korea, the Bankers' Association decides on deposit rates for all members which vary commonly by maturity only. Until 1982 the Korean rates were set at very much higher nominal levels reaching up to 26 percent in the late 60s and 24 percent in the 70s. Though Pakistan has no deposit ceiling rates, its levels were constrained by the low loan rate ceilings. Pakistan had, however, a lower inflation which at times resulted in positive real deposit rates.

Savers and other surplus units did respond to the high yield strategy. Both the amount and the number of depositors have been growing at a fairly high rate. The number of bank accounts rose from 6,257 million in June 1971 to 10.71 million in June 1977 to 18.06 million in June 1982 or 1 account per 5 persons in 1982. In the same year, personal deposits comprised the larger part of the total, 78 percent. Almost 40

percent of deposits came from small depositors with balances of up to Rs 5,000; an additional 20 percent from depositors with Rs 5,000-10,000. Rural deposits amounted to 25.8 percent while smaller urban centers' deposits, 30.4 percent. The National Saving Schemes contributed as much as 53 percent to fixed-term deposits. In FY 1982-1983, deposits on profit and loss sharing basis is reported to compose 14.3 percent of saving and fixed-term bank deposits (Tan, 1983).

5.2. Loan Rate Ceilings and Loan Supply. A complex loan ceiling structure has been in force with the rate differentiated according to use, maturity, source of funds, whether small scale or large scale and by lending institution (See Table 7.). The rate differentiation does not follow a clear pattern of prioritization. The ceilings of 11.0 percent for fixed investment and 14.0 percent for working capital apply in general. Most commercial bank loans are governed by these ceiling rates. Loans for business and industry at SEFC and for housing at HBFC are categorized by size with their smallest sized loans granted at 9.0 percent. Loans in commercial banks, PICIC, NDPC, ADBP and the cooperative banks are classified into short-term, and medium and long-term. The loan rate for agriculture, a high priority sector, is set at 11.0 percent, a much higher level than for small home construction, business, and industry. Loans for locally manufactured machines and those falling under the export bonus



schemes are charged minimal rates of 2.0 and 3.0 percent, respectively. Cooperative Societies can charge 13.0 and 13.5 percent for their short and medium-to-long-term loans while the Federal Cooperative Bank, 8.0 and 8.5 percent for the corresponding maturities. IDBP loans for hotels and non-repatriable investments are at 13-14 percent interest rate. Short-term loans for government commodity operation have a ceiling of 10.0 if refinanced by the State Bank and 11.5 percent if funded from the banks' own sources. We find the rate structure to be highly irregular and in some cases inconsistent with the credit priorities. This structure reflects the ad hoc manner in which the ceilings were chosen and a segmented perspective in which the financial system was viewed. It is as if each ceiling is adopted independently of the other ceilings.

The cost of funds was not fully considered in the choice of the ceilings. During the 1977-1981 period,<sup>3</sup> the ceiling rates were below the inflation rate which averaged about 10.0 percent. The 11.0 percent ceiling for fixed investment was moreover below the long-term deposit rates. For loans which obtain special refinancing at the State Bank, the lending institutions are allowed generally high but varying interest rate spread (= SPB rate-ceiling rate) ranging from 1.0 to 7.0 percentage points. The interest rate

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<sup>3</sup>The average annual inflation rate using the GNP deflator was 9.9 percent; the Gross Fixed Capital Investment deflator was 10.4 percent, the WPI was 9.1 percent and the CPI was 10.2 percent.

spread may be compared to the 2.75 spread which bankers stated to be needed to cover their average intermediation cost. The special SBP rate varies from zero for locally manufactured machines and export bonus financing, 4.0 percent for ADBP, 7.0 percent for the Federal Bank for Cooperatives, and 8.0 percent for HBFC.<sup>4</sup> These together with the loan rate ceilings result in the following interest rate spreads:

HBFC	9.0 to 12.0 - 8.0
ADBP	11.0 - 4.0
FBC	8.0 to 8.5 - 7.0
IDBP	
Agro-based projects	11.0 - 10.0
Hotels and NRI	13.0 to 14.0 - 10.0
Commercial banks	
Government Commodity Operation	10.25 - 10.0
Locally Manufactured Machines	2.0 - 0.0
Export Bonus Schemes	3.0 - 0.0

The interest rate ceilings and the bank rates should effect the various financial institutions differently. Specialized institutions such as IDBP, ADBP, PICIC, HBFC and SBFC, which are almost totally dependent on the state bank for their regular source of rupee funds have little operational flexibility. The State Bank decides on the supply, the cost and the interest

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<sup>4</sup>Special rates are granted other financial institutions such as PICIC, BEL for specific purposes which are not included in the annual report.

earnings of their funds. Those granted higher interest rate spread earn greater gross profit margin; those given larger fund allocation can expand accordingly. This close SBP control limits these institutions' task to loan portfolio management, i.e., the identification and selection of loans within their respective target clientele. On the whole, the interest rate spread was high enough to cover intermediation cost, using commercial bank and NDFC standard. This spread and the availability of SBP funds protect these DFIs from the competition of other financial institutions. But they dissuaded them from engaging in intermediation activities and permitted some to be less than prudent in their loan management. SBP support has allowed the inefficient, like IDBP and PICIC, to survive but it did not push the better managed like ADBP to develop into effective intermediaries.

The DFIs' performance varied greatly. IDBP and PICIC which have been assailed by high rates of arrearages and a historic accumulation of administrative problems show declining assets measured in real terms, IDBP by 45 percent and PICIC by 41.5 percent from June 1974 to June 1981. Their poor performance pulled down the growth of the DFIs as a group to only 13.3 percent for the same period. NDFC which followed a more independent tract, i.e., relying on deposits rather than SBP funds, shows the highest growth rate, 405.7 percent. ADBP and HBFC's growth on the other hand, is mainly explained by continued SBP funding granted at favorable rates.

The 11 percent ceiling rate also affected the demand for long-term funds (or long-term deposits) by banks. It was unprofitable for banks to source their loans, short-term and long-term alike, from long-term deposits which have higher interest rate ceilings so they did not aggressively compete for these deposits. That their interest rates on term deposits were always lower than the NSS or the NDFC term deposits is evidence of their decision not to compete for term deposits. Only about 14.0 percent of total deposits was for longer than one year maturity for the period FY 1976-1977 to 1980-1981. Commercial banks can definitely tap more longer term funds if these were found profitable for they have an extensive branch network to use for the purpose. They can, in addition, be able to lengthen the maturity structure of their deposits which are heavily concentrated in demand and savings deposits (80.0 percent in June 1982). The success of the NSS in drawing long-term funds is indicative of the potential role banks can play in long-term fund mobilization.

5.3. Credit Allocation Strategy. The aggregate credit expansion ceiling is roughly estimated to be equal to the projected GNP growth and permitted inflation rate. For each industrial sector (agriculture, industry, etc.) the credit ceiling for fixed investment and for working capital is based on its output growth multiplied by a bench mark fixed investment-to-output and working capital-to-output ratios. The credit target for the various

sectors is then distributed to commercial banks according to their previous year's deposit level. The mandatory targets for agriculture; small-scale business, agriculture, industry, and construction; and tobacco marketing are arrived at in a more arbitrary manner. SBP and commercial bank credit to the Government depends on its planned expenditure and deficit.

The credit targets are implemented as credit expansion ceilings which allow the financial institutions to lend at levels below the target. [This way of targeting establishes a tendency for monetary expansion to fall below planned levels.] The shortfall in mandatory target for fixed investment and for public sector enterprises were especially large in FY 1981-82; 46 percent and 40 percent respectively.<sup>5</sup> (See Tan, 1983, p. 42.) The shortfall could be partly due to the inability of financial institutions to find bankable projects under some of the ceiling and mandatory credit categories. It could also be partly due to the optimistic targets set by the NCCC for private sector enterprises which may not have as yet recovered their confidence from the effects of the nationalization of industries began in 1972. The credit ceiling for the private sector in fact grew at 18.3 percent from FY 1978-79 to 1979-80, 4.0 percent in FY 1979-80 to 1980-81, 26.4 percent in FY

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<sup>5</sup>Credit granted by scheduled banks, PICIC and NDFC.

1980-81 to 1981-82 and 79.0 percent in FY 1981-82 to 1982-83. The ceiling for the public sector grew at a slower rate averaging 24 percent for the four-year period. The shortfall could be further explained by the low interest rate ceiling.

5.4. Credit Flow to the Government. A low tax base combined with a relatively large national budget of about 23 percent of GNP lead the Government to regularly incur substantial deficits which were partly financed by the banking system. Credit from the financial system comes mainly in the form of commercial bank government security purchases to meet the required 30 percent liquid assets to deposit ratio. The revenue account includes funds from the national saving schemes which contributed an average of 10 percent to total revenue.

The Government has in effect competed with the private sector in the use of funds mobilized through deposits and with financial institutions in the use of SBP credit. The 30 percent liquidity ratio for banks means the allocation of this percentage of deposit funds to the Government. Its share in the outstanding credit of SBP was 66 percent in June 1982. The Government and the public sector enterprises' shares add up to about one-half in FY 1981-82 and much higher in earlier years. The decline in the proportion going to the whole public sector is attributed to the decline in deficits and the larger credit allocation to the private sector.

The growth of the various DFIs depended on the quality of their loan portfolio, which in turn determined loan collection and on the supply of funds each could obtain from the State Bank and external borrowing. PICIC's and IDBP's high loan arrearages not only reduced their relending capability but also their creditability vis their fund suppliers. The equity market, in turn, was adversely affected by the country's East-West separation and the nationalization of industries. The interest rate policy was also unfavorable to this market as mentioned in the introduction. A more detailed description of the performance of the market is given below.

5.5. Summary. Pakistan has achieved a fairly high degree of financial development due mainly to its saving mobilization policy and the establishment of a good number of development finance institutions. The widespread network of commercial bank branches, the National Saving Scheme windows and the post offices have made financial investment accessible to most Pakistanis. Interest rate on deposits and the yield on other financial assets were set high enough as to draw savings into the financial system, including those from low income and rural households. There has been a net rural to urban flow of funds. The policy on credit allocation and pricing has not been as successful as that on saving mobilization and in some way it weakened the effectiveness of the latter. Direct credit allocation control and low loan rate

ceilings especially for long-term uses have been ineffective in directing credit to the desired loan categories. The downward term structure of loan rates had the expected disincentive effect on long-term financing which the mandatory targets were unable to counteract. Commercial banks as well as the NDFC have in fact chosen a fairly short loan portfolio. The low long-term loan ceiling seemed to have also discouraged these intermediaries from attracting long-term deposits.

The specialized financial institutions were established to fill the credit need, especially of long-term nature, of sectors which the existing commercial banks did not service--agriculture, industry, housing. They were established like "infant industries" where special funding at concessionary cost was provided for both their capital and operating requirements. The SBP (the Central Bank) decides on almost all the major aspects of their operation--the supply of funds from SBP and government-negotiated foreign loans, their interest cost and the interest rates on loans. Freeing themselves from their dependence on this special funding would allow them to mobilize funds from other sources and to achieve higher growth rates. Most of these DFI's have existed for more than 15 years (PICIC, IDBP, ADBP, BEFC, SBFC) so that they can no longer be treated as infants.



## 6. Thailand

The financial structure of Thailand diverges very much from that of Korea, Pakistan and the Philippines. Government ownership and control of financial institutions and therefore the relative importance and number of specialized institutions are very small. Credit policy has been conservative and non-interventionist leading to relatively low inflation rate and allowing for greater private sector initiative. On the other hand, low ceiling rates for loans and deposits have been imposed on banks. The low ceilings were compensated for by low inflation rate resulting in positive real rates for most years. Moreover, the ceiling rates applied to banks only and this allowed other financial institutions, particularly finance companies, to act as a vent for financial transactions at higher rates. Only few activities are granted favorable credit terms—agriculture and export activities via the rediscounting window. Banks could choose not to take advantage of the rediscounting facility. All these meant a relatively weak government interference in financial activities.

While the government does not expressly aim to promote saving mobilization, the country succeeded to achieve a continuous improvement in intermediation rate and financial development as indicated by the rise in  $M_2$ /GNP from 25.6 percent to 34.8 percent from 1960 to 1970, to 45.5 percent in 1982. This is a higher rate of financial development than that achieved in the three other

countries studied. Thailand's  $M_2$ /GNP ratio of 45.5 percent was higher than South Korea's 41.2 percent in 1982. This is notable given the much lower income per capita of Thailand: 17,220 baht.

Go (ADB, 1984) undertook a fairly detailed analysis of Thailand's financial saving. She found that the growth rate of GNP and the real interest rate were significant determinants of  $M_2$  growth.  $M_2$  growth was highest when inflation rate was lowest or when the real ceiling rates were highest (1973, 1977, 1978). The overall upward trend in the ratio is also explained by the expansion of depository offices. Go's regression of  $M_2$ /GNP on real rate of interest, GNP growth and number of depository offices gave significant coefficients for all three variables. She also observed <sup>a</sup> fairly large contribution (39%) of rural deposits to the total commercial bank deposits and <sup>a</sup> high proportion (90%) of long-term deposits, i.e., with more than one year maturity, in the total. Financial savings in fact comprised 65.6 percent of household asset portfolio.

