

Central Bank as Banker and Advisor to the Government

All central banks act as banker and adviser to their respective governments. Section 27 (1) of Central Bank of Solomon Islands Act 1976, amended in 1985 provides that CBSI shall act as banker and adviser to the government.

This section also stipulates that the Bank shall act as adviser to the Minister of Finance on monetary and banking matters.

Before describing these functions in detail, it would be useful to explain why it is necessary to give the Central Bank these particular responsibilities. The main reason is that the execution of these duties will help the Bank in its main task of formulating and implementing policies to maintain monetary stability.

A change in monetary stock, as previously mentioned, occurs when there is variation in one or a combination in the following:

- Government' cash holdings and deposits with the Central Bank and or commercial banks;
- Loans and advances to government; and
- Holdings of treasury bills and development bonds by the Central Bank and/or commercial banks.

For example, if government's tax and other receipts exceed its expenditure (ie. Budget surplus), government's cash holding and deposits at the Central Bank and/or commercial banks will rise. Consequently, the stock of high-powered money with the public will fall.

On the other hand, if the government's tax and its receipts are less than its expenditures (ie. budget deficit) and if the government finances this budgetary deficit through short-term loans and advances from the banking system, or if it borrows against treasury bills or other securities from the Central Bank, the stock of high-powered money will rise.

If the deficit is financed by borrowing from the Central Bank, this new injection of funds into the system will add to inflationary pressures in the economy, hence threatening monetary stability. The Central Bank is obliged, therefore, to advise the government to exercise restraint in its borrowings from the Bank because of the inflationary impact of such borrowings.

There are other legal restraints in place to prevent excessive government borrowing. In order to ensure that excessive borrowing by government does not result in excessive monetary expansion and resulting instability.

The Central Bank Act provides that the total amount of all outstanding advances extended by the Bank to the government or to any statutory corporation and the holdings by the Bank of notes, treasury bills, securities and other evidence of indebtedness of, or guaranteed by, the government or any statutory corporation (exclusive of some statutory credit as outlined in the Act) should not exceed 30% of the government's average annual ordinary revenue calculated over the last three financial years.

If this limit is reached the Bank must notify the Minister of Finance immediately and permit no further increases. The Minister is empowered to direct the Bank to permit further temporary increases up to a ceiling of 40% of the average annual ordinary revenue for a period not exceeding six months.

The Central Bank meets the government's need for long-term finance by arranging for the issue of Development Bonds and making a market for these bonds.

The Bank's close contact and technical knowledge of the financial marketing enables it to play a key role in advising the government on the amount of funds that can be raised, the interest rate to be applied to the different maturities, and other related terms and conditions.

This is designed to ensure that the operations relating to the issue of such bonds have the desired effect on the money and capital markets and allows the government to raise long-term funds on the best possible terms. The Central Bank is also empowered to maintain accounts for statutory corporations.

Regarding the Bank's advisory functions, informal meetings are held between the Minister of Finance, the Permanent Secretary of the Ministry, the Governor and Deputy Governor, usually on a fortnightly basis, to discuss current issues and problems.

The Bank also keeps in close contact with the Budget Unit and other relevant sections of the Ministry of Finance to ensure, among other things, that the government's domestic debt is financed without any disruptions to the financial system.

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