

# Central Bank of Solomon Islands

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## **Governor's Statement on the Occasion of the 25<sup>th</sup> Anniversary - 21<sup>st</sup> June, 2001**

### Introduction

Hon. Prime Minister, Hon. Speaker of Parliament, Ministers of the Crown, Members of the National Parliament, Members of the diplomatic corps, Heads of Churches, Permanent Secretaries and senior government officials, Heads of statutory authorities, Bank Managers, Former and current Directors of the Central Bank, Former staff of the Central Bank, NGO Representatives, Private Sector Representatives, Media Representatives, CBSI staff, Friends, Ladies and Gentlemen!

It is a pleasure and honour for me, to welcome you all to this morning's gathering. I am especially grateful to the Hon. Prime Minister for accepting to be our Guest of Honour this morning. I would also like to acknowledge the presence of Mr. Tony Hughes. Mr. Hughes, was a member of the first Board of Directors of the original Monetary Authority, and later became the first Governor of the Bank. We also have with us Mr. Richard Tinoni, who was the first recruit to SIMA, when he joined as Secretary to the Board of Directors in February 1977. Regrettably, I am unable to introduce the Caretaker Leader of Opposition, who as Minister for Finance in 1983, oversaw the conversion of the Monetary Authority to the Central Bank. Unfortunately, it is not possible also to introduce the other pioneers of central banking in Solomon Islands as most of them have already passed away or simply inaccessible.

As you would have seen from your invitation, this gathering is to mark the Silver Jubilee of the Central Bank. Today is a very happy occasion for us in the Bank. It marks a very important milestone in the life of the Bank, and that of the financial system in Solomon Islands. It is therefore a great achievement for us nationally, in our economic development and in the process of nation building.

The idea of a central bank had been part of the making of an independent Solomon Islands. Part of building a national identity, nation building is to have a national currency. Accordingly this entailed having to have an issuer of the currency. So even in the early seventies, when the architects of our nation were pondering over issues such as the constitution, international boundaries, systems of government etc., a national currency was already part of the considerations. The concept had therefore been here much longer than 25 years.

This concept took off after the study report by Mr. EC Dommen, an economist who was part of a UN team, which was tasked to research the idea. In their report of April 1972, the team recorded a number as advantages - for Solomon Islands - to have a national currency:

- 1) A symbol of nationhood and an element of nation-building
- 2) With foreign reserves being held to back local currency, it will provide investment earnings for the country, which would benefit the balance of payments
- 3) Solomon Islands will have power over exchange rate policy suitable to the country's needs
- 4) With a local national currency it will enhance statistical information gathering and analysis which will enhance better understanding of the balance of payments and Solomon Islands economic progress
- 5) Holding local currency instead of overseas currency will reduce costs to local banks for currency management
- 6) Solomon Islands public should be able to get denominations and types of currency features suitable to their needs
- 7) The currency will provide backing for issuance of securities, a very important source of loan capital for the government

That report affirmed the government's desire to have a national currency. Work on the establishment of the institution, including drafting of the enabling legislation, began a few years later. Initially, the institution was to have taken the form of a currency board. However, the law, which was finally enacted on 21<sup>st</sup> June 1976, had a monetary authority status.

### **Board of Directors**

A Board of Directors was obviously the first matter to ascertain, so the Board was appointed under the Chairmanship of Mr. John Palfrey, who was seconded by the Bank of England. Other Directors were Mr. Jezriel Korinihona, Mr. Gordon Siama, Mr. Stephen Yee, and Mr. Anthony V Hughes, then Secretary for Finance. I note that except for Mr. AV Hughes, all these pioneer central bankers have already passed away. We owe a lot to these men who laid the foundations for this institution and the financial system in Solomon Islands.

Membership of the Board remained at five until 1979, when it was increased to seven. Following further amendments in 1983, this number was increased to the current nine. Until 1981, one person held the role of Chairman of the Board and that of the Managing Director. In November 1981, these tasks were separated, upon which Mr. AV Hughes was appointed Chairman of the Board of SIMA1[1]. However, after the amendments in 1983, which converted SIMA into the current CBSI2[2], the Governor is also the Chairman of the Board.