6.1. Financial Structure. Table 10 which is reproduced from Go's study (ADB, 1984) describes the composition and relative importance of the various types of intermediaries in the financial system. The system consists mainly of three large commercial banks, several finance companies, five government specialized institutions (GFIs), life insurance companies and a few minor nonbank credit institutions. Commercial banks dominate the system with an asset

share of 66.8 percent in 1980. Next in importance are the finance companies with an asset share of 14.5 percent and the government savings banks of 6.2 percent for the same year. The GFIs consisting of the Bank for Agriculture and Agricultural Cooperative (BAAC), the Industrial Finance Corporation of Thailand (IFCT), the Government Housing Bank (GHB), the Government Savings Bank (GSB) and the Small Industrial Finance Office (SIFO) have a combined share of only 13.3 percent. To be noted is the very small relative size of IFCT, the investment bank or .9 of one percent.

The growth of  $M_2$ /GNP ratio implied a fairly fast growth of financial institutions' intermediation activities. Deposits in all financial institutions grew in real terms at an average rate of 20.5 percent from 1970-1980. The banking system relied on intermediated funds for sourcing their loans. (See Table 11.) Non-government deposits formed an average 68.1 percent of total liabilities while government deposits, only 2.9 percent over the period 1975-1983. Borrowing from abroad comprised an important source of commercial bank funds or 9.6 percent. Though given preferred rediscounting facilities for loans to selected sectors--exports, agriculture and a few industrial activities--they chose to borrow minimally from the Bank of Thailand. BOT credit to these banks formed only 4.9 percent of their total liabilities. On the other hand, the GFIs on the whole used more varied sources: government funds, central bank credit and their own deposits on the following proportions:

1.4 , 5.2 , 66.5 percent. Their reliance on central bank credit has been very much lower than that of the Philippine's and Pakistan's GFIs. This may be attributed to the conservation of monetary policy which restricted central bank credit to financial institutions. It could be that saving mobilization was successful because central bank credit was not readily available.

The Government Savings Bank (GSB) is the largest GFI. Like Pakistan's National Savings Scheme and Korea's local banks, it has been an effective saving mobilizer (6.4 percent of total deposits in 1980). According to Go (ADB, 1984), its clients were mostly small depositors including students and farmers who numbered 12 million in 1980. This number compares well with the commercial banks' 3.5 million. The GSB funds were largely loaned at low interest rates to the Government Housing Bank. This practice disallowed GSB from maximizing revenue and led to financial layering involving additional transactions cost. It is possible that GSB's growth has been much hampered by its inability to compete in the loan market.

Commercial banks have also been used to finance GFI loans. They are required to lend at least 13 percent of their loan portfolio to agricultural borrowers or to the Bank for Agricultural Cooperative. Commercial banks have found lending to BAC preferable to lending directly to agriculture. This portfolio requirement

has similar impact as in the GSB case. This portfolio restriction is more limited than that for Pakistan, or the Philippines 25 percent portfolio requirement for agriculture.

6.2. Interest Rate Policy. Thailand has continued to impose ceiling rates on both loans and deposits. These were varied at very infrequent intervals so that the real rates changed mainly with inflation rate. Unlike the complex and long list of rates used in other countries, Thailand set a simple ceiling structure. A uniform ceiling structure applied to all banking institution. The deposit ceiling varied only according to maturity starting at 8.0 percent for savings deposits and rising to 14.0 percent for 3-5 year deposits in 1980. Only three loan rates were set--7.0 percent for priority activities with refinancing at the BOT, 12.0 percent for call loans and 18.0 percent for all others.<sup>6</sup>

A fairly high interest rate spread was allowed by the structure. Banks could get as much as 18.0-12.0 margin on their regular intermediate loans, or 12.0-8.0 for their very short-term loans.

The BOT set two rediscounting rates, a regular one at 12.5 percent and for priority activities at 5.0 percent. Rediscounting

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<sup>6</sup>A special agricultural category was given 10.0 rate but transaction on it was negligible and is therefore excluded from the list.

for regular loans is given at rates competitive with deposits so it does not offer any special advantage to banks to use this source. Loans for priority sectors give banks a much smaller margin than regular loans or 7.0-5.0 percent. This small margin discouraged banks from lending to priority sectors. Consequently their central bank borrowing has been very small.

The inflation rate was maintained at very low level in the 60s with the rate averaging only 2.9 percent. The real deposit rate was positive throughout. Over the 1970 to 1982 period, inflation rose drastically to an average rate of 9.0 percent and fluctuated widely. It spurted from almost zero percent in 1970 to 1972 to 24.4 percent in 1973-1974, and then again to 19.7 percent in 1979-80. The spurts immediately followed the oil shocks. There was a fairly successful attempt to control inflation as shown by the quick way the extreme rates were brought down. Over this period, longer than one year time deposit rates were mostly positive or in 9 out of 13 years. This was not a bad record when compared to the other three countries. It is likely, however, that the ceiling rates exercised a repressive impact on financial development. The deposit ceilings possibly allowed banks a much wider spread than if they were made to compete for funds freely in the market. The low ceiling was tantamount to giving them a monopoly profit and therefore in restricting saving mobilization. Assuming the optimal intermediation or transaction cost to be around 3.0

percent,<sup>7</sup> the average deposit rate on all maturities could be about 15.0 percent while currently it is about 12.0 percent. More funds would have been channelled to the financial system if the rates were competitively set. Barring untoward world events, Thailand may be expected to maintain lower inflation rate in the 1980s which would reduce but not totally avoid the repressive impact of the ceilings on financial development. The inflation rate averaged 6.0 percent in 1981-83. At this rate, the real deposit rate would then be from 3.0 to 8.0 percent, not too low by world historical experience. The ceiling may even cease to be operative at this inflation rate. In 1983, banks were reported to pay lower than the ceiling rates though they continued to charge the loan ceiling rates.

Thailand has a very oligopolistic banking structure. The system is dominated by only three large commercial banks. Compare this number to the 22 banks in the Philippines and to the 6 in Korea supplemented by many smaller local banks and a number of fairly large specialized banks. Thailand's three large banks can easily obtain agreement among themselves on interest rate fixing. Any plan for liberalization of interest rate should consider this oligopolistic structure. Abandoning the ceilings would not have much impact if they are merely to substitute for by oligopolistic

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<sup>7</sup> Bankers estimate the intermediation cost to be from 2.5 to 3.0.

interest rate setting. The interest rate liberalization in the Philippines may be used as a lesson in this regard.

To conclude, Thailand's fairly conservative monetary policy and modest selective credit control program was found encouraging to financial development. Interest rate ceilings were the principal intervention in the market but due to the low inflation rate, their negative impact was minimized. Selective credit control via preferential rediscounting and loan rates covered a few sectors and was not rigorously enforced. Commercial banks could choose not to implement the SCC program. At the same time, the specialized government banks were not important enough as to substantially change the allocation of credit. As a whole, Thailand's financial market was to a large extent left to itself.



## 7. The Philippine Case

The Philippine financial structure and credit policy has a few common features with those in the other three countries. The policy package as a whole is, however, very different from the policy packages used in the other countries. There is also a difference in the management style of the GFIs.

The government owns a number of financial institutions which comprised a fairly large segment of the market or about 40 percent of the total assets of the financial system. The largest commercial bank, the Philippine National Bank (PNB), and the largest investment bank, the Development Bank of the Philippines (DBP) are both state-owned. State ownership of financial institution is smaller than that of Korea and Pakistan (100%) but much larger than that of Thailand (13.3 %). The Philippines also uses selective credit control through preferential loan rates and rediscounting facilities for priority activities. The similarities end here. The more important differences are discussed below.

1. The government never took savings mobilization as a major objective of its credit policy though there were some token programs for this purpose. It did not establish special savings institutions like Korea's local banks, Pakistan's National Savings Scheme or Thailand's Government Savings Bank. It set ceiling rates on both deposits and loans at levels that resulted in much lower

real rates when inflation rate rose to two-digit level from the 70s onward. Recall Pakistan set deposit rate floors while Korea set very high nominal deposit rates. Thailand, on the other hand, set ceilings on both deposit and loan rates but had a lower inflation rate.

2. Selective credit control via preferential loan rates and rediscounting facilities was applied extensively but to loosely undelineated loan categories. So many productive sectors could avail of preferential loan terms at the GFIs and the private specialized banks (rural banks and private development banks). Consequently, its SCC lost much of its selectiveness for almost any productive activity could qualify for a loan at these banks. Favored sectors in the other countries were narrowly separated.

3. Rediscounting was available for all loans at all banking institutions at very low cost or below most deposit rates. Priority loans could be rediscounted at even lower rates. Table 13 shows that the rediscounting rates were set so low that a wide loan-rediscounting margin was granted to all lending institutions. Recall that in Korea, the ordinary rediscounting rate was equal the medium term deposit rate, and in Thailand even the preferential rediscounting rate gave a smaller margin than ordinary loan-deposit margin, thus discouraging central bank borrowing. Cheap rediscounting in Pakistan was available to selected loan categories only.

4. The management of the GFIs appears to differ from the other countries particularly Korea and Thailand. There was direct political intervention in GFI loan decisions in recent years in the Philippines

The combination of these policies have had the expected disintermediation and malallocation consequences. Philippine  $M_2$ /GNP ratio is the lowest of the four countries (or 20.0 percent). The ratio even worsened from a higher level of 25.9 percent attained in 1967. The stagnation of the ratio took place while per capita income was growing at fairly high rate and banking offices were spreading throughout the country. (Banking offices grew from 1,417 in 1970 to 3,877 in 1982.) The near bankruptcy of the GFIs and many rural banks could also be traced to this policy package.

In our diagrammatic analysis in Section 1, it was shown that when SCC is called for because of externalities and other reasons, the optimal strategy is higher than market rate combined with direct subsidy to the selected borrowers. The subsidy may be paid directly to them or through the lending institution as a compensation for the lower rate of interest it is to charge the borrowers. This strategy leads to optimal resource allocation and saving mobilization.

Low interest rate ceilings and easy and cheap rediscounting rule are the worst possible combination of monetary tools. On the one hand, financial savings are discouraged by the low deposit rate. On the other hand, financial institutions are attracted to central

bank credit and find little incentive to mobilize savings. The low loan ceilings lead to excess demand and to credit rationing problems.

The disintermediation and credit rationing problem intensifies with the expansion and loose nature of the selective credit program. The looser the classification of priority or favored borrowers, the larger the number who can qualify and therefore the larger the excess demand. This creates pressure for more central bank credit and/or for intervention in the loan decisions of lending institutions. The GFLs and other specialized banks are the main implementors of this policy. Their poor performance is traceable to its defects.

7.1. Rediscounting and Interest Rate Policy. Interest rates were freed in July 1981 and the regular rediscounting rate was raised chaotically in 1983. But until these dates, a complex rate structure prevailed as shown in Table 13.

The deposit ceilings varied simply by maturity. They were raised gradually over time. The levels were about equal those in Thailand and Pakistan. The high inflation rates in the early 70s and in 1979-1981 brought the real rate to high negative values. The impact of the negative rate on intermediation is seen in Table 14 as  $M_2/\text{GNP}$  fell from 22 percent in 1970 to 16.8 in 1975 and rose back to 23.5 in 1983. As the real deposit rate rose to modest positive levels, the ratio recovered to previous levels.

The freeing of the rate in 1981 did not lead to very significant adjustment of deposit rates to higher levels. It was argued [Tan, 1982] that the banking oligopoly via the Philippine Bankers' Association prevented the rate from rising to competitive levels. Currently, the time deposit rate is still way below inflation rate though loan rate has tended to reflect more fully market tightness quite readily. Currently, time deposit rates are quoted at 18 percent for one year deposit and 35 percent for commercial bank loans.

The selective credit program is partly reflected in the schedule of loan and rediscounting rates. In 1980 for instance, there were 12 groups of priority sectors granted easy rediscounting. The rediscount rate, volume and loan rate varied among loan categories. Loans to the most preferred, which include supervised credit, small scale industries, and non-traditional exports, could be rediscounted up to 100 percent of the loan value at the rediscount rate of 3.0 percent or less and loaned at 5.0 to 12.0 interest rate. The corresponding conditions for the least preferred of the priority sectors were 80 percent, 8.0 percent and 12.0 percent. The regular loans had until this year a rediscounting ceiling based on the equity of the bank, a rediscounting rate of 8.0 percent and a loan rate of 18 percent. The margins (loan rate-rediscounting rate) allowed for the various groups were:

	<u>1980</u>	<u>1983</u>
1. Supervised credit	12.0-1.0	12.0-3.0
2. Special Programs I	6.0-3.0	6.0 to 12.0-8.0
3. Special Program II	10.0-4.0	14.0-8.0
4. Non-traditional Exports	12.0-6.0	
5. Regular Loans	16.0-6.0	18.0-8.0
6. Energy-Generating Projects		8.0 to 10.0-3.0

The one-year time deposit rate in 1980 was 14.0 percent or 75 percent more than the rediscounting rate. The whole rate structure chosen made rediscounting the cheaper source of funds. Private commercial bank rediscounting was however constrained by the value of their equity but GFIs faced no definite ceiling. The incentive to discount was therefore stronger for the GFIs.

