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## MALAITA CONFERENCE

### Introduction

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### Introduction

At the outset, let me take this opportunity to thank the Organizing Committee for inviting me to participate in this conference. I understand this is the second of its kind, and from what I learnt, the first one has had commendable results for the Province. I believe these achievements were possible only through consultations such as this forum and credit must be given to the vision of the conference initiators.

As we prepare to enter the new millennium, this is a very important gathering and it is fitting that the conference theme is forward looking. It is my hope that the next several days will be well-spent and in the interest of the future of Malaita Province and Solomon Islands as a whole.

I was asked to speak on the subject “Credit Creation”, which for purposes of discussions I want to rephrase to “Credit Extension and Debt Creation”. In so doing, my paper will be in four parts. First, I will try to enlighten you of some fundamentals for “Credit Extension and Debt Creation”, and thereby set the stage for the next topic in our agenda for today. Secondly, I will outline my thoughts on the kind of environment that will be necessary for the efficient and viable operation of “a Credit Extension and Debt Creation System”<sup>1</sup>[1]. Thirdly, I will take stock of the financial infrastructure currently available in Malaita and look at their potentials for the Province. And to conclude, I have suggested some recommendations for the Conference to consider, in particular as regards to the question of developing the financial system in Malaita Province.

### Fundamentals for “Credit Extension and Debt Creation”

#### *Surplus Units and Deficit Units*

“Credit extension and debt creation” refers to the situation where people with surplus money (surplus units) are willing to lend to those who are short (deficit units) of money. The deficit units seek to borrow from those with savings and promise to repay the amount at a price and at an agreed time in future. This process, also referred to as “savings mobilisation” is where the savings by some people are channeled through an intermediary to meet the financing needs of others.

In less sophisticated societies, the process of “credit extension and debt creation” involves essentially two parties: the “surplus unit” lends to the “deficit unit”. A simple transaction between the two parties results in credit extended (to the borrower) and debt created (by the lender). The borrower is expected to use the money in a manner which will generate more money, to repay the lender: and thus money being created.

#### *The Intermediary*

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However, in modern society, due to its complexities, the two parties do not usually meet face to face. It is therefore fundamental that there is a third party – the Intermediary, who would “bring the two parties together”. The Intermediary matches the financial shortage of one party with the surplus of the other. The process of intermediation is the role now played by banks and other financial institutions – particularly lending institutions. The intermediary role is a technical one and requires good financial and management skills – especially where there are many clients (the public) involved. This is not a cheap role to play. The Intermediary therefore charges fees and costs which would include his profit margin. In most cases these are passed on to the borrower. Without the Intermediary, the savings mobilisation process would be difficult, and the financial system would be inefficient.

The Credit Market (financial system) plays a very important role in generating economic activities and growth in an economy. A well-developed and healthy financial system will play this role effectively. The challenge that is faced by Solomon Islands, is how best we develop and support the growth of the institutions which play the intermediary role. As will be appreciated, the efficiency and effectiveness of a credit market depends on its health. Its health is determined by the health of the financial institutions making up the system. A healthy financial institution is one which is allowed to match its assets with its liabilities; one which assesses and accounts for all risks; one which is allowed to lend only for financially viable loan proposals. Healthy financial institutions make a sound financial system – one which is efficient and effective in its service delivery.

### ***Duties of the Parties***

So in the process of credit extension and debt creation, it is fundamental that we have these three parties: the lender on the one hand, the borrower on the other and the Intermediary in the middle. It is important that this process functions well. In order for that to happen the three parties must perform their roles efficiently and effectively under the terms of their agreement. For example, the lender must not demand his money earlier or in bigger amounts than what has been previously agreed. The borrower on the other hand, must make repayments when they become due. The Intermediary, while ensuring both parties live up to their agreement, must see to it that confidence is maintained in his internal procedures.

In the modern system, the Intermediary does more than just simply ensuring the two parties adhere to their agreement. Because the two parties never meet, the Intermediary initiates the process. This process includes collecting deposits from the public and on-lending those deposits to the public; he mitigates the shortcomings of the agreement; he matches assets against liabilities; makes sure the entire process is efficient and effective. For that role he collects a fee - usually charged as interest on loans, or as commissions, and other charges.