By law, Directors are appointed on personal merit, and as such the Bank has had a very diverse group of people on the Board. (*The Hon. Prime Minister also served on this Board when they were PS, Finance*) Besides the different personalities, we have had people of very diverse professional backgrounds: economists, financial managers,

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lawyers, accountants, businessmen, trade unionists, clerics, and even politicians. Recently a lady was on the Board. Even in terms of age, there had been vast differences in age groupings. As you can imagine this provided for lively discussions during and outside meetings, and sometimes quite an entertaining group of people to be with. These people brought to the Bank a wide range of experiences, to our mutual benefit.

The past twenty-five years, in particular the last ten, have been quite turbulent for the Board especially in regards the country's economic situation. The Board has been faced with some very difficult decisions. However, it is heartening to note that on the whole, we have had a very responsible group, concerned and determined to serve the Bank well. The Board had always acted professionally, responsibly and had remained focused and consistent in terms of its policy advice. This is very essential for the integrity of the Bank and the Board itself.

The CBSI is probably the first in taking its Board meetings in outside Honiara. In fact we would have already done at least two rounds each of the provinces. For us in the Bank, these have been very educational and being in the rural have proved very refreshing. I understand that other institutions have emulated this example. We are planning to do more in future, as the Bank's Board has now increased its provincial meetings to three per annum.

### **Personnel and Staff Development**

In terms of staffing, except Mr. John Palfrey<sup>3</sup>[3], who was the Managing Director and Chairman of SIMA then, there were no staff in 1976. It was not until February 1977 did recruitment start, when Mr. R G Tinoni joined SIMA as Secretary to the Board. Recruitment had to be accelerated to ensure the capacity of the new institution was ready to tackle its mandate under the Act. So the following month, the late John T Kaitu joined in the exchange control area and Mr. Isaac Molia in the currency division. By the end of that second year SIMA staff totaled eleven. Each year thereafter the number kept increasing, as the authority assumed more and more of the functions stipulated under the Act. During the last two years however, recruitment for administrative positions had to be slowed down to allow for emphasis on the policy and core functions of the Bank. At the end of last year, the total staff complement was 94, including all auxiliary staff.

In the early stages of the Bank's development, its management staff was supplied under the IMF technical assistance program, with officers on secondment from central banks of Australia, England, India, Israel, New Zealand and Sri Lanka. The Bank still benefits from the IMF TA program. However, we are proud to say that right now, the Bank is one of the few organizations in Solomon Islands that have been fully localized. This is attributable to the Bank's staff development program. Such a development program is inevitable given the awesome responsibility of managing an

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institution with a mandate covering uncharted waters for Solomon Islanders. Credit must go to past (and present) management for having the foresight to ensure the staff is adequately prepared and equipped for the various responsibilities in the Bank. I can assure you that the Bank staff is well trained to handle their respective duties. Besides, we have a team of professionals, most of whom would be in possession of their second degree in the fields of economics, banking, accounting, finance and management. Most of these officers would have acquired these qualifications since joining the Bank, thanks to a very comprehensive staff development policy, which has been in place since late 1980's.

The Bank is also proud of its fair recruitment policy: with the current staff complement of 94, it broadly represents the social make up of the country – and more than a third are females.

CBSI staff is a close-knit group. Staff grievances are always dealt with quite amicably through an in-house staff-management consultative group. This mechanism ensures dialogue, consultation, feedback, understanding and provides a system where reward goes where it is due. Staff members treat each other and their responsibilities with respect. Staff hold with great respect their being members of the Central Bank, a premier institution in the country, and it has to retain its credibility both at the Board level as well as at staff level. At the same time, we recognize the risks involved in abusing the powers of the Central Bank. No wonder, the founders of the Bank have taken particular attention to making appointments to the Board as well as on the management to ensure the Bank's integrity and reputation is maintained.

## **Premises**

In 1976, SIMA operated from a small room in the now burnt Ministry of Finance building while awaiting the completion of its office premises inside the Rove Police Head Quarters.

The choice for the location at Rove is not known, but if security was part of the consideration, then indeed that objective was met. In fact the physical security of the building was provided around the clock at no extra cost to SIMA. However, soon that accommodation became congested as the staff grew. Besides, its location made access by visitors and clients became rather cumbersome and inconvenient to doing normal business and in performing other functions under the law. Late in 1979 therefore, SIMA bought the old Agriculture & Loans Board (DBSI's forerunner) building on Mud Alley. After some minor renovations and additions, that building was occupied in late 1980. Except for Research and Currency, all functions of the Authority moved from Rove into the new home on Mud Alley that year.

