



Did the thieves steal our taxes?
An essay on the Innocent Frauds that perpetuate economic misunderstandings over the corruption scandal and Philippine policymaking

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Like any modern government, the Philippine government spends, by law, reserve balances created by BSP ex nihilo, not taxes. This process creates money. This implies the following: (i) the recently discovered massive misappropriation of government funds earmarked for infrastructure projects means that taxes have not been stolen; (ii) this is so because it is impossible to steal taxes. In the accounting procedures of modern economies these are returned to Treasury and, ultimately, to BSP and then “destroyed”. This is the law; (iii) the thieves have stolen bank deposits that were intended for projects. However, deposits are not how tax payments are ultimately settled with the government; (iv) the thieves must be punished but their actions have not made BSP and the Philippine Government poorer; and (v) the Philippine government can financially afford to construct the infrastructure that was not built. Corruption makes things worse but it is not the Philippines’ original sin. We end by arguing that, as the Philippine government is not financially constrained, it needs to implement a much more active fiscal strategy for the country to develop.

1. Introduction: the innocent frauds that perpetuate economic misunderstandings

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De La Salle University students, as well as students from other Philippine Universities, walked out of their classrooms in late 2025, in protest for what the country is going through, the corruption scandal concerning the flood control projects. What is interesting about it is that many of them complained because, they argued, “thieves have stolen our taxes.” We asked businessmen and even colleagues in academia and most, if not all, really thought, like the students, that the flood control projects are paid out of taxes. The funds apparently are kept somewhere (nobody knew exactly where), in some sort of a special account (or in a *baul?*), out of which the government (Treasury) makes payments for infrastructure, education, health, etc. The result is that the flood control projects have not been completed and, therefore, our taxes have been stolen.

[We \(Felipe, Largiza, and Sauler\) decided wrote a short essay where we argued](#) that while the first part of the claim is, obviously, factually correct, the second is technically incorrect: the thieves did not steal taxes. This is so because of the legal procedures involved in the government payment and taxation system. This point raised quite a few eyebrows. While the article was mostly well received, it also elicited criticisms. Some of them referred to issues that we had not discussed in the article. Other comments, however, concerned our account of the operational reality of government payments and taxation. These were the product of the authors’ poor understanding of how governments operate, and of using conceptualizations of actual economies that are inconsistent with the reality.²

This essay elaborates on the previous one and clarifies important misunderstandings about the public sector’s finances. We realized that many people, including economists and government officials, have a poor understanding of the mechanics of government finances, much more complex than those of a family or a firm. This is because governments do not simply collect taxes and spend *them*, as appears in standard textbooks, or as officials in the government seem to believe.

We go further. We will argue that government spending is a powerful tool for nation building that the Philippines has neglected, even avoided, during the last decades. More broadly, fiscal policy has to be in the driver’s

² An example is the [comment](#) by Professor Alfredo Paloyo. [See our reply here.](#)

seat of the nation's economic policy if the Philippines is to become a first-world nation in the coming decades.³

We leave aside the political dimensions and implications of the corruption scandal because this was never our objective – our position on it is, as it could not be otherwise, that it is unacceptable and that those who have infringed the law must be punished. The funds stolen, income illegally earned, allows them to have living standards way above those of the average citizen. The mechanisms to prevent a similar situation from happening again must be put in place. We also maintain our view that the country's relative backwardness and low income per capita are not the result of corruption but of the economic structure, in particular the lack of industrialization (including the backwardness of the agricultural sector – in need of modernization). Corruption makes things worse but it is not the original sin.

We hope the clarifications we provide about how the government spends and taxes, and about how the monetary system works, help everyone grasp better the finances of the corruption scandal; and more broadly, help policy makers rethink questions concerning the budget deficit and national debt, which have kept the country trapped for decades by the false belief that government spending is limited by taxes. This is not a matter of interpretation or theory – it is simply accounting. It is compatible with any personal political views about the government's role in the economy, though we challenge the argument that the fiscal deficit should be lower *because* it damages the economy. A lower fiscal deficit reduces peso for peso the domestic private sector's balance and corporate profits – it is paradoxical to hear private sector leaders complain about the fiscal deficit, or the national debt, when these represent a windfall for them. It is important to understand these points, so as not to confuse the mechanics of government spending, taxation, and national debt, with the fight against corruption.

We stress that most of what follows is not theory but facts. It is difficult to comprehend how incorrect accounts of the government's operations have populated the discourse for decades. Who does not think that budget deficits or debt are 'bad' for the nation? Or that if governments go around

³ Details are provided in Felipe et al. (2026), "The Philippine Economy Toward 2050: Economic Structure and Monetary Reality" (Taylor and Francis). Forthcoming.

printing money, of course, this causes inflation? And does not the government have to watch out its spending like a good family that has a budget constraint? Terms such as “deficit” and “debt” cause chills but they are misunderstood, and we all have been forced to legitimize terms such as “sound finance”, “fiscal responsibility”, “fiscal discipline”, or “fiscal space”. We refer to them as *innocent frauds*.

We will argue that the thieves have stolen something, for sure, but not taxes because it is technically impossible to steal taxes. This does not exonerate the crooks but it is important to understand the financial operations of the government (in particular of Treasury and Budget) and central bank, especially what is known as *reserve accounting* and *reserve balances*.⁴ This has implications for understanding why we have not been able to move forward decisively like other East Asian nations (apart from the lack of industrialization and the stagnation of agriculture). Development requires an active government that understands the power it has to control and use the monetary system for the nation’s benefit. It is unfortunate that the term ‘being fiscally responsible’ (discussed below) has made it into the public discourse and has diverted a sensible discussion about the role of the government in a developing nation like the Philippines.