### ***Security of Funds***

Another important requirement of a sound and healthy financial market system relates to the security of funds. It is absolutely essential that depositors are confident - even guaranteed - of the safety and security of their savings. The physical security of money held by banks should be provided by the bank concerned, but also be guaranteed by the financial system. The public should be confident that the bank is able to not only look after their deposits and pay an interest on them, but that these monies can be paid out to the depositors on demand or when due. This is a liability that bank management must ensure it provides for on a daily basis. Not only that; the

public must be guaranteed that upon collection of deposits the owners of the bank do not run away with the money.

Likewise security must be guaranteed for the money that borrowers have borrowed. The system must be able to guarantee the recovery of borrowed money. The borrower must be prevented from disappearing with the money that he received from a lender. For that to happen it is essential that the system operate in an environment of trust and confidence. The lender must trust the borrower to repay the loan. Alternatively, the borrower must guarantee repaying the loan and trust the lender not to recall his funds from him prematurely. If the borrower disappeared with the funds and did not repay the loan, the system would suffer. The same also applies if lenders recall their funds earlier. The more of this happening, the inefficient the financial system would become. This would result in loss of confidence and trust in the system. Consequently it would become unhealthy and unsound and would eventually collapse.

### ***Legal Framework***

That leads us to another fundamental for a sound financial system: it should have ways to prevent activities of cheaters. To address this, a country must have laws and regulations to safeguard the financial system. It must have a strong court system that is able to punish offenders and award restitution to the offended. In this regard, some of you may have witnessed friends being ordered by the courts to sell their houses, businesses, or surrender properties to repay money they have borrowed. While the courts should be commended for that, I think our present laws still need strengthening to clamp down on cheaters. In order for the market to operate with stability and to maintain public confidence in the system, punitive legal disciplinary actions are necessary.

### ***Stability and Integrity of the System***

Let me remind the Conference that it is very important to ensure the stability and integrity of the financial system. A strong legal system is necessary in dealing with cheaters in the market. But it should also ensure the system is free of illicit financial activities.

I am sure you are all aware of the events last year when pyramid schemes and other “get-rich-quick” schemes almost engulfed the whole of Solomon Islands. These activities are not only illegal in terms of current Solomon Island laws, but are wrong from a moral and ethical stand point. Besides, it is common sense that promises of extra-ordinary returns on investment such as those which were seen last year cannot be realistic. I hope those who were involved in those schemes will by now realize their mistakes and will learn to stay out of such schemes in future.

These schemes are a direct threat to a savings culture and a cause for instability and loss of confidence in the financial system. An undeveloped market like ours cannot sustain such activities. Furthermore, they enrich only very few (including the owners) and leave many people poorer. As hundreds of investors have found out, this can happen very quickly. It is for these reasons that the Central Bank has been warning the public against these schemes. As envisaged, those who did not heed those warnings have lost their savings with the collapse of the schemes.

I would like to assure you that the Central Bank is taking legislative amendments to safeguard against the emergence of such schemes in future.

## Development of “Savings Culture and Borrowing Culture”

### *Savings Culture*

Besides the need for a strong and effective legal system, the financial system must be supported through the development and growth of a “Savings Culture”. It should be noted that unless there are savings in the market to start off with, there would be very little chance for credit extension. A credit market will not be able to function without savings. Savings will not be available to the financial system until people, households and business houses know how to save. It is therefore important to encourage a savings culture.

In simple terms “a savings culture” is the habit of putting aside a portion of one’s income on a regular basis for saving purposes. Savings can be held as cash, jewelry, land, buildings or cash deposits with financial institutions. From an economic development view point, the form in which the savings are kept, and where they are kept is important. If they are all in jewelry, for example, they may not be readily convertible into a form useful to another user. Likewise, if we keep all our savings in cash but under our pillows or bury them in the ground, those savings are still useless because they cannot be used for any economic activity; they are not accessible to borrowers. If we spent all the money we earn for immediate consumption only, then this too will not help in the growth of the credit market nor the economy in the long term. It should be re-emphasised that savings which are “on demand”, are not a very useful source for the long-term needs of the credit market. The credit market would develop better with long-term savings.

Inducing the public to develop a savings culture is therefore, one of the greatest challenges that we face in Solomon Islands.