SIMA's role and functions kept expanding. In fact, by 1983 the newly acquired premises had become inadequate. And so we had to build a new home which would accommodate all the expanding role and functions of a fully-fledged central bank.

A core function of a central bank is to be custodian of the currency, so extra care had to be taken by the designers to ensure the currency vault is not only secure, but also big enough to cater for the currency operations of a growing economy. But central banks also keep other valuables, such as gold. At the time this building was being designed, the gold ridge project was also being finalized. I was told that then Minister was very particular about the size of the vault - whether it would be big enough to hold the gold from Gold Ridge. On a visit to the Bank of England, he and the Governor were taken to the vault, where there was a lot of gold. On their return he told the Governor, " Perhaps we cannot afford to have too big a vault." You can be assured however, that the designers did take careful consideration of the minister's concerns. So while we eagerly await the first gold bar to be deposited with us, there is a lot space in the vault under ground here.

The construction of the present Central Bank HQ was completed in 1985, and occupied that same year. At that time it was a landmark in Honiara: in fact it had triggered off a new look on Mendana Avenue as more buildings went up or existing ones being redone. As many of you know, it is not easy maintaining the look of a good building like this one, but we try hard to do that.

Given the ever-increasing responsibilities given to the Bank, these premises are again already congested. Plans were afoot to redo the old Mud Alley building but these have had to be put on hold.

As is required of a central bank, with all the currency stocks, we have to ensure that physical security in and around this building is maintained. Over the years, the security systems have been reviewed and upgraded an number of times. In early 1999, following a thorough overhaul, work began on a more state-of-the-art system. In spite of an eight months' delay, caused by the events in June last year, the new system is in place.

On staff housing, the Bank has acquired and built several management houses. It has also acquired the Bokona staff housing estate, which now has a pool of houses for the rest of the staff. The establishment of the Staff Housing Loan Scheme in 1979 has proven to be a worthwhile and successful idea. Not only that it relieved the Bank of the problems with staff housing in Honiara, but the scheme has enabled many members of staff to possess their own real property, yet another mark of the foresightedness of previous management.

### **Administration & Organizational developments**

In its first year 1976, SIMA operations concentrated mainly on preparatory work, in particular, for the new currency. Accordingly initial recruitment was mainly for currency and exchange controls regulations: only a small number was in administration. Recruitment however, went into full swing early in 1977, in time for the new staff to undergo training for the task ahead.

With 24 October 1977 having been set for the introduction of the new currency, and considering only an eight months transitional period, even on currency operations alone, there was a lot to do during that period. Besides that, there were other preparatory work: on the Exchange Controls, designing and building of the new office premises, establishment of office procedures, recruitment and training, and a whole host of other logistics in the creation of a new organisation. With hindsight, it is really amazing how Mr. John Palfrey could have managed all these activities by himself in that first year of operation.

The Authority's currency and banking functions continued to expand each year. By 1979 it was providing banking services to the banks, statutory authorities, the government, and also assumed responsibility as agent for government securities that year. By 1981, SIMA entered the banks' clearing system and was providing the clearinghouse.

Developments on the legislative front usually trigger most of these new tasks. Early in its third year of existence, work was already progressing towards converting SIMA to a full-fledged central bank. In that year, SIMA assumed responsibility for the management of the country's external reserves. Also in 1979, SIMA adopted the determination of daily exchange rate. These three functions were amalgamated into the Foreign Exchange Department.

Collection, analysis and dissemination of information of data on the economy were an important function of the new organisation. However, it did not actually take shape until 1980 in the formation of the research unit. Since then SIMA began initiating monetary policy issues, providing analysis and commentary on general economic conditions, which led to the establishment of the current Economics Department. This department has now become the "nerve center" for the Bank's monetary, financial and general analysis on the domestic economy. These analyses form the basis for the Bank's advice and views on various economic and financial policies to the government. Apart from that, the information gathered by the department is disseminated to the public through the various reports that we publish. Later on this morning we will have the opportunity to witness the Hon. Prime Minister launch the Bank's website, another major development in this function.