Central to the discussion is the fact that most people also believe that when the government runs a fiscal deficit, it is at the mercy of the private sector because it (the government) has to borrow to make up the difference between spending and taxes. This gives rise to the so-called national debt, which has been portrayed as a national shame. These people believe that each Filipino owes about PHP 130,000, though, when asked, they were not sure to whom it is owed. We were surprised when some students and businessmen told us that they think it is owed to foreigners. This is wrong. Some academics gave us tortuous explanations that indicate that they do

⁴ Reserve balances are the peso-denominated demand deposits that banks hold in their accounts at the Bangko Sentral ng Pilipinas, which are used to meet statutory reserve requirements and to settle interbank and government payments through the central bank’s clearing and settlement systems. See Sections 94 and 100 of [RA 7653](#). Reserve accounting is the system of central-bank bookkeeping and settlement through which commercial banks’ reserve balances—held as demand deposits at the central bank—are credited and debited in real time and at end-of-day to record payments, satisfy statutory reserve requirements, and implement monetary policy.

not really know and understand what national government debt issued in the domestic currency is and does to an economy.

The most surprising aspect of the discussion is that what we describe below is the standard practice of all modern governments, including that of the Philippines. It is not a theory that one may question but operational reality. The facts we summarize have been there for a long time, certainly since the imposition of the full fiat monetary system in 1971, when the United States ended the convertibility of the dollar into gold, which signified the total end of any form of gold standard. We realized during the last few months that many people, including economists, still argue today as if we were in the gold standard, when countries had to accumulate gold to make international payments.

Our modern monetary system is very different. The use of fiat money as opposed to the gold standard implies that the monetary account we use in the Philippines, the peso, is not backed by anything like gold or silver, or anything else (just read what is written in any bill). It has no intrinsic value whatsoever. We use it in the Philippines as legal tender because we are forced by the government to make payments with it, in particular taxes. This means that firms and consumers need to get pesos to operate (make payments). One may argue, as we have been told, that the pesos we use come from our employers (to pay our salaries). That is correct in some sense. But the point is: who creates the pesos that your employer uses? Who puts them in circulation?

The remainder of the document is structured as follows. Section 2 explains a first source of money creation in modern economies, namely bank lending. Section 3 further elaborates on the second source of money creation, government spending, and delves on the specifics how governments spend (make payments) and tax. Section 4 introduces the operations of the Bangko Sentral ng Pilipinas (BSP). This is important because its monetary policy is intimately linked to the country's fiscal policy (spending and taxing). The description in Section 3 serves as prelude for what comes in Section 5, the conclusion that the thieves behind the corruption scandal have not stolen our taxes because the operational system and accounting means taxes and spending all occur on BSP's balance sheet who has no legal limitations in creating more of them. Section 6 then clarifies what they did appropriate. Section 7 returns to the operational reality and discusses much-misunderstood national debt, in

particular why it is issued and its role in the economy. Section 8 offers some final words on the need to have an active fiscal policy in the Philippines. The Appendix provides a Glossary of widely used misleading terms.

2. On Money Creation

It is important to start with basic facts that many people are not aware of. There are two sources of money creation. One is commercial banks via lending. The other one is government spending.

When you obtain a loan from your bank for PHP 1 million, your bank books the loan as its asset. The bank creates the PHP 1million out of thin air. Then, it settles your payment for you (that is, the reason you are borrowing is because you had a payment to make – something you wanted to purchase, or someone you needed to pay). If your payment is to someone who already banks with your bank, then your bank simply credits his/her account for the payment – again, creating the funds out of thin air. If your payment is to someone who banks at a different bank, then your bank sends the amount to that bank via its reserve account at the Bangko Sentral ng Pilipinas (BSP) – BSP simply debits your bank’s reserve account and credits the recipient’s bank, and the recipient’s bank promptly creates balances, again out of thin air, for the recipient’s deposit account. Here’s the kicker, though: if your bank has no balances in its reserve account at BSP, BSP makes a loan to your bank, creating the balances out of thin air and crediting them to its reserve account in order to ensure the payment from your bank to the recipient’s bank is always made whole.

Banks and BSP create money in this way *ex nihilo* and the supply of reserve balances is operationally infinite. Are there economic limits to this? Yes, and we discuss them below. But the point here is to understand that the quantity of “money” that can circulate has no operational limit—our economy is literally never constrained by how much “money” is circulating at any point in time, whether that be in the form of paper currency, deposits, or reserve balances. Likewise, how much “savers” are holding onto also does not constrain what banks and BSP can create at any point in time.

3. A second source of Money Creation: Government Spending and Taxation

The standard practice and operational reality is that the government (Treasury) makes payments not by using your taxes but by coordinating with BSP. This is the second source of money creation. The most basic fact to understand is that government spending, tax payments, and government bond sales all occur through accounts at BSP—these are simply debits and credits between reserve accounts that all banks hold and the government’s BSP account. This is so by law and standard procedure.

Thus, we pose the following question: if the government’s banker (BSP) can create pesos *ex nihilo*, does it make sense to think that you need to pay pesos to the government, in the form of taxes, for the government to be able to spend? The reality is actually the opposite—in order to pay taxes and purchase a government bond, it is the banks that first must have or otherwise acquire from BSP itself peso reserves in their reserve accounts. It’s not the government that needs the private sector’s money; instead, it’s the private sector that needs the government’s money.

