

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 15, 1946.

To Chairman Eccles

Subject: Philippine loan

From Mr. Knapp

The National Advisory Council is holding a special meeting this afternoon to consider Philippine problem, and the Staff Committee is meeting on this matter this morning, having received from the Philippines over the weekend certain additional information concerning the budgetary position in the Islands. The following memorandum is therefore a tentative and preliminary report.

You will recall that the Philippine Government has applied to the Export-Import Bank for a loan of 250 million dollars to cover an anticipated balance of payments deficit during the next three years, and has also approached the Treasury Department with a loan proposal for 400 million dollars during the next five years to cover estimated internal budget deficits.

With respect to the balance of payments loan proposal the Council, upon the advice of the Staff Committee, has already determined that no such loan should be necessary, especially in view of the large military expenditures which we will be making in the Philippines during the next year or so. The Council has also ruled out the Export-Import Bank as a source of funds for a "budgetary" loan. The issue has therefore resolved itself into the question of whether the Council should initiate legislation in this session of Congress to provide a budgetary loan to the Philippines (or support legislation of this character which we understand may be introduced by Congressman Bell).

A decision on this issue involves detailed consideration of the Philippine budgetary position between now and say next March, by which time the new session of Congress might be ready to act on this matter. On the basis of existing taxes and sums due from the United States, the Philippine Government should have revenues of around 40 million dollars during this nine-month period, but its expenditures may run to 100 million dollars (peso figures all converted to dollars at the rate of 2 pesos = 1 dollar). Possible sources of funds for meeting the 60 million dollar deficit are the following:

1. The existing cash balance of the Philippine Government (excluding dollars held as the required currency reserve) amounts to about 40 million dollars. However, about 30 million dollars is owing at the present time, including 17 million dollars on outstanding "Treasury warrants" which may or may not be renewable.

2. The Philippine Government seems to contemplate very little action in the way of ordinary fiscal measures to raise additional money, such as new internal taxes, increased tax rates, and internal

loans. It should be recognized that the prospects of raising any substantial amount by way of internal loans at the present time are not at all promising.

3. An important special source of revenue might be sales to the public of surplus property to be received by the Philippine Government free of charge under the provisions of the recent Philippine Rehabilitation Act. The Philippines have the right to select 100 million dollars fair value of surplus property, but they have so far been slow to take advantage of this opportunity, and of course some of the property may be required for public purposes and therefore would not be available for sale to raise revenues. Also, the market for surplus property may have been saturated by FLC sales of 60 million dollars which have already been made in the Islands.

4. As a final alternative to a loan to be appropriated by Congress, certain measures permitting an expansion of the peso currency issue in the Philippines should be considered. As you know, this currency is at present subject to a rigid 100 per cent dollar reserve requirement which leaves very little freedom of action.

a. It appears to be a fair presumption that some 25 million dollars of peso currency against which dollar reserves are now held has, in fact, been lost or destroyed. The Philippine Government might simply act on this presumption and issue further peso currency to this amount. If action on a presumption were deemed improper, it could call in the old currency to establish the exact amount of lost and destroyed notes, but such a measure would take time and would involve expense. (C) A further possibility would be abandonment of the 100 per cent reserve requirement and the creation of a limited fiduciary issue of peso currency. Since such a measure standing alone might arouse distrust and in particular stimulate flight of American capital from the Philippines, it would be feasible simultaneously to announce an agreement by the U.S. Stabilization Fund to purchase for dollars the amount of fiduciary pesos issued. Of course there will always be a certain amount of pesos in circulation in the Philippines, so that such an agreement would remain a dead letter, and have merely psychological value, unless in future years the Philippine Government should greatly expand its fiduciary issue. It might therefore be necessary to have the agreement include provisions restricting further fiduciary issues without consultation with the United States.

All of this should be regarded as an emergency program to handle the situation pending a thorough reorganization of the Philippine banking and currency setup and the introduction of a Philippine central bank, operating on a fractional reserve principle.

JBK:mla