### *Banking Facilities and Services*

An ideal savings culture is one which not only encourages the public to save, but it must also make available the right kind of infrastructure to the locations that will capture savings. The system must provide services which are conducive to using the financial system.

In Solomon Islands the vast majority of the population still do not use the banks. There are several reasons given for this. First, many people are not familiar with the banks – so they shy off from going to the banks. Secondly, some people do not yet see the benefit of using the banks. They even see banks as an inconvenience to their daily business. So they rather keep their savings with them in their houses. Thirdly, in many parts of the country banking facilities are not available. This is acknowledged as an important factor and steps must be taken to address it.

Whichever is the reason, it is evident that there is a lot of work to be done. The first two will need more rigorous promotional and encouragement work. As regards the third, it needs the concerted effort by the government in general, together with the financial institutions, to ensure that banking and financial services are accessible by the majority of the population. As will be appreciated, this is a very expensive exercise and the banks as commercial entities cannot be expected to do it unless they see some benefit for them in it.

### *Types of Savings*

Encouraging people to develop a savings culture can be in two forms. First, it can be required through compulsory means. In Solomon Islands for example, the only compulsory saving

institution is the National Provident Fund where under the NPF Act contributions by employees and employers are deducted before the employee gets his pay. This forced saving scheme has accumulated a large amount of funds that has not only become the main deposit base of the banking system, but has boosted the economic development of Solomon Islands for a number of years. This is the benefit of making savings available in the financial system (credit market). However, in terms of individual direct assistance, this forced saving scheme applies only to the members.

The second is to encourage savings through voluntary choice. This option is not easy because the decision to save money is an individual one. This decision is affected by factors like the level of income, personal savings attitude, the availability of job opportunities, cost of living and the availability of resources that can be converted into cash. However, if a “credit extension and debt creation market” is to function efficiently and viably, then efforts must be made to encourage voluntary long-term saving by the public. If everybody (including business houses) in Solomon Islands would save (besides NPF contributions) some of their income monthly, there would be far more financial resources for mobilisation. And when there are consistent financial resources available in the market, there is bound to be more economic activities, as those resources are converted into commercial projects and investments.

### ***Extension Service Promotion by CBSI***

For a number of years, the Central Bank tries to encourage the development and extension of financial services and savings in Solomon Islands. Through its weekly radio program, “Money Matters” the Central Bank provides public education and promotion. Besides, the Bank through direct budgetary support has assisted in the development of credit unions as a means of encouraging and teaching the public the benefits to save (and borrow) even in small amounts. Also for a period of five years, Central Bank had assisted in the upkeep of DBSI’s branch network while they were undergoing restructuring a few years ago. Furthermore, in its efforts to encourage Solomon Islanders to participate in business ventures, the Bank offers support to qualified borrowers through its Small Business Finance Scheme: a scheme which is operated in conjunction with the commercial banks and the Development Bank. Most importantly, as part of its statutory functions, the Central Bank ensures that stability, confidence and the integrity of the financial system is maintained.

An important objective of these efforts is to introduce Solomon Islanders to the financial system. To date we have seen some positive results in this regard. As a matter of fact we have found that for a number of Solomon Islanders, these schemes were only “a stepping stone” for them in their business ventures. Whereas before they were shy of the banks, for most of them, banks have become a facility in their businesses. This is the role for which the banks are here for. However, it must be emphasised that those “success stories” only came as a result of the effort and determination of those individuals concerned. It should also be noted, that the Central Bank by itself cannot adequately promote a savings culture among the people. It must be addressed at all levels of society.

### ***Borrowing Culture***

Let me now briefly touch on the need for a good “borrowing culture”. As I have explained earlier, debt extension or borrowing, in a financial system, is possible when savers are willing to lend their money to borrowers. It should be reiterated that, essential as savings are to the financial

system, in order for this market to operate, there has to be a market (demand) for these savings. Ideally this demand should come from a good “borrowing culture”.

A good “borrowing culture”, refers to the responsibility that borrowers must exercise when they borrow money. A responsible borrower will ensure that he repays the money when it is due. An irresponsible borrower will escape with the borrowed money and refuse to repay.

The system can only function well if the borrowers know the importance of their responsibility. This responsibility requires that borrowers of money must ensure that they repay the money they have borrowed in accordance with the terms under which the funds were lent in the first place. Borrowers who take no responsibility in repaying their debts contribute to weakening the credit market and undermine the strength of the financial system. This in turn impedes the growth of financial services in the country.