We reproduce in Figure 1 (already shown in the first essay) here the T-accounts involved when the government spends, let’s say PHP100. The arrows help explain the sequence, starting with the fact that government spending simultaneously creates Reserve Balances in the BSP (+100RB) and is a decline by the same amount in the Government’s account at BSP (−100Gov). The funds (government spending) are deposited in the beneficiary’s (household/firm) bank account as a deposit (+100D), an asset for the beneficiary and a liability for the bank. Ultimately, this is an increase in Net Worth of the beneficiary (+100NW), which is also a liability for the Government (−100NW). It all matches. QED.

Figure 1. Government spending

Government		BSP		Bank		Households/Firms	
A	L/E	A	L/E	A	L/E	A	L/E
-100 <i>Govt</i>	-100 <i>NW</i>		+100 <i>RB</i>	+ 100 <i>RB</i>	+100 <i>D</i>	+ 100 <i>D</i>	+ 100 <i>NW</i>

Note: A = Assets; L/E = Liabilities/Equity; NW = Net Worth; RB = Reserve Balances held by banks in accounts at BSP; D = Deposit; Govt = Philippine government account at BSP; Liab/Eq = Liabilities and Equity;

Source: Authors

We note that, in day-to-day operations, the Philippine Treasury must have a positive balance at the BSP before it spends – but that is an *operational rule*, not a hard financial constraint – and the BSP stands behind the system to ensure settlement. The National Government (NG) holds its main account at the Bangko Sentral ng Pilipinas (BSP). This is effectively a Treasury Single Account (TSA). When the Treasury spends: (i) BSP debits the NG account; (ii) BSP credits reserve accounts of commercial banks; and (iii) Banks credit deposits of recipients.

Does the Treasury need funds *before* spending? Legally, yes. Treasury must have balances in its account at BSP before it spends. This is standard cash-management practice.⁵ But this is *not* a financing constraint (this is the key point). The requirement to have balances does not mean the government is financially constrained like a household. The reason is that the state controls the institutions that ensure balances appear when needed.

How are balances ensured in practice? This follows three steps. First, bond issuance precedes spending. The Bureau of the Treasury (BTr) issues T-bills / T-bonds. Primary dealers buy them. Settlement occurs through BSP. NG account is credited before spending occurs. This sequencing is policy choice, not necessity. Importantly, as we explain below, the primary dealers themselves are part of a system of government auctions which has significant differences from traditional financing—primary dealers effectively have a guaranteed profitable business model in return for ensuring that government bond auctions settle at competitive prices.

Second, BSP provisional advances (important detail). Under the BSP Charter ([RA 7653](#), as amended by [RA 11211](#)), BSP may grant provisional advances to the National Government, subject to quantitative limits, short maturity, and mandatory repayment. This is explicit central bank support, even if framed conservatively in the law. So even legally, the BSP is not a passive bystander. It can supply liquidity to the Treasury when required.

Third, settlement cannot be refused. At the system level, BSP must ensure payments clear. Government checks cannot bounce due to “lack of money” in a macro sense. The constraint is administrative, not financial.

All this means that it is important to separate self-imposed rules from intrinsic constraints: (i) Self-imposed rules: -No overdrafts -Bond-before-

⁵ Bindseil, Ulrich. 2014. *Monetary Policy Operations and the Financial System*. Oxford University Press.

spend -Cash-balance targets; (ii) Intrinsic constraints are not policy choices of the government but strategically and operationally necessary: -Gold convertibility -Foreign-currency debt -Fixed exchange rate defensive operations. The Philippines has: -Its own currency -A floating exchange rate -Debt overwhelmingly in PHP. So, the rule mentioned above is voluntary discipline, not necessity.

4. Introducing the Operations of the Bangko Sentral ng Pilipinas

Before we complete the accounting of government spending and taxation, it is important to understand BSP's operations and how they interact, inherently, with government daily spending, revenue, and bond sale flows. BSP, like all central banks, operates on a day-to-day basis by setting an interest rate target.

In order to achieve its chosen target rate, BSP has to make sure that the quantity of balances banks hold in their reserve accounts at BSP is the quantity they desire to hold at the target rate. If banks are holding more than this amount, banks will try to lend the excess to each other but will find no borrowers and the interest rate banks charge each other for overnight loans will fall below BSP's target rate. BSP and Treasury will then issue debt to drain the excess liquidity in the system. This means that the possible inflationary effect of government spending is neutralized. We return to the analysis of debt in Section 7.

If, on the other hand, banks are holding fewer balances than desired at BSP's targeted rate, then they will try to borrow but find no willing lenders and the rate banks charge each other will be bid above BSP's target rate.

Therefore, BSP has its own set of tools to adjust the quantity of banks' reserve balances in their accounts at BSP to make sure the interest rate for banks to borrow and lend to each other stays at its target rate. This is also why BSP lends to banks that do not have balances in their reserve accounts when they need to settle a payment as we described above – if BSP refused to do this, it could not achieve its target rate, and, worse still, could threaten the functioning of the national payments system.

However, because the government's account, like banks' reserve accounts, is also at BSP, payments to and from the government – namely taxes, government spending, and bond sales – affect the quantity of banks' reserve balances at BSP, and thus also can require BSP to use its own tools

to keep the interest rate at its chosen target. When taxes are paid, this will reduce the quantity of banks' reserve balances in their accounts at BSP in order to credit the government's account at BSP, so BSP has to make sure banks are holding enough reserve balances to settle their customers' tax liabilities without moving the interest rate above its target interest rate. When the government spends, this will add to banks' reserve balances as the government's account at BSP is debited, and BSP here must make use its tools to ensure the interest rate does not fall below its target rate.