The lending and rediscounting schedule is as extensive and cumbersome as that in Pakistan. Like this country, it appears that the rates for the various loan categories were chosen arbitrarily and haphazardly. No basis was offered for choosing the extremely low rediscounting rate of 3.0 percent for the National Grains Authority activities or manpower export while regular food marketing firms and the overseas workers themselves could obtain loans at market rates. In 1980, regular loans were granted higher margins of as much as 18.0-11.0 than many priority programs. This would tend to defeat the objective of encouraging lending to private sectors while at the same time unnecessarily lowering the cost of funds for the regular activities.

CB credit has been expanding at a rapid rate or at an average annual rate of 24.2 from 1970-1982. An increasing proportion of the credit went to the GFIs, 1.7 percent in 1970 and 7.1 percent in 1982. CB credit and foreign borrowing in fact supported the rise in the relative importance of the GFIs. The latter grew from P3,359.7M in 1975 to P14,316.5M in 1982 or at an average annual rate of 48.6 percent.

The disintermediation impact of the rediscounting and interest rate policy is reflected in the large share of CB credit in the liability portfolio of banks. In 1976, total CB credits to all banking institution comprised 12.6 of their total liabilities. The share barely changed since then and stands at 11.4 percent in 1982. Commercial banks' CB credits/liabilities ratio averaged 8.9 percent over this period, a much higher ratio than Thailand (4.9 %) also slightly lower than Korea (13.8%). The GFI ratios are even higher.

DBP, PNB, LB and the PAB did very little savings mobilization. Table 17 shows that their principal fund sources were the CB, other government financial institutions, government deposits and foreign borrowing. CB credits are not clearly reported in GFI balance sheets since they are included in the Bills and Bonds Payable and not in Due to CB account. The Bills and Bonds Payable consists mostly of the issues sold to government financial institutions including the CB. This fund source category accounted for a growing share of the total liabilities of DBP and PNB. For the DBP, its share was 33.8 percent in 1976 and rose to 63.2 percent in 1982. In 1981 for which we have

data, CE credits to DBP comprised 37.5 percent of this account or 17.6 percent of total liabilities. For the PNB, Bills and Bonds formed 41.7 percent in 1976 and reached 51.3 percent in 1982.

Deposits at the DBP came almost wholly from the government.

PNB deposits formed on the average about 52.6 percent of total liabilities of which 49.0 percent came from the government. The DBP in a way undertook zero intermediation while the PNB mobilized about the equivalent of 25 percent of its total liabilities.

The Land Bank did equally poorly in intermediating funds. Bills and Bonds assumed rapidly increasing portion of its liabilities starting at 7.4 percent in 1976 and reaching 44.4 percent in 1982. Its deposits came largely from the government also or an average of 76.6 percent over the 1977-1982 period. Private deposits thus contributed only 11.1 percent of its fund source.

The cash flow accounts of the GFIs reveal ~~even more~~ pointedly their year to year dependence on government funds for carrying out their lending operation. Normally, an intermediary would loan out each year funds collected from new deposits and other placements by surplus units plus the repayment of maturing loans. This intermediation process would be reflected in the cash inflow from these two sources relative to new loans granted or to the cash inflow. The data are summarized below. Of the total cash inflow received by the DBP in 1981 to 1982 for which the report was available new private deposits and loan collection amounted to only 4.2 percent. These



intermediated cash inflow financed only 26.1 percent for its new loans. Loans collections to beginning outstanding loans ratio was 4.7. FMS ratios for 1980-1982 were much higher: intermediated funds to cash inflow = 29.5 percent, intermediated funds to new loans = 85.5 percent and loan collections to beginning outstanding loans = 84.7 percent. As a commercial bank, FMS grants both short and long term loans. The high loan collection rate may be explained by short-term loan turnover. It does not indicate how well its long term transactions fare.

The Land Bank appears to be trying to increase its relative importance by borrowing heavily from various government sources to expand its asset base. Consequently, its new deposits and loan collections contributed minimally to its total cash inflow or only 3.5 percent in 1981-82. Only a small portion of these borrowings went to loans so that it is able to show a fairly high intermediated funds--new loans ratio of 69.2 percent. Its collection rate was not bad, 80.5 percent.

Another Bank, the smallest, gives the following ratios: 23.6 for intermediated funds--cash inflow, 60.0 percent for intermediated funds to new loans and 52.4 for loan collections/outstanding loans.

The data show that the ready availability to the GLIs or CB credit and other government-generated funds has worked as a strong disincentive against their intermediation process. They also distorted the cost of capital. There is some evidence showing that it also led to inefficient loan decisions. As argued earlier, reliance on non-intermediated funds is permissive of bad lending decisions. GLI officials could afford to be more lax with the evaluation of loan applicants since the risk of default is not expected to damage the growth and stability of the institution. The government could always be expected to replenish GLIs' loanable funds no matter the defaults and poor collections. In contrast, an ordinary intermediary is dependent on new deposits and loan collection for relending so that when these stop, lending also stops.

## 7.2. The DBP Loan Performance

The malallocative effects of the policy the case of the DBP.<sup>8</sup> Apparently, non-economic considerations swung loan decisions in favor of very large projects of doubtful economic

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<sup>8</sup> In 1953 when its work was deemed completed, the Rehabilitation and Finance Corporation was converted into a development bank. From a modest bank with assets valued at ₱664 million in 1955, it has since become a giant with assets of ₱44.0 billion at the end of 1983. Its rate of expansion was gradual in its first decade and a half of existence. Its growth accelerated in the mid-70s as funds from the government and foreign creditors poured in. CB outstanding credit to this bank rose from ₱35 million in 1960 to ₱70 million in 1970, and then to ₱ 241.6M in 1975 and to ₱ 8,623.0M in 1982.

worth. Many of these have defaulted. The defaults are creating substantial shortfalls in the bank's loanable funds that at present cannot be filled up by the CB and the government because of the IMF conditionality. In 1981 to 1982, collection rate was only 4.2 percent and the proportion of new loans financed from new deposits and loan repayment was just 26.1 percent. DBP lending level will be cut to the value of its loan collection if it is unable to borrow from its traditional sources. Prospects for improved collection are however dim given the high default rate of the bank's loan portfolio.

There is no direct evidence on non-repayment or default rate but this can be inferred from some of the bank's balance sheet accounts. Note that the DBP is essentially a lending institution so that its assets should be concentrated on the loan account. In 1971, the share of loans in the total assets was 79.2 percent. Loans' share shows a declining trend reaching 52.0 percent in 1982. On the other hand, investment in securities and other properties' account has absorbed an increasing share from 11.2 percent to 39.2 percent for the same period, or from P248 million to P17,232 million. There is minimal securities market in the country so that the account does not include much private securities. It consists mainly of defaulting loans that had been converted into equity or investment. The conversion of defaulting loans to equity is a practice adopted by GFIs especially the DBP to bail out their large distressed clients. Upon conversion, the loan account is reduced and the investment account is increased

by the value of the defaulting loans. The default rate is inferred from the changes in the investment account since the DBP reports on conversions only occasionally.

Another account that contains uncollected loans is mortgage receivables and miscellaneous investment. By law, forfeited collateral on defaulting loans are put in the process of sale. Such loans are entered in the Mortgage Receivable account. If the forfeited collateral is instead acquired by the bank, it appears in the Other Assets account. Together with investment in securities, these accounts amount to as much as 39.2 percent of total assets in 1982. Apparently, DBP's experience with loan default has worsened for these accounts' share in total assets has an increasing trend.

Default rate is estimated to be the increment or debits to these accounts as a proportion of the beginning balance of loans and advances. Debits to the account are directly reported for 1977 to 1982. Over this period, the rate increased from 8.3 percent to 21.9 percent. DBP's reported repayment rate of 14.2 percent for 1981-1982 on the other hand, seems to be too high considering the high default rate computed above and the low collection rate obtained from the cash flow data. One reason may be that this repayment account reflects accounting entries from loans to investment in securities.

We note that PDCP, the private sector equivalent of DBP, has been unscathed by the series of financial crises experienced the last three years. Looking at the asset

accounts, we find the share of loans to be larger, 72.6 percent, with investment in securities and money market papers forming only 12.0 percent of the total assets in 1981. This account is mostly private securities and contains no foreclosed loan account. Gross income to earning asset ratio is significantly higher than DBP, an average of 13.5 percent versus 10.9 percent for 1976-1981, and 10.5 percent versus 9.3 percent in 1970-1975. Its net income to earning assets ratio is also substantially higher, about 2.0 percent versus DBP's 1.0 percent. In 1982, DBP's net income dropped to 117.3 million.

The government, at least on paper, strongly supports agricultural and small and medium scale industry development. The rediscounting schedule has also been favorable to this sector. It is relevant to see how DBP meets this objective. The tables on the sectoral and size distribution of loans show that this objective has not been pursued by the DBP. The proportion of loans allocated to agriculture dropped from about one-third around 1960 to 20.4 percent in 1982. There is, moreover, an increasing concentration of loans to large borrowers. In the last five years, about 70 percent of loans outstanding was in over ₦5 million sizes with the share of medium and small scale borrowers (those with ₦100,000 to ₦500,000 loans) about 5 percent. Those in the lowest loan brackets form an insignificant group of borrowers.

### 7.3. PNB's Performance

The PNB is the oldest state bank having been founded before independence in 1916. It has also been the largest bank, its assets rose in nominal value from ₦4.2 billion in 1960 to ₦70.5 billion in 1983 and comprised 21.0 percent of total banking assets and 28.4 percent of commercial bank assets in 1982. Its relative importance was even larger in earlier years, 26.9 percent and 35.7 percent, respectively, in 1960. It is classified as a commercial bank because of its checking account function but it also operates as a development bank. Like other state banks, its decisions particularly on its loan portfolio, is subject to closer government control. It has been made to fund priority activities particularly in provincial areas. The maturity structure of its loans is longer than that of private commercial banks.

PNB's intermediation and allocative performance appears very much better than the DBP, but definitely worse than the three largest nonpolitical private banks (BPI, Metrobank and Far East Bank). Private deposits formed an average of only 25 percent of total liabilities in 1976-1982 as compared to 54 percent for the private banks. As reported earlier it had a much higher intermediated funds to loans ratios and collection rate. Like the DBP, PNB has committed

substantial funds to large borrowers some of which are in distress and defaulting like Delta Motors. The PNB also invested in the equity of many new public corporations as well as politically favored private ones via the National Investment Development Corporations. Investments and other asset accounts grew in value from P893 million in 1981 to P9,308 million in 1983 or more than 10 times. Defaults on investments could not be reflected in the accounts for the investment value is recorded at cost in either Investments in bonds, bills and equity or Other Assets balance sheet accounts. More detailed data would be needed to arrive at a conclusion about the quality of PNB's portfolio. Unofficial reports on NIDC investments show a fairly large number of unprofitable and failing firms. It is possible that PNB's more recently acquired assets are as bad as DBP.

PNB's earnings from interest, services and capital gains were fairly modest. In 1980-1983 total earnings to total assets ratio averaged only 10.6 way below the prevailing loan rate of at least

18.0 percent. This low rate is partly explained by the bank's loans to priority sectors whose loan rates are set at very low levels. It could also be explained by poor collection and low return on its investment. Recall that loans to priority sectors are granted to give at least 3.0 percent interest rate spread. Regular loans are given even higher spreads. If the interest rate on its loans were collected promptly, the bank would be able to show a fairly high interest rate spread. Its financial statements show that the spread averaged only 1.1 percent in the 80s. The spread for the last two years were even lower or .8 of one percent versus 1.5 percent in mid-70s. This spread is below what bankers consider to be adequate to cover their intermediation or from 2.5 to 3.0 percent. Apparently, the special loan accommodations to PNB from the CB and other government sources did not result in its earning a higher rate of profit. Defaults and bad investments must have eaten up its potential spread.

#### 7.4. The Land Bank and the Philippine Amanah Bank

The Land Bank and the Amanah Bank are still minor GFIs whose assets in 1982 amounted to only 7.8 billion and .2 billion in comparison with DBP's 44.2 billion and PNB's P58.1 billion. LB



is lower showing very rapid growth in the last five years and is departing from its highly specialized nature of catering to the credit needs of farmers on the land reform program. Its assets rose from 2.4B in 1976 to 7.8B in 1982, an increasing proportion of which went to investments and other assets. Their share rose from 4.5 percent in 1975 to 17.6 percent in 1982. Both banks are also dependent on non-intermediated funds with private deposits forming only 9.5 and 33.6 percent, respectively, of their total liabilities for the same period. Their performance was, on the whole, much better than the DBP. They had a much higher collection rate in 1980-1982 so that they were able to finance more than 60 percent of their new loans from new deposits and loan collection or 69 percent for LB and 60.0 percent for PAB. The higher collection rate led to a higher earnings to asset ratio and interest spread: 9.6 percent for LB and .9 percent for PAB.

The Land Bank may be expected to play an increasing developmental role especially if the refinancing policy is abandoned and the bank is made to rely on intermediated funds.