Supervision is a function of the now, Financial Institutions Department. This function stipulated in the original legislation, but SIMA did not actually take up this role until after 1983. This was due mainly to the need to train staff: good bank supervisors are made, not born! Most of our work in this area is still done off site: that is, in terms of regular

reporting by the banks. The department has been strengthened through an IMF TA program and more recently the WB, mainly in training and upgrading of systems and procedures. In 1998 another important and major step in this role took effect upon the enactment a new Financial Institutions Act. Under that new legislation, the supervisory powers of the central bank have been extended to cover non-bank financial institutions, for example, NPF and DBSI. Full implementation now awaits a ministerial order.

A function which remains largely unattended, is the promotion of financial services in the rural areas. Over the years, a lot has been expected of the Central Bank in this regard: where the Bank has been expected to take on a developmental role and even a public service provider. However, I am not sure if this approach should not be discontinued. It was found that in so doing, we have often found ourselves performing entirely conflicting roles, as well as indulging in certain functions which fall outside the Bank's mandate. We have also come to realize that these are very costly objectives to pursue: no wonder, despite the many calls to extend banking outreach in the rural areas, volunteers are not falling over themselves to take up the offers. However, for its part, the Central Bank has tried (and will continue to) to help and to encourage others to take an interest in the provision of financial services outside Honiara. In that regard, the Bank has provided some assistance to DBSI in the past, and for a long time, it has directly assisted credit union activities. Our assistance to commercial banks has been rather limited, they being entirely commercial enterprises. But on that aspect, it should be noted that banks' rural outreach programs elsewhere in the world are actually taking a reversal. Hence, a decision to extend banks' presence in the rural Solomon Islands is obviously not only a real challenge, but one that can only be attractive if the returns are more than adequate. In any case, this is a matter which should fall within the normal social functions of the government.

### **Currency Operation**

Designing and the production of a new currency is a long and delicate process. Even with modern technology, we find that it still takes as long as it was in the early days of SIMA.

The detailed designs for the Solomon Islands national currency had been approved by the Council of Ministers in 1975. This approval denominated the first bank notes to be in \$2, \$5 and \$10<sup>4</sup>[4]; and for coins, it would be in 1, 2, 5, 10, 20 cents and \$1 denominations<sup>5</sup>[5]. Later on in our program, the Hon Minister of Finance<sup>6</sup>[6], will open our Currency Display after which all guests are invited to visit the displays. My staff will be there to explain and answer your questions so I should not disappoint you at this stage.

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However, I would like to make a very general point on the development of bank notes in Solomon Islands. As you would have noticed in the program, later on during the morning, the Hon. Minister will launch two bank notes, namely the \$2 polymer note and the upgraded \$50 bank note. These two notes feature some of the latest technology in bank note development, which encapsulate better security, more durability and more user-friendly features. This is an important milestone in the development of the national currency, and it is very gratifying that their issuance has coincided with the Silver Jubilee. Again you will be given the opportunity to learn about these new notes in the Currency Display.

At the time we first issued Solomon Islands own national currency, the Australian currency was the legal tender, so plans to exchange the currencies was set to begin later in 1977 until June 1978, a period which has had to be extended for another three months due to the amount of work and other delays involved. October 24 1977 was set for the issue of the new currency. The first experience for the staff in the art of actual currency operations was to move 80 tons of coins from Ports Authority and 18 tons of notes from Henderson, at the same time into the Rove vaults. As can be imagined, this was a very big operation, involving police and the entire staff.

In terms of its numismatic activities, these began quite early as well. In fact, coins had been on sale since 1977. However, the real serious business did not start until the first \$100 Gold Coin, dated 1978, was struck to coincide with the country's independence celebrations. Since then the Bank has participated in many international events in its numismatic operations, accounting for a consistent stream of income for the Bank.

## **Legislation**

On legislation, the SIMA Act had been through many amendments since its enactment on 21 June 1976. As noted earlier, these amendments have allowed for the progress of the SIMA in its development, for example, amendments which increased membership of the Board from 5 to present 9; powers to provide banking services to banks, government and statutory bodies; and powers to supervise the banks and so on. Apart from the enabling legislation for SIMA, one of the milestones was the amendment in January 1983, which enabled the conversion of the SIMA Act into the CBSI Act, giving the institution full central banking status. Since then there have been other minor amendments.