Where does this leave us? Similar to how bank lending in tandem with BSP's interest rate target means bank loans create money out of thin air, the fact that the government's account is also on BSP's balance sheet means that when you pay your taxes, your bank's actions to settle this with the government results in its own balances at BSP – money – being destroyed; likewise, when the government spends, balances in banks' BSP reserve accounts – money – are *created*.

It is important to repeat and stress that government spending and taxation are separate and delinked operational processes: taxes are not parked in a special account to be used to pay for infrastructure projects. This is of course not to say that the government does not need a proper accounting system of spending and taxation. Of course this is needed.

5. *The Thieves could not and did not Steal our Taxes*

The description in Section 3 of the spending system means that governments do not use taxes to finance projects. This raises the question: where do taxes go? Figure 2 (also shown in the first essay) shows the T-accounts involved when households/firms pay taxes. As in the case of government spending, the arrows help follow the sequence, the inverse of that in Figure 1. In this case, this sequence starts with the tax payer (household/firm) instructing his/her bank to debit his/her account ($-100D$). This is settled at the bank's account at BSP ($-100RB$), which credits the Government's account also at BSP ($+100Gov$). Overall, the taxpayer's Net Worth declined and that of the Government increased. It all matches. QED.

Figure 2. Households/Firms pay taxes

Government	BSP	Bank	Households/Firms
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A	L/E	A	L/E	A	L/E	A	L/E
+100 <i>Govt</i>	+100 <i>NW</i>		-100 <i>RB</i>	-100 <i>RB</i>	-100 <i>D</i>	-100 <i>D</i>	-100 <i>NW</i>

Note: A = Assets; L/E = Liabilities/Equity; NW = Net Worth; RB = Reserve Balances held by banks in accounts at BSP; D = Deposit; Govt = Philippine government account at BSP; Liab/Eq = Liabilities and Equity;

Source: Authors

Taxes, literally, destroy money—how can something that has been destroyed at some point later be stolen?⁶ What is true is that funds allocated for the flood projects and spent resulted in the creation of reserve balances in bank accounts, which in turn credited the private bank accounts of the spending recipients. The recipients then did any number of things, in the process of not actually carrying out the tasks the funds were allocated for, which we will discuss more below. This is naturally a crime and must be punished, but it is very important to understand that this does not affect the capacity of the government and BSP to continue spending. Neither the government nor BSP are poorer than before.

Importantly, we stress that there is no operational procedure through which the national government uses tax receipts or borrowing for its spending. Taxing and spending are operationally independent procedures.

As a consequence, and however unexpected this may sound, the truth is that the government can replenish the funds (technically, there is no limit to this) that were previously allotted for flood control. This does not mean that we are claiming that the corruption scandal is irrelevant because the government can afford to pay, again, for the flood control projects.

⁶ We make it clear that the law does not literally say “tax payments destroy reserves.” Instead, the legal basis (Section 113 of [RA 7653](#)) establishes the central bank as the official depository of government funds and the mechanism through which tax remittances and government payments are processed. The economic effect on reserves comes from how the banking system and central bank settlement operations work, as mandated by law. The process in steps is as follows: (i) Taxes credit the Treasury’s account at the BSP; (ii) Commercial banks’ reserve balances fall; (iii) BSP liabilities to banks decline; (iv) BSP liabilities to Treasury rise. The economic effect is that reserves are removed from the interbank system.

Even to the degree that punishments require recipients to pay the government back, this is fine as a punishment but it is important to understand that “paying the government back” is simply destroying balances their banks hold at BSP—it does not actually affect the government’s ability to carry out the projects as intended, which is financially always as unlimited as BSP’s ability to create pesos.

6. *What the Thieves stole...*

We are now in a position to explain, through a series of examples, the mechanics of what the thieves did, and ultimately stole. We mentioned above that the funds allocated to the flood control projects are *reserve balances* created by BSP, which were credited to the private bank accounts of the beneficiaries. These are bank deposits that mirror the reserve balances on the Asset side of commercial banks’ balances and on the Liabilities side of BSP’s balance sheet.

In the examples that follow, BSP, the Thief’s Bank, and the Thief’s account at his/her bank appear in all of them because they are common to all cases: BSP creates reserve balances ($+RB_{tb}$). The counterpart is the decrease in the Government’s Account at BSP ($-Gov$). These Reserve Balances are credited to the Thief’s bank and become deposits in thief’s account ($+D_t$), which appears in in the Liabilities side of the Thief’s bank and as Net Worth ($+NW_t$) in the Liabilities side of the Thief’s account. This, we insist, will be the same in all cases, shown in the first row. Up to here, all this is legal and this is standard operating procedure.

Example 1. Purchases of hard but low-visibility assets. Real estate, here and abroad. Mr. XX (e.g., NYC apartment, Paris apartment) are flagship examples, but also real estate developments especially in provinces and "future growth" (e.g., resorts). It is shown in the second row of Figure 3.