Amanah Bank has remained the smallest GFI. Its assets grew at only 30.9 percent per year from 1976-1982. Its portfolio composition has not changed much either with investments and other assets averaging 14.8 percent over the period. This high ratio together with the high collection rate should indicate a low default

rate. These are not, however, conclusive indicators for defaulting loans can remain indefinitely in the loan account and the high collection may reflect short-term loan turnover.

### 7.5. Liquidity Control and Management of Credit

The CB pursues its twin objective of stabilization and growth via liquidity and selective credit control. Target level and growth of liquidity or  $M_3$  ( $= M_1$  + saving and time deposits + deposit substitutes) are set for each planning period and at the beginning of each year. The target values chosen accommodate expected GNP growth and inflation plus some stabilization objective. The targetting exercise is fairly rough and not based on any econometric study. In the last Five-Year Plan, 1978-1982,  $M_3$  was targetted to grow at 17.6 percent annual rate while money supply or  $M_1$  at 16.0 percent. How this growth rate is to be achieved is not discussed in either the CB reports or the National Plan. The sources of the monetary base and the multiplier are neither stated. Yet one is surprised at how closely the targetted liquidity was achieved during the last planning period. Table 23 shows the ratio of actual  $M_3$  to target  $M_3$  in each year deviated from unity by less than 3.0 percentage points only. Money supply or  $M_1$  shows a larger fluctuation from target which is to be explained by portfolio changes between  $M_1$  and the other monetary assets--savings and time deposits, and deposit substitutes. Control over liquidity seems to have been effected through CBCI (CB certificates of indebtedness) transactions rather than through other instruments--rediscounting and reserve requirement. CB credit to the government and to financial institutions under various selective rediscounting rules was granted quite liberally. When this resulted in excessive liquidity CBCIs were sold to mop up

liquidity. In fact, the CB frequently reported mopping up liquidity at the same time that it was expanding credit for special purposes. This inconsistency is seen in the management of credit, particularly that of GFIs.

The Investment Coordinating Committee which includes CB representative sets targets for credit expansion of the financial system and for its major component institutions including individual GFIs. In the table, the targetted growth rates for credit or loans,  $M_1$  and  $M_3$ , were approximately equal at a little less than 18.0 percent. The target growth in credit for the various groups of financial institutions were allowed to differ slightly from the aggregate target---the GFIs were allowed a higher growth than private banks following the Plan's liberalized selective credit expansion interest. In the course of the Plan period, the actual loans increased at much higher rates for all banking institutions. GFIs' credit growth was 55.4 percent as compared to its target growth of 19.8 percent, while private banks' growth was 34.2 percent versus the target of 16.8 percent. The target set for each year was always exceeded except for 1978. PNB and Land Bank exceeded their planned credit by more than 100 percent in most years. The PNB exceeded its target at an increasing rate from .94 in 1978 to 2.51 in 1982 while the Land Bank ratio fluctuated at the high rates of 1.82 to 2.55.

The credit granted by the financial system is a result of the interaction of supply and demand for loans and other credit. Supply consists of intermediated funds, rediscounting, special government

financing and foreign borrowing. As seen in Table 15 and 19 and in individual GFI accounts, CB credit and foreign borrowing grew very rapidly during the plan period, explaining the fast growth of unplanned expansion of loans by the major financial institutions. Note that the supply of funds from these sources were directly controlled by the monetary authority so that any excess credit over the target resulted from its decision. This is specially true in the case of the GFIs which are almost totally dependent on these sources for their loanable funds.

Money supply and total liquidity did not grow as fast as credit because of the large BOP deficits incurred during the period. The foreign exchange component of the credit went out of the country as imports and possibly capital flow. The easy credit policy, in turn, fed on imports and created more deficits.

GFIs form a very important segment of the financial market and is the major supplier of long-term funds. Most of its funds are government funds (CB is government). And yet there is no planning and supervisory body to set their lending criteria, to define and redefine their role and to review their performance. The Investment Coordinating Committee has a limited authority, i.e., the approval of large (P300 million or more loan) GFI-financed projects, public and private. The CB which has supervisory authority over all financial institutions but has no power over the GFIs' performance. There are no rules governing their accountability for loan losses.

As a country develops the need for GFIs diminishes. Market imperfections including financial segmentation disappears. The Philippine GFIs in contrast, were expanded in relative importance and intrusion into market intermediation processes intensified. The Philippines should consider following the denationalization moves in Korea or the historical examples of Thailand and Malaysia where GFIs and financial interventions are minimal.

## 8. Saving Rate and Financial Saving

A quantitative estimate using regression of the effect of interest rate on the saving rate and the holding of financial assets, specifically bank deposits, was done by ADB for Korea, Thailand and Pakistan. A similar set of regression specifications was applied to Philippine data (semestral 1970-1982) to allow for a comparison of results. Pakistan's regression results are not included due to the shortness of Pakistan's time series because of the country's separation from East Pakistan and the reported poorer quality of data on saving. The regressions on the saving function gave mixed results while those on financial saving were generally good. (See Table 24.)

Korea has a very high saving rate, 20.1 percent in 1976-80 including household saving which account 35.6 percent and government saving of 26.1 percent of total saving. The regression equations show the national saving rate and the household saving rate to be significantly determined by the level and the growth of real GNP. Thailand is another high saving country and like Korea, its saving rate is also significantly influenced by income growth (real GDP). Here the real interest is significant. The Philippines showed insignificant effects of both GNP growth and interest rate on saving. Real interest rate on deposits was found significant only in Thailand. This country differs from the two in its low inflation rate which led not only to a higher real deposit rate but to a more stable expected rate.

The regressions on financial saving proxied by bank deposits of various types gave generally good results. The influence of income growth, real interest rate on deposits of one-year maturity and the accessibility to banking facilities had significant coefficients of the expected sign. Similar results are found by Fry (1982) in other countries in his large comparative study on financial saving and savings functions. It is expected that the responsiveness of deposits to the real rate would inter control on loan rate and the generous rediscounting rules are abandoned. Banks and other financial institutions would then be stimulated to compete for private funds in their effort to achieve an optimum level of activity. In the absence of control, the optimum activity level would imply a higher intermediation rate.

## 9. CONCLUDING REMARKS

Governments in modern time which are attempting to accelerate economic growth may choose from several sources of finance---taxes, private saving, foreign borrowing and central bank credit or inflation. Political considerations impose ready limits to a government's ability to impose high taxes. Up to a point private savings can be increased by all sorts of incentives such as high interest rates, tax rebates and the like. Foreign borrowing may be tapped to the extent it can be invested efficiently. These sources of development funds have natural limits. In contrast, inflationary finance is unlimited. Modern central banks are generally empowered to create money, and governments which decide to use this power can do so at will. Inflation as a tax requires no direct consent from the governed while regular taxes have to be approved through some legislative process and implemented via some collection mechanism. The ease with which CB credit can be created makes inflationary finance of development an easy choice for the less prudent governments. This explains the extensive adoption of rediscounting as a major selective credit control instrument by LDCs.

The paper tried to show the serious disadvantages of using this tool. It was argued how rediscounting goes against the process of financial market development institutions with a good substitute for intermediated private savings. Rediscounting shifts the supply of funds and leads to lower interest rate. In some cases like the Philippines and Pakistan, cumbersome rediscounting rules are imposed



which exacerbate the intervention in the intermediation process. These rules are usually chosen in an ad hoc manner on the basis of intuitive reasoning rather than economic rationale.

The experience of the four countries in the use of selective credit control and the role and importance of their GFIs in their SCC program reveals the undesirable consequences of cumbersome inflationary finance. The four countries---Korea, Pakistan, Philippines and Thailand---used different combinations of SCC which vary on their reliance on rediscounting. At the extremes are the Philippines and Thailand; the Philippines for utmost control and rediscounting, Thailand for the least. Their SCC and general credit programs are summarized below

1. Korea followed a high interest rate policy; the government owned and controlled all financial institutions; and preferential rediscount and loan rates were given to a limited number of specific sectors. All non-preferred sectors had high loan rates reaching 28 percent in the late 1960s. Non-preferred rediscounting rate about equaled the deposit rate, thus discouraging rediscounting for ordinary loans. The high inflation rate sometimes rendered the real deposit and loan rate negative despite the very high nominal deposit and loan ceilings. The management problems expected of government banks appeared not to have cropped in Korea. Bank performance has proved fairly good. Because of inflation, Korea's financial market

developed but at a slow pace. Its  $M_2$ /GNP practically stagnated at about 42 percent after its rapid rise around 1970.

2. Pakistan adopted a very bad combination of low loan rate, government ownership and control of all financial institutions and cumbersome loan, and rediscounting schedules. With one exception, its specialized institutions relied on CB credit and government budgetary support for their loanable fund supply. Long-term loan rates were set lower than time deposit rates. This interest rate structure worked against banks' drive to attract deposits and was therefore inconsistent with its active saving mobilization drive. Some of its GFIs have serious default problem.

3. Thailand. Thailand is the least interventionist of the four countries studied except for the interest rate ceilings imposed on loans and deposits. Government ownership and control of financial institutions is limited to four fairly small specialized institutions. It is the most conservative as far as inflation rate and inflationary finance is concerned. The low inflation rate made the ceiling rates not so restrictive. Preferential rediscounting is limited to a very small set of priority activities. The loan rate-rediscounting spread on these is low relative to the loan rate-deposit rate spread allowed non-preferred borrowers. Consequently, banks avoided rediscounting and relied mainly on funds from private saving and other surplus. Implementation of the ceiling rates was reported to be lax so that the market was able to operate relatively freely.

All these led to a faster financial growth as shown by the upward trend in  $M_2/\text{GNP}$  reaching a level that is even higher than the more developed Korea, 45.5 percent.

4. The Philippines. A cumbersome rediscounting and loan structure, easy rediscounting facility for all types of loans, preferred and non-preferred, a large public financial sector and until 1981, low loan and deposit ceilings combined to repress financial development and misallocate financial resources. At the same time rediscounting <sup>led to</sup> inflation. Utmost reliance on CB credit permitted the GFIs to diverge from economic lending criteria and misallocate their resources to bad projects. As a consequence, the default rate in the two major GFIs has reached crisis proportion. The country shows the lowest financial development with its  $M_2/\text{GNP}$  at 22.0 percent or half of Thailand.

The most serious defect of Philippine policy lies with rediscounting. It obstructs intermediation process, creates a built-in inflationary bias and permits (and possibly encourages) inefficient GFI management. The interest rate liberalization of mid-1981 to early 1982 has not led to the desired results for the rediscounting policy continues to discourage intermediation and competition by the GFIs. Theoretically, rediscounting should be available only for last recourse or emergency needs of the financial system. Loanable funds should come from mobilized savings and current

surplus for unless they do, the funds distort the borrowing and lending decisions of financial intermediaries.

It seems too simple-minded to blame rediscounting for the ills that the financial system presently experiences. Yet one could not but be convinced that if the GFI's and other banks were mainly acting as financial intermediaries rather than as conduit of CB funds, they would not have been as imprudent with the funds as they were in the last five to 10 years. Alternatively, the GFI's may be denationalized and made to compete with the existing private banks.

Table 1

## SELECTIVE CREDIT INSTRUMENTS

Country	Subsidized Loan Rates for Priority Sectors	Preferential Rediscount Rates	Budgetary Subsidies	Credit Floors	Credit Ceilings	Proliferation of Specialized Financial Institutions
BU	x			x	x	x
IN	x	x			x	x
IO	x	x	x	x	x	x
KO	x	x	x	x	x	x
MA	x	x		x		
NE	x	x		x	x	x
PA	x	x	x	x	x	x
PH	x	x	x	x		x
				(PD 717)		
SR	x	x	x		x	
TA	x	x				
TH	x	x		x		

Table 2

FINANCIAL STRUCTURE OF KOREA  
1975 AND 1982

	Percentage Distribution of Assets of Financial Institutions		Rate of Growth of Assets 1975-1982 (% p.a. in 1975 prices)
	1975	1982	
A. Monetary System	76.50	74.21	11.76
1. The Bank of Korea	15.52	9.98	5.39
2. Deposit money banks	60.98	64.23	13.08
a. Commercial banks	37.85	41.28	13.64
i) 5 nationwide commercial banks	31.28	32.04	12.63
ii) 10 local banks	4.72	4.22	10.47
iii) branches of foreign banks	1.85	5.03	29.43
b. Specialized banks	23.12	22.94	12.12
i) Korea Exchange Bank	12.92	11.58	10.51
ii) Small and Medium Industry Bank	2.05	2.53	15.65
iii) Citizens National Bank	1.90	2.85	18.98
iv) Korea Housing Bank	1.20	1.74	18.37
v) Credit sector of agricultural cooperatives	4.62	3.80	9.16
vi) Credit sector of fisheries cooperatives	0.44	0.44	12.26
B. Nonbank Financial Institutions	23.50	25.78	13.74
1. Development banks	17.22	12.80	7.59
a. Korea Development Bank	16.62	10.30	4.82
b. Korea Long-term Credit Bank	0.38	0.80	25.04
c. Korea Export-Import Bank	0.22	1.70	50.72
2. Trust accounts	1.74	4.86	29.94
3. Insurance companies	1.48	3.25	25.63
a. Life insurance companies	0.75	2.34	31.38
b. Nonlife insurance companies	0.72	0.91	15.38
4. Investment and finance companies	1.58	2.20	17.70
5. Mutual savings and finance companies	0.45	1.24	29.51
6. Postal savings accounts	0.32	0.00	-41.85
7. Securities firms	0.71	0.30	-0.57
a. <del>Korea Securities Finance Corporation</del>	<del>0.19</del>	<del>0.19</del>	<del>0.19</del>
b. Securities dealers and brokers (net)	0.39	-	-
c. Investment trust companies (net)	0.12	-	-
8. Merchant banks	-	1.13	-
Total Assets of the Financial System (%)	100.00	100.00	12.24
(in billion won)	14,006.0	97,817.2	

Source: Planning. Domestic Resource Mobilization Through Financial Development: Korea. Asian Development Bank Economics Office, 1974.