In this regard I might add that this is one of the main causes of the problems now experienced by DBSI. Over the years, DBSI had lent funds to many borrowers who did not live up to their commitments. As a result it has now got more than 50% of its portfolio as “non-performing” loans. It is no secret that DBSI is now facing severe financial difficulties.

We cannot expect the financial institutions to function properly if the attitude of irresponsible borrowers is not changed.

### **Financial Infrastructure in Malaita Province**

Before I conclude my presentation, let me give you a stock take of the financial services, in terms of the infrastructure and financial resources, currently available on Malaita Province. In terms of the commercial banks the Province has two bank branches and two bank agencies. Besides, the Development Bank and the National Provident Fund have a branch each in Auki. The largest financial service that is owned and managed by community groups in Malaita is the Credit Unions. The Province has some 40 credit unions, which is the second largest (after Honiara) number of credit unions for the whole of Solomon Islands. The Province is also served by market produce centers – five fisheries and copra-buying centres. These provide cash conversion facilities especially to the rural people for their produces.

From available data, Malaita Province accounts for about 7% of total bank deposits. However, in examining the figures further, one finds that total deposits almost equal total withdrawals. In other words, most accounts held by banks for Malaita Province would be of a “working nature” rather than for savings purposes.

According to Development Bank records, as at the end of 1998, 408 loans amounting to \$6 million were outstanding for borrowers from Malaita Province. In terms of the Small Business Finance Scheme, almost 17% of total loans extended was to Malaita alone. The amount of loan outstanding in respect of Malaita Province at end of 1998 (nominated by commercial banks) was \$1.5 million.

From another angle, demographic data for Malaita Province show that it has the highest population density. According to the United Nations estimate in 1996, there were 22,418 households in Malaita Province with a population of 128,000 people. While the assumption has yet to be supported with statistical evidence, it is known that there are more business enterprising

concerns on Malaita than other Provinces. This trend may have even been further boasted recently.

These statistics would demonstrate one important point: that the potential growth of the financial system for Malaita Province is yet to be realised. If every household were encouraged to save at least \$50 a year, and all the business houses were to save some of their income, the potential savings that can be available for credit extension in Malaita will be very substantial. The availability of these potential savings in a form that will enable credit extension to responsible individuals and business houses (for borrowing) can generate significant amount of economic activity in the Province. With more economic activity, economic growth is enhanced and that leads to better living standards for our people. I have no doubt in my mind that as soon as the financial institutions (including the banks) perceived this happening, they will want to be part of it. They will want to extend their services deeper in the Province as they see commercial opportunities for them.

### **Recommendations**

In conclusion, let me just sum up my presentation by making the following suggestions as recommendations for the Conference to consider in the development of the Malaita Province financial system:

**[a] *It is fundamental to understand and appreciate the role of the financial system.***

***As much as one may wish, the financial system is only a conduit. It is a tool and should be used properly. It needs to grow and cared for.***

**[b] *It is essential to encourage a Savings Culture.***

***The financial system cannot function without savings. Credit cannot be created by itself: its source is savings. It is important that the public of Malaita learn how to save.***

**[c] *There is a need to promote a Good Borrowing Culture.***

***The public needs to understand the benefits of being a responsible borrower. At the same time they should appreciate the consequences of being irresponsible.***

**[d] *There is a need to extend and promote banking and other financial services in the Province.***

***The public of Malaita should be encouraged to use the financial system – both as savers and borrowers. But more rigorous efforts should be made by the authorities and financial institutions to increase financial services and facilities in the Province.***

**[e] *There is a need to promote and ensure a healthy, sound and stable financial system.***

***Adequate laws and regulations have to be instituted to ensure soundness of the financial system and to safeguard against illicit financial activities hence to ensure stability and confidence.***

Ladies and gentlemen, I believe all our people will be looking forward to the outcome of this Conference, and for all I know judging by the attendance and participation of such a list of distinguished Malaitans, already expectations may already be high. In this regard the conclusions and recommendations of the Conference will be important. As a Malaitan myself, it is my earnest hope that this Conference will pave the way for our provincial government authorities, together with the private sector, to take Malaita Province into the new millennium.

Thank you very much for listening.