In this case, we introduce two specific agents to this example, the Real Estate Company in the Philippines (*re*) and the latter’s bank (*reb*). The thief purchases an apartment through a Real Estate Company, which owns (sells) apartments. When it sells ($-Apt$), the apartment becomes an asset of the Thief ($+Apt$). The Thief then pays ($-D_t$), which also appears in the Liabilities side of his/her bank ($-D_t$), and the Real Estate Company is credited ($+D_{re}$), which is a Liability for its bank ($+D_{re}$), the counterpart of which is the increase in Reserve Balances of its bank ($+RB_{reb}$). As the Thief

paid the apartment, this induced a decline in the Reserve Balances of its bank ($-RB_{tb}$). These last two annotations of Reserve Balances have their respective counterparts in the Liabilities side of BSP, $+RB_{reb}$ and RB_{tb} , respectively. It all matches. The Net Worth of the lucky Thief increased ($+NW_t$) and the source is the Reserve Balances created by BSP. It all matches. QED.

Figure 3. Purchases of Assets in the Philippines with the stolen funds

BSP		Thief's Bank (tb)		Thief (t)		Philippine Real Estate Company's Bank (reb)		Philippine Real Estate Company (re)	
A	L/E	A	L/E	A	L/E	A	L/E	A	L/E
	$+RB_{tb}$ $-Govt$	$+RB_{tb}$	$+D_t$	$+D_t$	$+NW_t$				
	$-RB_{tb}$ $+RB_{reb}$	$-RB_{tb}$	$-D_t$	$-D_t$ $+Apt$		$+RB_{reb}$	$+D_{re}$	$+D_{re}$ $-Apt$	

Note: A = Assets; L/E = Liabilities/Equity; RB = reserve balances held by banks in accounts at BSP; Govt = Philippine government account at BSP; D = deposits; NW = net worth; Apt = apartment

Subscripts: tb = Thief's bank; t = Thief; re = real estate company; reb = real estate company's bank

Source: Authors

We just add that what we have described here equally applies to the purchase of luxurious goods like cars luxury vehicles, jewelry, watches, art, overseas travel and education.

Example 2. Figure 4 shows the international version in which the thief purchases a New York apartment. Here we have the Real Estate Company (*re*), this time in New York, and the latter's bank (*reb*), also in New York. The thief purchases an apartment through a Real Estate Company, which owns (sells) apartments. When it sells ($-Apt$), the apartment becomes an asset of the Thief ($+Apt$). The Thief then pays ($-D_t$), which also appears in the Liabilities side of his/her bank ($-D_t$). The difference here is the Thief's Philippines-based bank settles the Thief's payment using its own US dollar deposit account at a New York bank ($-\$D_{tb}$) – we assume for simplicity the Thief's bank and the Real Estate Company both bank at the same New York Bank – rather than via reserve balances in the previous figure. Agaib, it all matches. QED.

Figure 4. Purchase of New York Apartment with the stolen funds

BSP		Thief's Bank (tb)		Thief (t)		NY Real Estate Company's Bank (reb)		NY Real Estate Company (re)	
A	L/E	A	L/E	A	L/E	A	L/E	A	L/E
	$+RB_{tb}$ $-Govt$	$+RB_{tb}$	$+D_t$	$+D_t$	$+NW_t$				
		$-$D_{tb}$	$-D_t$	$-D_t$ $+Apt$			$+$D_{re}$ $-$D_{tb}$	$+$D_{re}$ $-Apt$	

Note: A = Assets; L/E = Liabilities/Equity; RB = reserve balances held by banks in accounts at BSP; Govt = Philippine government account at BSP; D = deposits; NW = net worth; Apt = apartment

Subscripts: tb = Thief's bank; t = Thief; re = real estate company; reb = real estate company's bank

Source: Authors

Example 3. Stolen funds are kept as cash for recycling as political power. PH politics is overwhelmingly cash-based, and would explain the five-story bunkers and similar storage depots being revealed. This case is shown in Figure 5. It is very simple as it involves only the Thief, its bank, and BSP/Government. The stolen funds are withdrawn from the Thief's bank ($-Cash$, $-D_t$) and they are kept in bills at home ($+Cash$). It all matches. QED.

Figure 5. Stolen Funds kept as cash for recycling political power

BSP		Thief's Bank (tb)		Thief (t)	
A	L/E	A	L/E	A	L/E
	$+RB_{tb}$ $-Gov$	$+RB_{tb}$	$+D_t$	$+D_t$	$+NW_t$
		$-Cash$	$-D_t$	$-D_t$ $+Cash$	

Note: A = Assets; L/E = Liabilities/Equity; Cash = paper money

Source: Authors

Example 4. Funds parked back in formal financial system as wealth management. This is shown in Figure 6.

Figure 6. Funds parked in the financial system

BSP		Thief's Bank (tb)		Thief (t)		Investor's Bank (ib)		Investor (i)	
A	L/E	A	L/E	A	L/E	A	L/E	A	L/E
	+RB _{tb} -Gov	+RB _{tb}	+D _t	+D _t	+NW _t				
	-RB _{tb} +RB _{ib}	-RB _{tb}	-D _t	-D _t +Stock		+RB _{ib}	+D _i	+D _i - Stock	

Note: A = Assets; L/E = Liabilities/Equity; Stock = shares of stock purchased in secondary market

Source: Authors

This case introduces the investor (*i*) and the investor's bank (*ib*)

To sum up, in every instance shown above, the thieves stole deposits that were intended for projects such as flood control, etc. However, deposits are not how tax payments are ultimately settled with the government, since taxpayers' banks are the ones finally settling any tax liability with the government through the former's reserve accounts at BSP. BSP has the operational ability to increase or decrease these amounts with simple keystrokes on a computer. Tax payments themselves result in reserve balances being literally destroyed in order for the government to receive payment.