Table 3

STRUCTURE OF RATES OF DEPOSIT MONEY BANKS:  
KOREA, 1980-1982

		Discounts on Bills <sup>a</sup>	Loan for Exports	Loans with MF <sup>b</sup>
<b>A. Bank of Korea Discount</b>				
Effective from:				
Month/Day				
1980	(1.12)	24.5	15.0	22.0
	(6.50)	23.5	15.0	22.0
	(9.18)	21.5	15.0	21.0
	(11.8)	19.5	15.0	18.5-19.5
1981	(11.9)	18.5	15.0	17.5-19.5
	(11.3)	17.5	15.0	16.5-17.5
	(12.29)	16.5	15.0	15.0-16.0
1982	(1.14)	15.5	12.0	15.0-16.0
	(3.29)	13.5	11.0	13.5-14.0
	(6.28)	10.0	10.0	10.0
<b>B. One Year Time Deposits</b>				
Month/Day		Money Deposit Banks	Other Financial Institutions	
1980	(1.12)	24.0	24.9	
	(4.18)	24.0		
	(9.18)	21.9		
	(9.22)		24.9	
	(11.8)	19.5		
	(11.13)		22.5	
1981	(2.20)	19.5		
	(7.1)	19.5		
	(11.9)	18.6		
	(11.18)		19.5	
	(11.30)	17.4		
	(12.14)		18.3	
	(12.29)	16.2		
1982	(1.14)	15.0		
	(1.25)		15.9	
	(3.29)	12.6		
	(4.1)		13.9	
	(6.28)	8.0		
	(7.1)		9.5	

Table 3  
(Continued)

	Jan. 1980	June 1982
<b>C. <u>Loan Rates</u></b>		
1980:		
Preferred Sectors:		
Exports and agriculture all banks	15.0	10.0
Public housing at KHB	8.0	8.0
Regular Loans		
Up to 3 years	21.5-22.0	10.0
Longer than 3 years	22.5-24.0	10.0
Korea Housing Bank		
Other Loans	16.5-18.5	10.0
Bank for agricultural cooperative		
Fishing and other loans	18.5-23.5	10.0

<sup>a</sup>After 1978 discount rates varied according to the credit-worthiness of the borrower. The rate shown is for the best credit risk.

<sup>b</sup>Loans to the shipbuilding and agricultural sectors are more heavily subsidized.

Source: Bank of Korea Monthly Economic Statistics.



Table 4

SOURCES OF FUNDS OF BANKING INSTITUTIONS OF KOREA, AVERAGE FOR 1975-1983  
(In Percent)

	Nationwide Commercial Banks <sup>b</sup>	Local Banks <sup>b</sup>	Specialized Banks <sup>b</sup>	Korea Exchange Bank <sup>c</sup>	Small and Medium Industry Banks <sup>e</sup>	Citizen's National Bank	Korea Housing Bank	Agricultural Cooperatives	Fisheries Cooperatives <sup>a</sup>
I. Deposits/Liabilities	58.3	67.5	53.3	22.2	69.9	91.5	56.0	56.4	53.0
A. Banks/Liabilities	.7	1.0	.2	.3		.1	.2	.3	
II. Borrowings/Liabilities					30.1	.7	-	43.6	47.0
A. Borrowings from BOK/ liabilities	13.8	13.6	6.4	10.2	10.2	.4	-	21.1	20.4
B. Borrowings from govern- ment/liabilities			7.2	-	3.0	.2	2.3	16.1	16.3
III. Treasury agencies/liabilities	.6	1.1	.7	-	-	-	-	-	-
IV. Foreign liabilities/liabil- ities	10.4	3.9	15.3	49.9 <sup>d</sup>	-	-	-	-	-

<sup>a</sup> For 1978-1983 only.

<sup>b</sup> Liabilities = Total Assets - Acceptances and Guarantees.

<sup>c</sup> Liabilities = Total Assets - (Paid in K, + Reserves + Acceptances and Guarantees).

<sup>d</sup> Foreign Liabilities = Deposits in Foreign Currency + Borrowings in Foreign Currency.

<sup>e</sup> Total Liabilities = Total Deposits + Total Borrowings.

Table 5

SELECTED FIGURES AND GROWTH RATES OF SOME  
ECONOMIC INDICATORS: KOREA, 1970-1982

	Real GNP	CPI	Real $M_2$	$\frac{M_2}{\text{GNP}}$
A. Growth Rates (in %)				
1970		15.1		
1971	9.4	13.4		
1972	5.8	11.7	15.7	9.4
1973	14.3	8.2	20.6	8.8
1974	8.0	24.3	-4.3	2.1
1975	7.1	26.3	2.8	3.9
1976	15.1	15.3	13.4	1.6
1977	10.3	10.1	20.1	8.8
1978	11.6	14.4	11.9	0.3
1979	6.3	18.3	4.4	1.7
1980	5.3	28.7	0.8	7.4
1981	7.1	21.3	7.6	1.4
1982	6.6	4.4	17.6	11.4
B. Figures				
	Real Interest Rate = Percentage interest paid on one year time deposits minus GNP deflator			$\frac{M_2}{\text{GNP}}$
1965	13.8			
1970	6.9			
1971	8.5			32.9
1972	-0.6			36.3
1973	-1.2			32.8
1974	-14.8			33.5
1975	-9.7			32.2
1976	-2.2			31.7
1977	-0.5			34.5
1978	-3.9			34.6
1979	-0.7			34.0
1980	-2.9			36.5
1981	3.1			37.0
1982	3.6			41.2

Source: Dowling, Domestic Resource Mobilization Through Financial Development: Korea. ADB Economics Office, 1984, Tables 7 and 11.

Table 8  
FINANCIAL STRUCTURE OF PAKISTAN, 1981

	Percentage Distribution of Assets and Domestically-Mobilized Funds of Financial Institutions
A. Commercial Banks as of Dec. 31, 1981	76.1
Habib Bank	22.4
National Bank of Pakistan	16.2
United Bank Ltd.	15.5
Muslim	7.8
Allied Bank	3.2
Subtotal	65.1
Foreign branches	11.0
B. Specialized Financial Institutions	
1. Industrial Development Bank of Pakistan (IDBP as of June 30, 1981)	1.3
2. Agricultural Development Bank of Pakistan (ADBP as of June 30, 1981)	1.9
3. Pakistan Industrial Credit and Investment Corporation (PICIC, June 30, 1981)	1.1
4. National Development Finance Corporation (NDFC, Dec. 31, 1981)	1.4
5. Federal Bank for Cooperatives (FBC, Dec. 31, 1981)	.4
6. Investment Corporation of Pakistan (ICP)	.6
7. National Investment Trust (NIT, June 30, 1981)	.6
8. Equity Participation Fund (EPF)	.1
9. Small Business Finance Co. (SBFC)	
10. Home Building Finance Corpo- ration (HBFC, June 30, 1981)	9.6
C. Government Saving Scheme (June, 1981)	na
D. Karachi Stock Exchange	5.5
Balance sheet value of ordinary shares + preferred shares + debentures	7.1
E. <del>State Life Insurance Co. (Dec. 31, 1981)</del>	<del>1.2</del>
Total	100.0

Source: Edita A. Tan, Pakistan's Financial System and Monetary Policy.  
September, 1983.

## B. Time or Fixed Deposit Rates

	6 Mos.-1 Yr.	1-2 Yrs.	2-3 Yrs.	3-4 Yrs.	4-5 Yrs.	5-7 Yrs.	1 Yr.	2 Yrs.	3 Yrs.	4 Yrs.	5 Yrs.	6 Yrs.	7 Yrs.
1. Time deposits	9.50	10.50	11.00	11.75	12.25								
2. Scheduled banks	9.89	10.38	11.06	12.02	12.31	12.38							
3. National savings scheme							12.0	11.8	11.8	14.2	14.5	14.6	14.1
a. Khas saving account							11.0	11.2	11.2	11.2	11.2	12.8	13.0
b. Khas deposit certificates													
4. NDFC							11.0	11.5	12.0	12.5	13.0		
a. Regular deposit							12.0	12.5	12.5	12.5	13.0		
b. Golden certificates of deposit													

## II. Loans

### A. Ceiling Rates on Loans to Commercial Banks

Conventional Loans	Fixed Investment Industry	Export Agriculture	Export Scheme	Locally-Manufactured Machines	Gov't Commodity Operation Refinanced	Gov't Commodity Operation Own Funds	Minimum Rates Finished Goods	Minimum Rates Others
14.0	11.0	11.0	3.0	2.0	10.25	11.50	13.0	15.0

### B. Some Specialized Financial Institutions

#### Agricultural Development Bank

< Rs 5,000      > Rs 5,000

- |   |      |      |      |
|---|------|------|------|
| 1. Short term   | 11.0 | 12.0 | 13.5 |
| 2. Medium- and long-term                                      | 11.0 | 11.0 |      |
| 3. Local currency   |      |      |      |
| 4. Foreign currency   |      |      |      |
| 5. IDBD present rates   |      |      |      |
| a. Foreign currency loans = 14% less 3% foreign exchange risk |      |      |      |
| b. Locally manufactured machines = 2% below the foreign rate  |      |      |      |
| c. Agro based = 1% above bank rate or 11%.                    |      |      |      |
| d. Hotel and = 4% above bank rate or 13-14%.                  |      |      |      |
| e. NPI investment projects = 3-4% above bank rate or 13-14%.  |      |      |      |

#### Federal Bank for Cooperatives

#### PICIC

#### NDFC

9.0

8.5

8.50-12.50  
14<sup>a</sup>

11.0-14.0<sup>a</sup>  
14.0<sup>b</sup>

ent.  
at 3.5.

## III. Yield on MT (June 1982) = 11.29

<sup>a</sup> Eleven percent (11%) for industries, 2-3 percent over bank rate for others.

<sup>b</sup> Includes 3 percent foreign exchange rate that goes to the Government.

Source: Tan, Pakistan's Financial System and Monetary Policy, September 1982.

Table 8

SELECTED FIGURES AND GROWTH RATES OF SOME  
ECONOMIC INDICATORS: PAKISTAN, 1970-1982

	$\frac{M_2}{GNP}$	$M_2$	GNP	CPI
A. Growth Rates (in %)				
FY 1970			9.0	
1971			0.1	5.7
1972			1.0	5.6
1973			7.5	8.7
1974			7.7	30.0
1975	-17.2	7.8	4.1	26.7
1976	7.0	25.9	4.4	11.7
1977	9.6	24.3	3.9	9.2
1978	2.4	23.0	10.4	6.9
1979	5.0	20.2	8.5	8.4
1980	-0.5	18.5	7.0	10.4
1981	-0.3	14.2	5.1	13.9
1982	-0.4	10.4	5.9	11.5
3. Figures				
			Minimum rates on on fixed term deposits (6 mos.-1 yr.)	Real Interest Rate - ACPI =
1970				
1971				
1972				
1973				
1974	37.8			
1975	31.3		8.5 <sup>A</sup>	26.7 -18.2
1976	33.5		8.5	11.7 3.2
1977	36.7		9.5 <sup>B</sup>	9.2 0.3
1978	37.6		9.5	6.9 2.6
1979	39.5		9.5	8.4 1.1
1980	39.3		9.5	10.4 - 0.9
1981	38.0		9.5	13.9 - 4.4
1982	36.3		9.5	11.5 - 2.0

<sup>A</sup> From 1-10-1975.

<sup>B</sup> Effective 7-6-77.

Source: Tan. Pakistan's Financial System and Monetary Policy. September, 1983. Tables 7 and 9A.

Table 9

SELECTED FIGURES AND GROWTH RATES OF SOME  
ECONOMIC INDICATORS: THAILAND, 1970-1982

	GNP	CPI	M <sub>2</sub> (Nominal)	M <sub>2</sub> GDP	Nominal Deposit Ceiling (1 Year) - ΔCPI	Real Deposit Interest Rate
A. Growth Rates (in percent)						
1970				6.4		
1971	6.6	0.48	22.3	9.2		
1972	10.0	4.91	29.6	8.7		
1973	17.2	15.41	23.5	- 6.8		
1974	30.3	24.35	28.1	- 4.2		
1975	19.6	5.26	22.3	4.3		
1976	11.0	4.20	23.2	6.0		
1977	11.3	7.20	25.0	2.9		
1978	28.4	8.33	19.3	- 1.0		
1979	17.6	9.83	13.0	- 3.1		
1980	18.4	19.71	26.9	- 0.7		
1981	19.2	12.70	21.5	0.0		
1982	14.6	5.19	29.9	12.3		
B. Figures						
1965			28.1	7	0.91	6.09
1970			34.8	7	0	7.00
1971			38.0	7	0.46	6.52
1972			41.3	7	4.91	2.09
1973			38.5	7	15.41	- 8.41
1974			36.9	8	24.35	-16.35
1975			38.5	8	5.26	2.74
1976			40.8	8	4.20	3.80
1977			42.0	8	7.20	0.80
1978			41.6	8	8.33	- 0.33
1979			40.3	9.1	9.83	- 0.73
1980			40.0	12	19.71	- 7.71
1981			40.0	13	12.70	0.30
1982			45.6	13	5.19	7.81

Source: IMF. International Financial Statistics Vol. XXXV #12, December 1982, and Vol. XXVIII #10, October 1975.

