

How can funds be raised for Covid19 responses?

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Say, for example, Government needs 100 billion. But there is only 50 billion in the treasury. How does it raise the extra 50 billion?

There are 4 ways to raise money

1. Collecting more taxes
2. Borrowing money from the public (domestic residents and foreigners)
3. Borrowing money from the BSP
4. BSP literally creating money.

#1 Collecting more taxes

- Either imposing new taxes, or trying to collect more from the current set
- If enough additional taxes are collected, the 'deficit' need not increase much higher than the 3% target. This is why the DOF favors this approach.

PROBLEM: With the economy at a standstill, the public has nothing more to give.

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#2 and #3: Borrowing money from the public or the BSP.

How it works

- In both cases, the Treasury sells bonds (IOUs). The public (through their banks) or the BSP may buy these bonds.
- Most likely, the public may want to hold on to cash at this time. The BSP however can easily 'print' money to buy bonds. (refer to #4 to see how this works)
- The Treasury now has cash and government can spend this cash

Problem

- Since the extra cash did not come from more revenues, the difference between revenues and spending has now increased. **That is, the deficit has increased.** (This is what DOF is worried about)

Our comment: So what if the deficit increases?

- Credit ratings at this time have no bearing. Good credit ratings allow governments to raise funds from abroad at lower interest rates. But today, all countries will likely be keeping funds for themselves for their own COVID responses. So we won't be able to borrow much anyway.
- At some point later (we don't know when), world interest rates will go up for all. Everyone will be in the same boat. In fact, our credit rating may not be hurt even if our deficit goes up now, if we show that this crisis was handled well and we made the right public investments.

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#4 BSP literally creates or "prints" money (out of thin air). This power to print money is the BSP's most important power. *

How it works

1. Banks have a 'checking account' with the BSP.
2. BSP credits these "checking accounts" with more reserves. It is an accounting entry.
3. Which means banks can now make more loans.

The Treasury also has a 'checking account' with the BSP. When the BSP buys bonds from the Treasury, it credits this account in the same way, creating money for the Treasury to use.

Issue:

- **Banks are key here.** If they are hesitant to loan out money because they do not think SMEs can pay, OR if SMEs/Households are intimidated by them, then nothing happens.
 - Brings up the question: how to encourage banks to lend? A guarantee from the DOF could help here.

*Note: In normal times, the BSP does not resort to printing money because it could pull up inflation. But these are not normal times; inflation is not a pressing problem in a contracted economy.

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In sum

1. More taxes is NOT an option at the moment.
2. Borrowing money from either the public or the BSP is an option. But if the public wants to hold on to cash, it will be left to the BSP, which can 'print' money to lend to the Treasury. In this current situation, inflation will not be a pressing problem and fears about a larger deficit MISPLACED.
3. BSP 'creating' money for banks to use is also an option. But it will hinge on the appetite of banks to lend as well as how easy it will be for SME/Households to approach banks.

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Post script:

1. Borrowing from multilaterals (WorldBank, ADB, AIIB, etc.) may be possible. It remains to be seen how much would be available given that many other lower income countries may need their help.
2. Suggestions have also been made to raise funds by selling government assets. This is a quick fix which should be a very last resort. The opportunity cost could be very high: what is obtained from selling assets now, most likely in a fire sale, may be far less than the present value of future income streams from these assets. It could signal an absolute inability of government to borrow money from its own citizens and the rest of the world, or find other ways to raise money.

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