7. More on the Operational Reality: Shameful Debt... is the country about to implode?

[The newly appointed Finance Secretary Frederick Go has stated](#) that the government aims at increasing tax collection. We stress that this will not increase the government's capacity to spend. Government spending will proceed as explained above. What higher tax collection will do is to *create the illusion* that the government has more funds to spend – then it will spend more. We repeat that this is not true. Higher taxes may reduce inequality if the very rich pay much more but they will not finance the roads, education, or health that we desperately need. These will be paid for as described above. And do not forget that taxes take away purchasing power from the private sector (consumption may decrease?) and, consequently, are deflationary.

What about the belief that if the government runs a fiscal deficit (that is, government spending is greater than taxes) is at the mercy of the private sector because the former (the government) has to borrow from the latter (the private sector)? We just argued above that the government spends reserve balances. Also, note that the idea of matching spending and taxes is simply an accounting practice, the product of mistakenly thinking about the family analogy, that government finances are like those of a family. This underlies the obsession with being “fiscally responsible” (we discuss this below).

But what happens, once again, in actual practice? In the face of a fiscal deficit (spending is greater than taxes – incidentally, why would ordinary citizens complain about this?), there would be excess reserve balances in the banking system. Commercial banks will want to lend those funds as profit maximizing companies but, to do so, they would have to offer them to one another at interest rates lower than the prevailing one. Note that this is the opposite of what many people and economists claim, namely that a fiscal deficit pushes interest rates upward. It is the opposite.

The implication is that BSP needs to make sure the excess reserves are mopped up. BSP will use its [Term Deposit Facility](#) (one of BSP’s main tools for achieving its interest rate target) or Treasury will issue Treasury Bills (T-bills) and offer them to the private sector, to the so-called [primary dealers](#) in auctions. Primary dealers bid for the T-bills because it is part of the privilege of being part of BSP’s operations – by participating they essentially have a guaranteed profitable business model with their costs of funds limited to BSP’s target rate.

Banks and others also buy these T-bills because they face zero-risk (yes, the government pays back), and because they (banks and dealers) need them as collateral in order to borrow from BSP. T-bills appear on the asset side of the commercial banking system. Dealers may offer T-bills to the public in what is called the secondary market, so that private citizens can also own T-bills. This is wealth of the private sector. Bidding in a T-bill auction is based on the interest rate set by BSP and what BSP is expected to do in the future, since this is the dealers’ cost of funds. If the bidding is competitive (i.e., several dealers and others involved) and the market is sufficiently liquid, then the bids are mostly based on the current and expected path of BSP’s target rate, since that is the cost of the bidder’s funding (like a basic Economics 101 competitive market, the price converges to the economic

costs). The story ends here except that we now should alert the reader that the government calls the T-bills *national debt* – how silly is that? Naturally, debt in the old days was...real debt. The first large, permanent national debts arose to finance war. They King had to pay back those who financed it. But this is not how governments spend today, much less how they finance wars. Hence, so-called national debt (a misnomer) is something very different today.

Certainly, the government is not at the mercy of the private sector when it issues debt. Settlement of government debt auctions, like taxes and government spending, occurs on BSP's balance sheet via bank reserve accounts and the government's account at BSP. The issuance of T-bills (debt) is, therefore, a portfolio operation that, like taxes, destroys banks' reserves in accounts at BSP. In order for these auctions to settle, BSP has to ensure – just like with tax payments – that banks have sufficient reserves in their accounts at BSP to sustain the interest rate at its chosen target.

It must also be clear that Treasury does not issue T-bills to finance government spending. The government's account is at BSP, which is financially unconstrained. The issuance of T-bills is, effectively, an interest management operation – operationally similar to BSP's own Term Deposit Facility – to ensure that BSP's policy rate remains at the level it was set. This is not a situation where the government bond market “disciplines” the government – the interest rates on peso-denominated government issuances remains tied to the current and expected paths of BSP's target rate. BSP has its own interest in this being true, which is that the transmission of its interest rate target to other interest rates in the economy travels through government bills and bonds. Thus, if it is not the case, BSP can step in to “stabilize market functioning” as it did during the [first few months especially of the COVID-19 period](#).

Consequently, it is incorrect to argue that each Filipino owes about PHP 130,000 (about PHP 17 trillion in total national debt); repeating this claim in the media is misleading and potentially harmful as it contributes to a flawed understanding of how public debt works. Actually, each Filipino owns, on average, PHP 130,000 in T-bills. It is true, of course, that Treasury pays interest on T-bills. How does it pay? Once again, by crediting the account of the holder (this, again, creates reserve balances, etc.). The important point is that interest on T-bills is income for the T-bill holder (the

same as the interest received for maintaining a checking account with the bank). Why would anyone in the private sector complain about this?

If at the end of the tenure of the T-bill (for example three years), the holder decides not want to renew it, he/she will get back the principal. How? We think at this stage it should be clear how the government would pay back the principal. We can take this argument further. Suppose nobody wants to renew the T-bills and every single holder claims the principal. This would not be a problem for the government (beyond administrative issues). The problem would be for the private sector, especially for the commercial banking system, and for BSP (what to do with the excess liquidity....issue debt again?). More to the point, and returning to the logic of dealers and others in government auctions, in a liquid government bond market there would be by definition plenty of dealers and other financial institutions willing to bid arounds the current and expected path of BSP's target rate since that is their cost of funds.