Table 10  
FINANCIAL STRUCTURE OF THAILAND  
1973 AND 1980

Financial Institutions	Percentage Distribution of Assets of Financial Institutions		Average Annual Growth Rate
	1973	1980	
1. Commercial banks	72.0	66.8	21.1
2. Finance companies	9.7	14.5	29.6
3. Life insurance companies	1.4	1.4	23.1
4. Agricultural cooperatives	1.5	( 1.3)	20.0
5. Savings cooperatives	( 0.0)	1.0	24.3
6. Pawnshops	0.0	( 0.8)	23.2
7. Credit foncier	0.0	0.9	46.3
8. Government savings bank	10.7	6.2	13.3
9. Bank for Agriculture and Agricultural Cooperatives	2.0	3.9	34.5
10. Industrial Finance Corpo- ration of Thailand	0.0	0.3	27.2
11. Government Housing Bank	0.0	2.3	90.0
12. Small Industrial Finance Office	-	0.0	77.7
Total Assets in:			
(Percent)	100.0	100.0	
(Baht Million)		449.0	

Source: Co. Domestic Resource Mobilization Through Financial Development:  
Thailand. ADB Economics Office, 1984.

SOURCES OF FUNDS OF BANKING INSTITUTIONS, THAILAND, 1970-1983  
(In Percent)

	1970	1975	1976	1977	1978	1979	1980	1981	1982	1983 <sup>d</sup>
I. Commercial Banks										
A. Deposits/Liabilities <sup>a</sup>	75.2	71.6	74.2	73.1	69.2	65.4	70.0	71.4	73.5	75.4
Bank deposits/liabilities	.3	.3	1.4	.7	.6	.6	.3	.2	.2	.1
Government deposits/liabilities	4.9	2.8	3.3	2.9	2.5	2.8	2.5	3.3	2.7	2.9
Non-government sector/liabilities	70.0	68.0	69.5	69.4	66.1	62.0	67.1	67.9	70.6	72.3
B. Borrowings/Liabilities	1.9	6.6	5.1	4.2	4.8	7.9	7.6	7.1	7.0	6.4
Borrowings from BOT/liabilities	1.9	6.2	3.9	3.4	3.7	6.3	5.5	5.6	4.8	4.3
C. Foreign liabilities/liabilities <sup>b</sup>	8.9	6.1	7.8	10.4	13.6	14.5	9.3	9.2	6.3	6.8
Foreign borrowings/liabilities	7.8	6.9	6.4	8.4	11.2	13.4	8.4	8.4	5.9	6.1
Other foreign liabilities/liabilities <sup>c</sup>	1.1	1.2	1.4	2.0	2.4	1.1	.9	.8	.9	.7
II. Bank for Agriculture and Agricultural Cooperatives										
A. Deposits/Liabilities	20.2	54.9	60.6	65.4	59.8	58.0	52.4	55.1	55.3	57.7
Commercial banks/liabilities	7.5	32.2	42.3	47.1	43.9	44.0	40.4	40.4	40.2	40.4
Business and household deposits/liab.	12.7	22.5	18.3	18.3	15.9	14.0	12.0	14.7	15.0	17.3
B. Borrowings/Liabilities	16.4	17.0	18.4	13.7	19.9	20.0	28.4	20.8	18.3	15.4
Bank of Thailand credit/liabilities	9.8	9.9	13.1	10.6	15.9	17.4	26.0	18.1	16.2	14.0
Government/Liabilities	.5	3.7	3.7	3.1	4.1	2.6	2.0	2.7	1.6	1.4
C. Foreign liabilities/liabilities	-	-	1.2	1.6	3.7	6.4	6.3	9.1	11.2	12.0
III. Government Savings Bank										
A. Deposits/Liabilities		74.0	75.0	77.9	78.1	80.0	80.7	80.9	81.1	80.9 <sup>h</sup>
Commercial banks DD/liabilities		-	-	-	-	-	-	-	-	-
Private sector deposits/liabilities		73.3	74.1	77.0	77.6	79.3	80.2	80.4	80.6	80.4
Government deposits/liabilities		.7	.8	.8	.5	.7	.5	.4	.5	.5
B. Borrowings/Liabilities		10.7	9.9	8.7	8.5	7.4	6.2	5.9	6.0	6.2
IV. Government Housing Bank										
A. Deposits/Liabilities			44.7	68.1	63.8	60.7	60.6	47.4	37.8	21.3
Commercial banks/liabilities			22.6	49.8	41.4	35.1	23.4	16.3	9.3	6.5
Private sector/liabilities			21.8	18.2	12.4	10.8	15.4	13.2	14.2	14.8
Other financial institutions/liab.			.2	-	10.0	14.8	21.9	17.8	14.3	-
B. Borrowings/Liabilities			43.3	9.6	5.5	5.5	14.0 <sup>a</sup>	29.9	36.6	47.4
Government/Liabilities			4.2	2.6	1.0	1.1	.3	.7	.7	.6
Bank of Thailand/liabilities			-	-	-	-	-	5.1	8.6	9.0
Other financial institutions/liab.			-	-	-	-	2.9	7.1	5.6	19.7
Commercial banks/liabilities			39.1	7.0	14.9	14.8	11.1	-	4.3	-
C. Foreign liabilities/liabilities			-	12.7	22.6	26.9	18.4	15.4	13.6	17.4



<sup>a</sup>Does not include deposits from non-residents and foreign currency deposits. Includes bonds, debentures and other borrowings from 1960 to 1983 of 2,000 million baht.

<sup>b</sup>Foreign liabilities + foreign currency deposits.

<sup>c</sup>Non-resident deposits, foreign currency deposits and deposits of banks.

<sup>d</sup>Data for 1983 are until September only.

<sup>e</sup>Up to July, 1983 only.

Source of basic data: Department of Economic Research, Bank of Thailand. BOT Monthly Bulletin Vol. XIV, #10, October 1974. The BOT Quarterly Bulletin. Vol. XXI, #1, March 1981 and Vol. XXIII, #3, September 1983.

Table 12  
STRUCTURE OF INTEREST RATE IN THAILAND  
1975, 1980, 1982

	1975	1980	1982
A. Bank of Thailand Rediscount			
1. Regular loans	10.0	15.0	15.0
2. Priority sectors: Exports, agriculture, etc.	5.0	5.0	5.0
B. Commercial Bank Loans			
1. Regular loans including non-preferred exports	15.0	18.0	19.0
2. Priority sectors with BOT refinancing	7.0	7.0	7.0
C. Deposit Rates in all Banking Institutions			
1. Savings deposits	4.5	8.0	8.0
2. Time deposits:			
3 months or less	6.0	9.0	9.0
6-less than 12	8.0	12.0	12.0

Source: Bank of Thailand Quarterly Bulletin.

Table 12

STRUCTURE OF INTEREST RATES, PHILIPPINES, 1980-83  
(In Percent per Annum)

	Commercial Banks <sup>a</sup>	Thrift Banks	Rural Banks
<b>I. Deposit Rates</b>			
<b>A. Savings deposits</b>			
<u>Date</u>			
Dec. 1, 1979	7	7 1/2	7 1/2
Aug. 22, 1980	9	9 1/2	9 1/2
July 1, 1981	no ceiling	no ceiling	no ceiling
<b>B. Time deposits</b>			
<u>Date</u>			
Dec. 1, 1979	8 1/2-12	9-12 1/2	9-12 1/2
Aug. 22, 1980 <sup>b</sup>	14	14 1/2	14 1/2
July 1, 1981	no ceiling	no ceiling	no ceiling
<b>C. "Now" accounts</b>			
<u>Date</u>			
Dec. 1, 1979	-	5	-
Aug. 22, 1980	7	7	7
July 1, 1981	no ceiling	no ceiling	no ceiling
<b>II. Regular Rediscounting Rates and Bank Lending Rates as of Aug. 22, 1980 and Sept. 1983</b>			
	<u>Loan Value</u> (%)	<u>Rediscount Rate</u> (%)	<u>Maximum Bank Lending Rate</u> (%)
<b>A. Aug. 22, 1980</b>			
Sectors			
1. One percent			
a. Supervised credits	100	1	12
2. Three percent			
a. Non-supervised credits	80	3	12
b. Small scale/cottage industries	80	3	12

Table 13  
(Continued)

	Loan Value (%)	Rediscount Rate (%)	Maximum Bank Lending Rate (%)
c. Special programs			
i) NGA-local purchases and procurement of corn, sorghum, soy bean and mungo	100	3	6
ii) NGA-importation of wheat and feedgrains	80	3	6
iii) FTI	100	3	6
iv) Fish production and marketing	100	3	10
3. Four percent			
a. Export industries- nontraditional	100	4	10
b. Special programs			
i) Grains Quedan	100	4	10
ii) Cotton	80	4	10
iii) Overseas construc- tion	80	4	10
iv) Phil. Virginia Tobacco Adm.	80	4	10
4. Six percent			
a. Export industries- traditional	80	6	12
5. Basic central bank redis- count rate (as of Dec. 1, 1979, Circular #704) shall be 11 percent.			
B. September 1983			
1. Three percent			
a. Supervised credits	100	3	12
b. Exports-nontraditional	80	3	12
c. Masaganang Maisan	100	3	15
d. Special programs			
i) NGA-FTI	100	3	6
ii) Food and Grains Quedan	80	3	10
e. Energy-generating projects			
i) Mini-hydro	100	3	10
ii) Dendro-thermal	100	3	8
f. Manpower exports	80	3	12

Table 13  
(Continued)

	Loan Value (%)	Rediscount Rate (%)	Maximum Bank Lending Rate (%)
g. Congress organizers	80	3	12
h. Coconut millers	80	3	12
2. Eight percent			
a. Non-supervised credits	80	8	14
b. Small/Medium scale industry	80	8	14
c. Exports-traditional	80	8	14
d. Tax credit certificates	80	8	14
e. Tobacco trading	80	8	14
f. Stock financing	80	8	14
g. Metal financing	80	8	14
h. Orchard growing/Upland farming	80	8	14
3. Twelve percent			
a. Dollar rediscounting	100	12	
4. For commercial banks, the rediscount rate is the Mla. Reference Rate 90 plus 2% or more (MRR 90 = weighted average of the interest paid during the immediately preceding week by the 10 commercial banks with the highest level of outstand- ing deposit substitutes or 90-day promissory notes).			
III. Bank Lending Rates (Secured Loans)			
	1980 <sup>c</sup>	1983 <sup>d</sup>	
A. 60 days and below		20.88	
B. 91-180 days	16%	24.25	
C. Over 1 to 2 years		22.97	
D. Over 2 years		Floating interest rate as of Aug. 22, 1980 (Circ. #755) for L-T loans of more than 4 years	

<sup>a</sup>Includes CBP, LBP, and banks with expanded commercial bank authority for 1980 and 1981.

<sup>b</sup>Rates are for TDs with original maturity of 730 days or less. Ceilings were lifted for TDs with original maturity of more than 730 days.

<sup>c</sup>The definition of short term was changed in October 1981 from 730 days to 365 days. The 3-1 interest rate is the ceiling rate.

<sup>d</sup>Rates were actual rates recorded as of December 1983. At the close of 1982, lending ceilings on short-term loans were lifted (CB Annual Report, 1982).

Sources: NREA Statistical Yearbook 1983.

CBP Appendix to the Annual Report 1980.

CB Review. September, 1983 and January, 1984.

Table 14

SELECTED FIGURES AND ECONOMIC INDICATORS  
PHILIPPINES, 1970-1982  
(In Percent)

	Real GNP <sup>a</sup>	CPI	Real M <sub>2</sub> <sup>a</sup>	M <sub>2</sub> GNP	Real Interest Rate <sup>b</sup>
I. Growth Rates					
1971	5.8	21.9	- .5	- 5.7	
1972	4.9	8.2	6.0	.9	
1973	9.6	16.5	.4	- 8.4	
1974	6.3	34.2	- 3.9	-14.3	
1975	5.8	6.8	6.3	0.2	
1976	6.1	9.2	18.7	11.9	
1977	7.0	9.9	19.6	12.2	
1978	6.8	7.3	14.7	7.1	
1979	6.8	16.5	- 3.1	- 8.8	
1980	4.4	17.6	6.2	1.4	
1981	3.7	12.4	7.4	3.3	
1982	2.6	10.4	11.5	8.8	
II. Figures					
1970				22.5	- 1.8
1971				21.2	-13.9
1972				21.4	- 0.2
1973				19.6	- 8.5
1974				16.8	-23.2
1975				16.8	4.2
1976				18.8	2.3
1977				21.1	2.1
1978				22.6	4.7
1979				20.6	- 4.5
1980				20.9	- 3.1
1981				21.6	1.6
1982				23.5	3.7

<sup>a</sup>M<sub>2</sub> was deflated by the GNP deflator (1972 = 100).