In August 1995, there were attempts to amend the act in a very substantial way. These amendments would have transferred the power to hire and fire - of the Governors and the Board, and the power to determine monetary policy - to be vested with the minister: in essence, wiping out the purpose and need for having a central bank. Upon realizing it did not have the support to pursue those amendments, the government stopped short of tabling them before Parliament.

Other developments on legislation included the Banking Ordinance, which was enacted in 1976 – this gave supervision and control of the banking system to SIMA. However, the authority did not pursue formal reporting by the banks until later in 1977. This

legislation was to be replaced by the enactment of the Financial Institutions Act 1998, which among other things widened the supervisory powers of the Central Bank to cover non-bank financial institutions.

The Exchange Control Act was another one passed in 1976. This law gave the Authority the responsibility to administer exchange controls. Several amendments were made over the past years, but these did not change the substance of the Act. These regulations are not intended to stop current account payments. As a matter of fact already in 1999 some headway had been made to liberalize these controls only to be overturned by the events that took place in June last year. We are still hopeful that normalcy will return soon so that we can get to liberalisation.

### **Banking system**

Developments in the banking system have seen some big changes. By the time SIMA was incepted, there were already three commercial banks operating in Solomon Islands, namely Commonwealth Bank of Australia, ANZ Bank and Hong Kong Shanghai Banking Corporation (HSBC). In 1985 Westpac came, together with its subsidiary finance company, AGC. However, in 1988, HSBC pulled out.

As most of you would know, NBSI came out of the original Commonwealth Bank of Australia, as result of an act of Parliament, which saw government taking shares in the bank with the Commonwealth Bank of Australia retaining the major shareholding. Later, the Commonwealth Bank shares were taken over by Bank of Hawaii, and more recently government shares were taken over by National Provident Fund.

Economic developments in recent years have been bearing heavily on the policy objective of extending financial services to the rural areas. It is common knowledge that without government support, such a policy is untenable. If anything, already this policy is backtracking. The banks are already withdrawing their services where they used to be, and recent developments as regards the future of Bank of Hawaii in Solomon Islands are particularly worrying.

### **International Relationships**

An important aspect of nation building is a country's presence in international organisations. In the financial sector, joining other nations on international forums is a very important step. In realizing this, the government made special efforts to attain membership of the IMF and the World Bank: this was done in September 1978. Two years later, on payment of the required subscriptions, Solomon Islands became a member of the International Finance Corporation and of the International Development Agency, for a full member of Bretton Woods organizations. Since then Solomon Islands has benefited from loans, provision of TA, training, policy dialogue and a twenty-four months cycle for consultation on the economy. These international financial institutions provide very useful dialogue and advice on economic and financial issues.

Since becoming a member of these Bretton Woods institutions, Solomon Islands has participated in many international meetings. This was further enhanced when the country joined the ADB and other regional organizations. Developments do point to the fact that membership and maintaining the goodwill and confidence of these international organizations is important to member countries. Experience has shown that countries do suffer when they isolate themselves from the international community. It is therefore in Solomon Islands' long-term interest that we maintain the goodwill of our development partners.

## **Policy**

On the policy front, a lot has already been said through the Bank's annual reports as well as my own statements over the years, so I will refrain from repeating them here.

However, I am compelled to point out that in the past ten years especially, looking back, it would appear that policy had been haphazard. As evidence can demonstrate, this has been so in response to the behaviour and consequences of fiscal policy. The Bank had tried to influence policy signals through several policy instruments: including prescribing statutory deposits; issuing its own paper, the Bokolo Bills; changing the definition and level of the liquid assets ratio (LAR), creating various facilities to assist bank lending, and so on. In the early 1990s, interest rates policy was at one stage regularized, only to be deregularised soon after, following market pressures.

On the exchange rate, there have also been drastic actions beginning with devaluations of 6% and 10% in 1981 and 1982 respectively, to the 20% devaluation in 1997. Until recently, policy stance has always been directed towards encouraging the export sector.