Today, some people complain that interest payments on T-bills represent a high percentage of the national budget (about PHP900-950 bn., equivalent to 13-14% of the national budget), and that the stock of T-bills (the stock of debt, about PHP 17 trillion) represents a *high* percentage of GDP ([over 60%](#)). If the reader has understood that the government has spent on, for example, infrastructure (funds transferred to a construction company), then offered T-bills to park excess liquidity, and then paid interest, it would be obvious that all this contributes positively to the economy. The debt-to-GDP ratio that circulates among doomsayers as the unsustainable limit is 60% for developing countries. Meaningless. Will the Philippine economy collapse because the ratio is already over 60%? When will this happen? How? We are not arguing that it has to be higher or lower but simply that such ratio is not very telling. Further, while economists have spilled uncountable volumes of ink worrying about government debt, there is no particular "debt ratio" that even their most sophisticated theories say governments should target – [while the most popular empirical studies were later debunked for having simple Excel errors.](#)

No economy has entered into a crisis as a consequence of running fiscal deficits and issuing debt – such as Treasury bills – denominated in its own currency. The problem comes from the rating agencies and international institutions that raise a red flag when the debt-to-GDP ratio increases. In the instances when the government stopped honoring debt in the national

currency, it was because the economy had collapsed as a result of an economic/political crisis. It was not caused by the fiscal deficit or the accumulated debt. The Philippine government has always honored peso debt. Today, about 70% of the Philippine national debt is peso-denominated and the other 30% is denominated in foreign currency. Why does the Philippine government issue foreign-currency denominated debt? It does it because the interest rate paid is lower than that in pesos and because the government needs to make payments in foreign currency. The government pays back this debt by buying the foreign currency in the market (e.g., exchanges pesos for US dollars –hence the exchange rate matters).

It is certainly true that some economies stop making payments in a foreign currency (debt crises), as the Philippines did in the 1980s. This is a different matter. It is of course possible not to be able to honor debt issued in a foreign currency. This is because the country in question cannot create reserve balances in the foreign currency (this should be obvious), and finds it difficult to continue buying the foreign currency in the foreign exchange market because the domestic currency depreciates so much that imports, for example, become unaffordable. A crisis follows.

Finally, while most people are concerned with national debt, they do not seem to be concerned with the debt that is a real problem for a country, the one that causes crises, namely that of the private sector.

8. On the need for a sensible fiscal policy for development

The thesis of this essay is that while the corruption scandal unveiled in 2025 is deplorable, the thieves have not stolen our taxes because these *cannot* be stolen. It is not that these are locked somewhere. Rather, it is that tax payments are ultimately settled for customers using banks' reserve accounts at BSP –these are destroyed when taxes are paid, while there is no limit to BSP's ability to create them.

We close the essay by emphasizing that the uncovered massive corruption scandal offers a huge opportunity for policy makers to rethink the role of fiscal policy by acknowledging the monetary reality about spending and taxing. The suggestion to use government spending as a tool for national building is to help the economy reach its full employment. This does not mean we undermine the role of the private sector. Quite the opposite. We

simply argue that no economy has developed and eventually reached high income without the helping hand of the government. This government not only implemented reforms and provided a level playing field, but also *financed development*. This means that it ran fiscal deficits that helped the private domestic sector run surpluses. When this was not done, a crisis followed.

The accounting of government spending shows that the money a government spends is created out of thin air on BSP's balance sheet (it is not taxes). This does not mean that stealing it is not a crime and that it does not have consequences: the flood projects are not there, and this has very negative consequences for those affected. Having said this, we need to understand that the theft does not make the Philippine national government and BSP poorer. What the country needs is stronger mechanisms to prevent this from happening again.

Likewise, the description of how the Philippine government spends and taxes does not mean that that the state can or should spend without restraint. It simply means that pesos—the national currency—are not a scarce resource, despite often being treated as such in policy discussions. In economic terms, scarcity refers to real resources: labor, materials, technology, and institutional capacity. While the economy may face real constraints, such as shortages of construction inputs or skilled workers, pesos themselves cannot be scarce. And the government faces another important constraint: low capabilities and knowledge.

There is little doubt that the government can *financially* afford the essential public services that the nation needs. Most of these services—including infrastructure, health, education, and efforts to eradicate malnutrition—are paid for in pesos. The limit on government spending is not financial but inflation. When this point is reached, the government should use taxation.

Also, we are aware of the Impossible Trilemma in open macroeconomics and we agree with its essence, but we prefer to restate it because we add a fourth policy dimension to it, fiscal policy. We advocate a flexible exchange rate (ideally, though this requires the economy be able to withstand significant depreciations—as an intermediate step, we advocate concrete policy actions to enhance this ability), increased monetary sovereignty (the ability to run macroeconomic policy to support full employment, price stability, and long run growth without having to reverse course in the face

of international financial markets' actions to depreciate the currency, increase commodity prices, and so forth), and capital controls when necessary.⁷ A government that issues its own floating currency can always set its interest rate and spend in its own currency, but must allow the exchange rate to adjust. We are mindful that the degree of monetary sovereignty of the Philippines is not the same as that of the United States or Japan. Ultimately, the goal of macroeconomic policymakers in the Philippines is to reduce to negligible how much the economy is at the mercy of international financial markets. For this, it needs to *change its economy* (transform it, make it more complex) so that the peso approaches the degree of sovereignty of the Korean won or the Singaporean dollar.