<sup>b</sup>The higher value of nominal rate on commercial bank time deposits less the growth in CPI. The former had these values effective on these dates:

Feb. 21, 1970	6 1/2 to 8
July 29, 1974	8 to 11
Jan. 2, 1976	8 1/2 to 12
Aug. 22, 1980	14 1/2 (for TDs of <del>120 days or less</del> )

Ceilings were lifted on July 1, 1981.

Dec. 1981	14
Dec. 1982	14.09

Sources: NEDA. Philippine Statistical Yearbook 1983.  
CB. Statistical Bulletin, 1981.

Table 15

## PERCENTAGE DISTRIBUTION OF DOMESTIC CREDITS OF THE CENTRAL BANK, 1970-1982

Year	Total CB Credits (in Million Pesos)	Total	Domestic Securities	Loans and Advances							CFBP <sup>b</sup>		
				National Government	Local and Semi- Gov't Entities	Specialized Gov't Banks <sup>c</sup>	Thrift Banks	Rural Banks	NBQB <sup>a</sup>	Commercial Banks	National Government	DBP	Commercial Banks
1970	4,367.5	100.0	52.5	10.9	9.0	1.7	.6	3.4	-	22.8	-	-	-
1971	4,326.5	100.0	53.9	10.3	6.8	4.7	.6	4.0	-	19.7	-	-	-
1972	4,879.2	100.0	51.7	11.3	5.5	5.1	.6	5.0	-	20.4	-	-	-
1973	4,563.4	100.0	63.6	3.4	5.7	4.0	.6	9.2	-	13.5	-	-	-
1974	7,612.0	100.0	43.6	2.2	3.3	.3	.4	11.0	2.4	36.9	-	-	-
1975	11,682.2	100.0	29.2	1.5	2.7	2.1	.4	10.1	1.1	52.8	-	-	-
1976	11,378.5	100.0	33.0	3.3	5.8	9.1	.4	11.3	.2	36.2	-	-	-
1977	11,018.6	100.0	36.5	6.8	6.5	11.8	.6	13.1	-	24.7	-	-	-
1978	16,591.8	100.0	21.5	15.2	4.5	9.6	.4	10.6	-	20.3	-	3.4	14.4
1979	22,620.4	100.0	16.2	13.1	3.0	10.2	.4	9.8	-	26.3	2.1	3.2	15.7
1980	30,268.2	100.0	15.5	10.2	1.8	7.4	.4	9.0	.1	32.4	3.2	6.6	13.4
1981	37,690.0	100.0	13.3	11.0	1.2	7.9	.4	8.5	.1	34.1	2.7	8.6	12.2
1982	47,444.4	100.0	16.5	8.7	.7	7.1	.5	8.2	.2	27.8	8.7	11.0	10.4

<sup>a</sup>Non-bank with quasi-banking functions.<sup>b</sup>Consolidated Fund Borrowing Program.<sup>c</sup>Includes DBP, LBP and PAB.

Sources: CBP Statistical Bulletin, 1982.

Table 16

STRUCTURE OF THE PHILIPPINE FINANCIAL SYSTEM, 1975, 1980, 1983  
(In Percent)

	1975	1980	1983 <sup>a</sup>	Real Growth Rates (in percent) <sup>d</sup>		
				1975-80	1980-83	1975-83
Total Assets (in million P) (in percent)	86,345.1 100.0	224,737.5 100.0	371,749.5 <sup>b</sup> 100.0	51.6	19.1	80.6
I. Banking System	80.1	86.1	79.4	63.0	8.2	76.4
A. Commercial banks	60.9	64.3	57.5 <sup>f</sup>	59.9	12.3	79.6
PNB	21.0	17.2	16.3 <sup>f</sup>	24.2	14.0 <sup>e</sup>	41.5 <sup>e</sup>
B. Thrift banks	2.5	4.7	4.2	188.9	12.4	224.8
Private development banks	.4	.7	1.2	146.9	115.9	433.0
Savings and mortgage banks	1.6	3.3	1.9	201.2	- 48.0	56.5
Stock savings and loan associations	.4	.7	1.1	184.4	97.5	461.8
C. Rural banks	3.2	2.4	2.4	17.0	20.7	41.2
D. Specialized government banks	13.5	14.7	15.3	64.7	30.4	114.9
DBP		12.0	13.1		36.3	
LBP		2.7	2.1		- 0.1	
PAB		.0	.1			
II. Non-bank Financial Institutions <sup>c</sup>	16.4	13.8	20.6	27.7	88.6	140.8
A. Government non-bank financial institutions		1.0				

<sup>a</sup>September 1983.

<sup>b</sup>Balance after the assets of monetary authorities are deducted.

<sup>c</sup>Includes investment houses, finance companies, securities dealers/brokers, investment companies, fund managers, lending investors, pawnshops, venture capital corporations, and non-bank thrift institutions.

<sup>d</sup>To compute for real growth rates, values were deflated by the GNP deflator (1972 = 100).

<sup>e</sup>1980-1982 only, 1975-1982 only.

<sup>f</sup>Percentage share of PNB was derived by assuming that the share of PNB assets to total commercial banks in 1983 to be equal to 1983 proportion

Sources: CBP Factbook: Philippine Financial System, 1976-81; CBP Report to the President: Economic and Financial Developments, Jan.-Sept. 1983; NEDA Statistical Yearbook 1983.



Table 17  
SOURCES OF FUNDS OF DBP, PNB AND LBP, 1976-1982  
(In Percent)

	1976	1977	1978	1979	1980	1981	1982	Ave. for 1976-82
<b>A. DBP</b>								
1. Deposits/Liabilities	35.5	27.1	20.5	19.4	24.3	22.2 <sup>a</sup>	19.8 <sup>a</sup>	
a. Government deposits/liabilities	35.0	26.5	18.8	19.1	24.0			
2. Due to CB/liabilities	- <sup>a</sup>							
3. Due to foreign banks/liabilities	- <sup>a</sup>	30.3	29.3	29.8	32.5	5.3	5.1	
4. Bills payable/liabilities	33.8	35.4	43.7	43.2	34.9	46.6	63.2	43.0
5. CB credits/liabilities <sup>b</sup>	9.3	9.0	13.1	14.0	15.6	17.6	7.7 <sup>c</sup>	13.7 <sup>c</sup>
<b>B. PNB</b>								
1. Deposits/Liabilities	39.4	46.2	42.5	49.2	45.9	35.3	34.2	41.8
a. Government deposits/liabilities	17.3	18.1	18.0	18.1	15.5	15.6	13.7	16.6
2. Due to CB/liabilities	.1 <sup>a</sup>	.0	.0	.0	.1	.1	.6	
3. Due to foreign banks/liabilities		2.2	.0	.2	5.2	6.4	.0	
4. Bills payable/liabilities	41.7	40.8	44.8	36.7	38.0	40.5	55.9 <sup>d</sup>	
a. Bills payable from CB/liabilities	11.3	8.7	6.8	19.2	16.6	9.7	7.6	
<b>C. LBP</b>								
1. Deposits/Liabilities	60.7 <sup>a</sup>	54.7	52.3	42.5	51.2	47.3	37.3	47.5
a. Government deposits/liabilities		47.0	45.1	34.1	32.4	32.0	27.8	36.4
2. Due to CB/liabilities		.1	.2	.1	.0	.0	.1	
3. Due to foreign banks/liabilities	-	-	-	-	-	-	-	
4. Bills payable/liabilities	7.4	11.1	7.4	11.6	17.5	22.3	44.4	

<sup>a</sup>Not reported.

<sup>b</sup>CB credits to specialized government banks/liabilities of DBP and LBP.

<sup>c</sup>Credits for 1982 do not include CFBP (Consolidated Fund Borrowing Program) for 1982 of DBP.

The average assumes the ratio for 1982 to be equal to 1981. This is a conservative assumption given the increasing trend of CB credit to DBP.

<sup>d</sup>From 1980, bills payable from banks and other financial institutions formed majority of bills payable.

Sources: CBP Factbook; Philippine Financial Statistics, 1976-82; PNB Annual Reports, 1976-82.

	1975	1976	1977	1978	1979	1980	1981	1982
Deposits/Cash inflow	16.2	30.4	76.5	30.2	15.8	43.0	29.8	30.3
a. Private deposits/Cash inflow			44.5			37.1	17.5	13.0
b. Government deposits/Cash inflow			32.0			5.9	12.3	17.3
Borrowings/Cash inflow	-	-	.1	2.0	-	4.3	6.5	5.3
a. CB loans/Cash inflow						3.5	5.6	4.4
b. Foreign borrowings/Cash inflow <sup>f</sup>			.1			.1		.7
Loan collections/Loans outstanding <sup>f</sup>		- <sup>e</sup>	11.6	21.6	3.0	36.5 <sup>g</sup>	62.6	29.7
Earnings from operations/Loans outstanding <sup>f</sup>		19.9	21.1	15.3	7.4	14.5	14.9	16.4
Earnings from operation-Operational Disbursements		3.5	2.1	2.4	- 8.3	2.7	2.5	9.6
<u>Earning Assets<sup>d</sup></u>								
Loan collection to total inflow	.1	.0	4.3	3.1	5.2	3.2	5.5	2.1
Private deposits + loans collection/Loan releases	615.6	485.2	700.1 (422.4)	476.8	107.7	926.0 (808.0)	540.2 (351.8)	792.0 (369.5)
(Philippine Amanah Bank)								
Deposits/Cash inflow	28.6	65.7	-	73.9	52.7	90.4	77.0	3.1 <sup>h</sup>
Borrowings/Inflow			77.5	-	-	-	-	-
Loan collections/Loans outstanding <sup>f</sup>		41.3	14.7	48.7	88.6	22.6	82.2	67.6
Earnings from operations/Loans outstanding <sup>f</sup>		25.6	17.1	17.9	53.7	16.9	20.4	16.8
Earnings from operations-Operational Disbursements		.9	.9	4.3	34.1	2.0	1.1	.9
<u>Earning Assets<sup>d</sup></u>								
Loan collection to total inflow	4.7	12.7	10.0	8.3	21.8	37.9	18.2	38.5
Private deposits + loans collection/Loan releases	91.7	204.3	35.9	859.0	161.5	560.5 (106.0)	247.3 (103.3)	59.7 ( 56.8) <sup>j</sup>

No deposits were reported in the inflow.

Gross figures for deposits were used since government withdrawals have been substantial such that the net effects of deposits for lending purposes have been minimal.

Data for borrowings were not broken down.

Earning assets include loans and discounts, agricultural credit loans, investment in bonds and other debt instruments, securities, leases, customer's liabilities, equity investments and bills purchased.

Less than .1 percent.

Loans outstanding included loans and discounts and agricultural credit loans.

Figures for 1982 are preliminary estimates.

Table 18  
 SELECTED CASH FLOW AMOUNTS AND RATIOS OF GFIs  
 1980-1982  
 (In Millions of Pesos and in Percent)

	DBP (1981-82)	PNE	LB	PAB
1. $\Delta$ Private Deposits	63	4,988 <sup>b</sup>	71	60
2. Loans Collections	3,314 <sup>a</sup>	72,220	4,785	164
3. Total Cash Inflow	79,434	388,511	137,406	950
4. Loan Releases	12,936	88,977	7,021	373
5. $\frac{(1) + (2)}{(3)}$ in Percent	4.2	19.9	3.5	23.6
6. $\frac{(1) * (2)}{(4)}$ in Percent	26.1	86.8	59.2	60.0
7. $\frac{\text{Loans Collections}}{\text{Loans Outstanding}}$	4.2	84.7	50.5 (1980-81)	52.4 (1980-81)

<sup>a</sup> Net of loans converted to equity.

<sup>b</sup>  $\Delta$  in private deposits for 1981 and 1982 were derived by multiplying the change in total deposits by the ratio of private deposits to total deposits for the respective years.

Source: BBA, unpublished.