## **Future**

Having achieved 25 years in central banking is undoubtedly a great achievement for Solomon Islands, in particular, the CBSI. Indeed the Bank has evolved quite remarkably during that period. The current status of the Central Bank contrasts markedly with its very humble beginning in 1976: from a very simple corner room in the Ministry of Finance to this handsome HQ building; from a one-man office to a staff complement of nearly 100 men and women; from a balance sheet of just \$100,000 (consisting of \$25,000 cash and \$75,000 worth metal for manufacturing coins) to a balance sheet of assets worth more than \$200 million; from a net profit of \$193 to an average of a few million dollars annually in the recent past.

In its 25 years of existence, the Bank has weathered many storms. The last ten, have been particularly difficult and a very challenging period from an economic stand point. As a young institution trying to find its way through uncharted waters, the Bank laboured (almost in vain) to exert its only influence - monetary policy - on economic management. It is probably true what people say about Solomon Islands economic circumstances: that our situation is such that even the writers of economic textbooks have yet to discover a proper description, let alone a solution for our economic problems.

In the last decade, the economy had taken an almost complete circle, beginning with government financial cash flow problems, to a collapse in the domestic securities market, to the collapse in export markets, to weakening export prices, to a social tension, to a collapse of the export sector, and now we are back into deeper government cash flow problems than in 1990. This is the vicious circle in which Solomon Islands has found itself. We must make every effort to get out of it.

In that light, while we can celebrate having achieved 25 years of existence, on the other hand, as a nation I think it is now time that we must take stock of our achievements. After 25 years, what have we really achieved in economic management? What has Solomon Islands learnt from 25 years of central banking? Have we learnt to do things better? Have we learnt to do things more efficiently? Have we already organized ourselves in the best possible way? What have we done to ensure harmony and cohesion between all policy arms of government? What have we done to enhance private sector growth? What have we done to ensure existing institutions are financially strong and healthy? As regards, the Central Bank, some of us are now asking, "Is the Bank still what was originally in the minds of the architects?" What about the intentions of the law? Is it not time now to take a good look at the Act? What about the behaviour of fiscal policy? How has it impacted on the Bank and on economic management? Could it be that the Central Bank, intended to be the saviour of Solomon Islands probity, been deflected from its path by political pressure to finance budget deficits and thus unwillingly contributed to economic decline?

In posing these questions, I am reminded again that while researching into the beginning of this institution, I have discovered that the initiators of the idea did have a currency board arrangement in mind. In any case, it is also clear that the idea for a central bank was well intentioned. It seems to me that in the last ten years especially, we may have gone too far with the intentions.

We ought to have learnt from the experience of the last ten years, that central banks are like a knife or fire with which one can hurt oneself really badly, if abused. It is from that perspective that central banks should be regarded. Many of you will probably cite countries, which have come to learn this very hard lesson. Unlike Solomon Islands, most of them have already taken important steps to eradicate the cause. In some cases, they have even gone ahead to redrafted legislation, which would insure against this by:

- a) Making central bank independence firmer and explicit, or
- b) Return to Currency Board status, or
- c) Adopting another currency as the legal tender (like SI before October 1977).

Ladies and gentlemen, these are quite difficult issues and very complicated subjects to mull over in a gathering like this. I also realize these are more for the long term than in the immediate term. However, I believe it is timely to make such a call. I would therefore call on economic managers, academics, policy makers and decision makers to think through these issues. Perhaps an appropriate forum could be convened where these subjects can be debated. I think it is now time to be reviewing our economic history and

to draw lessons from which we chart our future. I believe that Solomon Islands has now come to the cross roads in central banking, and hence some important decisions on these subjects have to be made sooner than later.

In conclusion, I am proud of the contributions the Bank has made to Solomon Islands in the last two decades and half. Indeed the Bank can stand tall, with others that it has contributed to the development of this country.

Ladies and Gentlemen, while 25 years may have already been a long time to develop, we are still evolving. The Bank is still growing, even if our balance sheet has declined somewhat in the last year. The Bank has stood up well, although really with somewhat shaky knees. Considering that some central banks in Europe are more than 400 years old, we are still a young institution, although some of us are already growing gray and bold. On this note, I am sure we will still look forward to the future.

Finally, ladies and gentlemen, may I thank you for listening and for your patience.

May God bless you all.