Moving forward, we advocate a much more active fiscal policy in the Philippines. While governments in most other countries also believe that they are subject to budget constraints, it is obvious that they *must* be aware that they can spend in their own currency. The result is much better infrastructure, public education, and public health, than in the Philippines.

This implies that setting fiscal targets is a meaningless practice for a sovereign government. The fiscal outcome is dependent on the spending choices of the non-government sector. The government should rather focus on maintaining net public spending at levels which sustain aggregate demand at its full employment level. If it achieves that target (full employment) then the fiscal balance will move accordingly and be sustainable.

The Philippines needs a serious fiscal strategy for development that is also tied to an inflation target (rather than to a budget constraint or any particular debt ratio). Neither monetary policy nor leaving development spending to the private sector will do it. This last point does not mean that we deny the role of the private sector in the economy. It means that the

⁷ Today, the Philippine peso, at slightly below PHP60/USD, is probably overvalued (an admittedly subjective assessment). A significant depreciation would help the manufacturing sector and tourism, for example, but would have to be accompanied by significant measures to transform the economy. Moreover, a devaluation or currency depreciation will increase growth provided the sum of the price elasticities of demand for imports and exports exceeds unity in absolute value. This is the s-called Marshall-Lerner condition. A once-and-for-all depreciation of the currency will not raise growth permanently. After the initial depreciation, growth would revert to its previous value. To raise growth permanently, would require continuous depreciation is successive periods.

government has a responsibility that cannot be delegated to the private sector, whose legitimate objectives are different.

It is mindboggling to hear officials at the Department of Education (with whom we sympathize) struggling to increase the department's budget to build classrooms – and appeal to the assistance of the private sector. What is the cost of building a school, a hospital, or a flood control project? Public goods such as these cost 'nothing.' They are paid for in pesos as described above –if the project requires foreign currency this has to be earned (a different business). Public goods like these must be valued in terms of the real resources the country dedicates to building them. What are these resources? The workers, machines, and materials used. These are real resources that the nation has, possibly underutilized. The real cost of building additional infrastructure through a government-sponsored employment program is the extra consumption that formerly unemployed workers could enjoy and the extra capital equipment that the workers would use in their productive pursuits. These projects generate income and employment. This is their value. Government programs have to be appraised by how they use real resources rather than in terms of the nominal money values involved. If the government continues thinking about them as a cost, we will always be behind.

Appendix: Glossary of widely used misleading terms

The government has a budget constraint, like a family. If by 'budget constraint' it is meant that the government cannot spend without restraint, and that spending must be planned, then we all should agree in principle. However, orthodox economists do not mean this. They clearly believe that the government must collect taxes to spend, and these (taxes), not being enough to cover spending, must be supplemented by issuing debt (T-bills). This operates as an ex-ante constraint. This is not an ex-ante constraint but an ex-post identity: government spending is, at the end of the year, equal to the sum of taxes plus, newly-issued debt plus the increase in the money supply.

“Sound finance”, “Fiscally responsible”, “Fiscal discipline”, “Fiscal Sustainability”, and “Fiscal consolidation”

These are problematic terms to the extent that they are based on a misconception: that a sovereign economy operates with financial constraints. A sovereign government is not revenue constrained.

The standard version of “fiscal responsibility” is based on the idea that currency issuing governments have limited financial resources and must maintain a policy stance that appeases the bond market lenders, or risk “running out of money”.

Defining “fiscal sustainability” in terms of the desirability of fiscal surpluses overlooks the reality that if the government runs a surplus, then non-government sector must be in deficit. That is, if the non-government sector is to run a surplus, the government must be in deficit.

In nations without external surpluses, a government surplus will always be reflected in a private domestic deficit. This cannot be a viable growth strategy because the private sector (which faces a financial constraint) cannot be in deficit (and accumulating ever increasing debt) on an ongoing basis. Ultimately, the fiscal drag will force the economy into recession as the private domestic sector seeks to save again to reduce the precariousness of its debt exposure.

Fiscal sustainability, therefore, involves a conceptualization of government that is free of financial constraints and has a range of possibilities that are not available to any non-government entity.

Given that the non-government sector will typically net save, a sovereign government must run deficits on a continuous basis. The size of the deficit will be determined by the full employment fiscal deficit condition

Are we running out of “fiscal space”?

IMF (2005) refers to fiscal space in the following terms:⁸

“[the] room in a government’s budget that allows it to provide resources for a desired purpose without jeopardizing the sustainability of its financial position or the stability of the economy. The idea is that fiscal space must exist or be created if extra resources are to be made available for worthwhile government spending. A government can create fiscal space by raising taxes, securing outside grants, cutting lower priority expenditure, borrowing resources (from citizens or foreign lenders), or borrowing from the banking system (and thereby expanding the money supply). But it must do this without compromising macroeconomic stability and fiscal sustainability – making sure that it has the capacity in the short term and the longer term to finance its desired expenditure programs as well as to service its debt.”

This description or definition of fiscal space is extremely unclear and misleading, and reflects an erroneous description of how an economy operates. The capacity of the sovereign government to mobilize resources depends only on the real resources (labor, natural resources, productive capacity, know how) available to the nation.

The purpose of a government is to pursue public purpose and wellbeing through fiscal sustainability, which must be constructed in terms of maintaining full employment and price stability. The full employment deficit condition must provide the focus for policymakers in this regard.

⁸ Heller, Peter S. (June 2005). “Fiscal Space: What It Is and How to Get It,” *Finance & Development* (IMF magazine), Volume 42, Number 2