	1975	1976	1977	1978	1979	1980	1981	1982
Deposits/Cash inflow	16.2	30.4	76.5	30.2	15.8	43.0	29.8	30.3
a. Private deposits/Cash inflow			44.5			37.1	17.5	13.0
b. Government deposits/Cash inflow			32.0			5.9	12.3	17.3
Borrowings/Cash inflow	-	-	.1	2.0	-	4.3	6.5	5.3
a. CB loans/Cash inflow						3.5	5.6	4.4
b. Foreign borrowings/Cash inflow <sup>f</sup>			.1			.1		.7
Loan collections/Loans outstanding <sup>f</sup>		- <sup>e</sup>	11.6	21.6	3.0	36.5 <sup>g</sup>	62.6	29.7
Earnings from operations/Loans outstanding <sup>f</sup>		19.9	21.1	15.3	7.4	14.5	14.9	16.4
Earnings from operation-Operational Disbursements		3.5	2.1	2.4	- 8.3	2.7	2.5	9.6
<u>Earning Assets<sup>d</sup></u>								
Loan collection to total inflow	.1	.0	4.3	3.1	5.2	3.2	5.5	2.1
Private deposits + loans collection/Loan releases	615.6	485.2	700.1 (422.4)	476.8	107.7	926.0 (808.0)	540.2 (351.8)	792.0 (369.5)
(Philippine Amanah Bank)								
Deposits/Cash inflow	28.6	65.7	-	73.9	52.7	90.4	77.0	3.1 <sup>h</sup>
Borrowings/Inflow			77.5	-	-	-	-	-
Loan collections/Loans outstanding <sup>f</sup>		41.3	14.7	48.7	88.6	22.6	82.2	67.6
Earnings from operations/Loans outstanding <sup>f</sup>		25.6	17.1	17.9	53.7	16.9	20.4	16.8
Earnings from operations-Operational Disbursements		.9	.9	4.3	34.1	2.0	1.1	.9
<u>Earning Assets<sup>d</sup></u>								
Loan collection to total inflow	4.7	12.7	10.0	8.3	21.8	37.9	18.2	38.5
Private deposits + loans collection/Loan releases	91.7	204.3	35.9	859.0	161.5	560.5 (106.0)	247.3 (103.3)	59.7 ( 56.8) <sup>j</sup>

No deposits were reported in the inflow.

Gross figures for deposits were used since government withdrawals have been substantial such that the net effects of deposits for lending purposes have been minimal.

Data for borrowings were not broken down.

Earning assets include loans and discounts, agricultural credit loans, investment in bonds and other debt instruments, securities, leases, customer's liabilities, equity investments and bills purchased.

Less than .1 percent.

Loans outstanding included loans and discounts and agricultural credit loans.

Figures for 1982 are preliminary estimates.

Table 21

SELECTED PERFORMANCE RATIOS: PNB, 1975-1982  
(In Percent)

	1975	1976	1977	1978	1979	1980	1981	1982
Equity Investments, Real and Other Properties Owned or Acquired, Other Assets	2.5	2.5	8.0	9.6	6.9	8.0	10.3	10.2
<u>Total Assets</u>								
Equity Investments, Real and Other Properties Owned or Acquired, Other Assets	3.9	3.9	12.5	14.2	10.4	12.8	16.9	18.0
<u>Loans and Discounts</u>								
Loan Collections	206.6	123.6	110.7	88.8	86.1	105.8 <sup>a</sup>	93.1	97.4 <sup>a</sup>
<u>Beginning Balance, Loans and Discounts</u>								

<sup>a</sup>Loan collections as reported in the cash flow statements, since these were not reported in the annual reports.

Source: CBP Factbook Philippine Financial Statistics, 1976-1982.  
PNB Annual Reports, 1976, 1979-1982.  
NEDA, Unpublished.

Table 22

SELECTED PERFORMANCE RATIOS, LBP AND PAB, 1976-1982  
(In Percent)

	1975	1976	1977	1978	1979	1980	1981	1982
<b>LBP</b>								
1. <u>Equity Investments, Real and Other Properties Owned or Acquired, Other Assets</u>	4.5 <sup>a</sup>	3.8	5.8	4.9	6.0	6.3	8.9	17.6
2. <u>Total Assets</u>								
1. <u>Equity Investments, Real and Other Properties Owned or Acquired, Other Assets</u>	21.9 <sup>a</sup>	9.7	67.2	26.4	14.3	14.1	18.9	34.58
2. <u>Loans and Discounts</u>								
3. <u>Loan collections<sup>b</sup></u>	33.8 <sup>a</sup>	0.0	11.0	119.3	11.3	59.1	87.4	31.2
Beginning balance, loans and discounts								
<b>PAB</b>								
1. <u>Equity Investments, Real and Other Properties Owned or Acquired, Other Assets</u>	15.1 <sup>a</sup>	10.4	8.9	11.7	19.2	9.4	17.6	15.7
2. <u>Total Assets</u>								
1. <u>Equity Investments, Real and Other Properties Owned or Acquired, Other Assets</u>	172.0 <sup>a</sup>	25.5	20.2	23.9	32.6	24.4	29.5	24.5
2. <u>Loans and Discounts</u>								
3. <u>Loan collections<sup>b</sup></u>	- <sup>c</sup>	198.0 <sup>a</sup>	20.7	63.1	115.4	26.5	98.9	82.2
Beginning balance, loans and discounts								

<sup>a</sup>These figures are applicable for the fiscal year ending June 30, 1975, all the rest are calendar years. For 1975, the numerator includes other assets, other assets acquired, and real properties transferred.

<sup>b</sup>Loan collections were obtained from the cash inflow statements.

<sup>c</sup>Not reported.

Sources: COA. Annual Financial Report of Government-Owned or Controlled Corporations, 1974-1975.

CBP. Yearbook Philippine Financial Statistics, 1976-1982.

NETS, published.

Table 23

RATIO OF ACTUAL TO TARGET VALUES OF LIQUIDITY AND CREDIT  
BY INSTITUTIONAL GROUPING IN THE 1978-1982  
FIVE-YEAR DEVELOPMENT PLAN

	1978	1979	1980	1981	1982	1982 Peso Value in Billion
A. Total Liquidity or $M_3 = M_1 + SD + TD + DS$	1.02	.97	.98	1.01	1.00	95.3
1. $M_1 = \text{Currency} + \text{DD}$	1.05	1.00	1.04	.93	.81	23.5
2. $M_3 - M_1$ or non-money deposits	1.01	.95	.95	1.05	1.09	71.8
B. Outstanding not Loanable Funds Actual/Target						
1. Total for banking system	.83	1.37	1.81	1.63	1.74	193.9
2. Government banks	.74	1.54	1.52	1.83	2.08	87.5
a. PNB	.94	1.77	1.87	2.05	2.51	40.3
b. DBP	.38	1.26	1.22	1.61	1.74	39.8
c. LE	2.55	2.26	1.82	2.31	2.40	7.4
3. Private banking system	.67	1.28	1.98	1.51	1.53	106.4
a. Commercial banks	.82	1.27	2.05	1.49	1.48	88.8
b. Rural banks	.91	.93	1.10	1.14	1.25	5.7
c. Private development banks	1.07	1.33	1.32	2.52	2.89	2.9
d. Savings and other thrift banks	1.79	2.05	2.33	2.04	2.27	8.9
C. Non-bank Financial Institutions Total	.67	.77	.78	.66	.67	50.2
1. Government	1.14	.97	.98	.98	1.04	24.5
a. SSS	1.11	1.06	1.09	1.06	1.18	15.1
b. GSIS	1.19	.91	.89	.91	.89	9.0
c. Agricultural Credit Administration	.93	.62	.57	.64	.60	.4
2. Private		.68	.69	.52	.50	25.7

Table 23  
(Continued)

	1978	1979	1980	1981	1982	1982 Peso Value in Billion
	Target	Actual				
D. Annual Compounded Growth Rate 1978-1982						
1. $M_2$	16.0	8.5				
2. $M_3$	17.6	16.4				
3. Outstanding net loans	17.8	34.7				
a. Total banking system	17.9	41.9				
1. Government	19.8	55.4				
2. Private	16.8	34.2				
b. Non-bank financial institution	17.6	17.4				
1. Government	21.1	18.1				
2. Private	16.2	- 2.4				

Notation: DD = demand deposit, SD = savings deposit, TD = time deposits, DS = deposit substitute.  
Liquidity is defined by CB as  $M_3$ .

Source: NEDA Philippine Five-Year Development Plan, 1978-1982.  
NEDA Philippine Development Reports, 1978-1982.



## REGRESSION RESULTS

Dependent Variables <sup>B</sup>	Independent Variables <sup>A</sup>					TT
	Intercept	R	GNP	g	B <sub>r</sub>	
1. Savings Functions						
NS/GNP						
a. Korea	-3.13	.166 (.25)	.0016 (9.72)	.609 (4.21)		
b. Thailand	.3264	-.0024 (-4.15)	.00026 (3.84)		-.7559 (-3.99)	
c. Pakistan <sup>d</sup>	-0.166	.365 (2.253)		-.021 (-0.148)		.0151
d. Philippines	6.66639	-.04058 (-.70591)	.00024 (.53311)		-.00042 (-.15986)	
HS/GNP						
a. Korea	-2.72	-0.044 (-1.24)	.0004 (2.879)	.348 (4.77)		
b. Thailand	.1079	-.0019 (-3.04)	.00008 (1.70)			
c. Philippines	14.99819	-.01609 (-.33963)	-.00039 (-1.04817)		.00202 (.92940)	
SO/GNP						
a. Thailand	.2559	-.0016 (-2.71)	.0004 (5.41)		-.7337 (-3.72)	
b. Philippines	-1.56448	-.01005 (-.49296)	.00011 (.69020)		-.00022 (.23221)	
Financial Savings Functions						
M <sub>2</sub> /GNP						
a. Thailand	.3554	.0008 (.93)	.0008 (7.33)	-.3865 (-1.20)	-.9421 (-3.25)	
b. Philippines	20.25905	.13150 (1.52315)	.00105 (1.55961)		-.00588 (-1.43331)	
TM/GNP						
a. Korea	30.54	.194 (2.06)		.0252	-.430 (-8.47)	
b. Thailand	.1905	.0009 (1.15)	.0011 (11.12)		-1.1056 (-4.47)	
c. Philippines	2.67235	.07918 (1.10579)	.00102 (1.31781)		-.00400 (-1.21858)	
DM <sub>2</sub> /GNP						
a. Korea	-464.23	7.798 (.85)	.166 (7.953)	+37.66 (2.08)		
b. Thailand	.0053	.0023 (5.24)	-.0039 (-3.06)	-.0039 (-3.06)	.1508 (1.62)	
c. Philippines	-7.2733	.01030 (.30173)	.00014 (.53476)		-.0041 (-.26069)	
Pakistan M/M <sub>-1</sub> <sup>d</sup>		2.362 (4.378)		.448 (1.222)		

Others				R <sup>2*</sup>	D.W.
D	HS <sub>-1</sub>	S <sub>f</sub> /GDP	M <sub>-1</sub> /M <sub>-2</sub>		
				.89	1.37
				.72	1.49
7.390 (3.539)				.396	1.77
				.10271	1.12165
	.328 (1.96)			.84	1.88
		-.4596 (-2.03)		.52	2.29
				.06074	.6079
				.78	2.10
				.58208	1.559
				.89	.83
				.03128	.43475
				.7836	
		-.2959 (-1.08)		.96	.98
				.41840	.27229
				.8095	
		-.2166 (-1.43)		.68	1.07
				.03707	2.803
			.330 (2.102)	.586	1.75

Table 24  
(Continued)

NOTES

A. Independent Variables

1.  $R$  = real interest rate

- a) Korea = nominal interest rate on one year time deposits less the GNP deflator
- b) Thailand = nominal interest rate on one year TD less export inflation (CPI)
- c) Pakistan = 12-month deposit rate of interest minus the expected rate of inflation (for financial savings; it is  $R - R_{-1}$ )
- d) Philippines = nominal rate on one year TD less ex post inflation (CPI)

2.  $GNP$

- a) Korea = real GNP in 1975 prices
- b) Thailand = real GDP
- c) Philippines = real GNP in 1972 prices

3.  $g$

- a) Korea = growth rate of real GNP
- b) Thailand = growth rate of real GDP
- c) Pakistan = rate of growth of real per capita permanent income

4.  $B_p$  = branches variables

- a) Korea = total population per deposit institution
- b) Thailand = branches per 10,000 population
- c) Philippines = number of offices of financial institutions

Table 24  
(Continued)

5. Others

a) Korea =  $HS_{-1}$  = household savings rate of the previous year

b) Thailand =  $S_f/GDP$  = foreign savings over GDP

c) Pakistan =  $TT$  = terms of trade  
 $D$  = population dependency ratio

$\frac{M_{-1}}{M_{-2}}$  = lagged rate of real per capita monetary growth

3. Dependent Variables

1. Total savings rate =  $NS/GNP$

- a) Korea = national savings rate
- b) Thailand = gross domestic savings to GDP
- c) Pakistan = national savings ratio
- d) Philippines = total savings to GNP ratio

2. Household savings rate =  $HS/GNP$

- a) Korea = household savings rate
- b) Thailand = household savings rate
- c) Philippines = private savings to GNP ratio

3. Other savings rate =  $SO/GNP$

- a) Thailand = Private savings to GDP ratio
- b) Philippines = corporate savings to GNP ratio

Table 24  
(Continued)

Dependent Variables: Financial Savings

1.  $M_2/\text{GDP} = M_1 + \text{time and savings deposits}/\text{GNP}$
2.  $\text{Time and savings deposits}/\text{GNP} = \text{TSD}/\text{GNP}$ 
  - a. Thailand = time and savings deposits/GDP
3.  $\Delta M_2/\text{GNP} = \text{change in savings and time deposits}/\text{GNP}$ 
  - a. Thailand = change in S and TD/GDP
4. for Pakistan =  $M/M_{-1} = \text{broad money}/\text{broad money of last year}$

<sup>a</sup>  $R^2$  for the Philippines.

<sup>d</sup> Variables for Pakistan are transformed variables (natural logarithms).

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