The Performance of Melanesian Central Banks

**Abstract:** Since independence, the Melanesian central banks of the Reserve Bank of Fiji, Bank of Papua New Guinea, Central Bank of Solomon Islands and Reserve Bank of Vanuatu have operated autonomously in their respective domestic economies through troublesome times. In one form or another, they have had to endure international condemnation, coups, corruption and crises. Using classic modernization theory and combination reporting analysis, this paper considers possible operational central bank efficiencies from the construction of a joint Melanesian central bank. Annual reports for the year ending 2008 from the cities of Suva, Port Moresby, Honiara and Port Vila were gathered to conduct textual analysis of the annual reporting of the Melanesian central banks, both individually and collectively through combination reporting analysis. The results of the analysis of the performance of the individual Melanesian central banks identify huge net losses resulting from speculative foreign currency trading, substantial risks from holding extensive foreign assets, and worrying governance issues through unusual dividend practices and balance sheet reserve manipulation. In light of the results, there appears a case for using combination reporting as an instrument for examining potential performance of emerging central bank problems and for considering a united Melanesian central bank to help rectify some of these problems. The implications of this study suggest that growth of linkages between Melanesian countries within the Asia Pacific region may abound through regional and economic central bank integration.

**Keywords:** Central Bank; Combination Reporting Analysis; Melanesian Independent Countries; Classic Modernization Theory

**JEL:** E42
Introduction

In recent times, the Melanesian countries of Fiji, Papua New Guinea, Solomon Islands and Vanuatu have endured international condemnation (Henderson, 2003): Fiji for its military led government (Fraenkel and Firth, 2007; Srebrnik, 2004), Papua New Guinea for its troubled economy (Windybank and Manning, 2003), Solomon Islands for its failed state (Hameiri, 2009; McKibbin, 2009) and Vanuatu for its rogue money laundering (Goldsworth, 2006; Van Fossen, 2003). Although Melanesian countries are well endowed in land mass and natural resources (Opeskin and MacDermott, 2009), social and economic indicators, as shown in Table 1, reveal that all four Melanesian countries have relatively low levels of gross national product per capita and life expectancy and high levels of external debt stock. Collectively, the Melanesian ‘fragile economies’ (Gegeo and Watson-Gegeo, 2002) represent an ‘arc of instability’ (Duncan and Chand, 2002; Rumley, Forbes and Griffin, 2006), shown in Table 1 by the low transparency scores in the Corruption Perceptions Index (Transparency International, 2010) and relatively low index figures in the Human Development Index (UNDP, 2011).

Table 1: Social and Economic Indicators of the Emerging Melanesian Independent Countries

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<tbody>
<tr>
<td>Fiji</td>
<td>0.741</td>
<td>4.0</td>
<td>3,930</td>
<td>62</td>
<td>860,623</td>
<td>15.2</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>0.541</td>
<td>2.1</td>
<td>1,010</td>
<td>67</td>
<td>6,858,266</td>
<td>62.9</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>0.610</td>
<td>2.8</td>
<td>1,180</td>
<td>67</td>
<td>538,148</td>
<td>38.8</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>0.693</td>
<td>3.6</td>
<td>2,330</td>
<td>71</td>
<td>239,651</td>
<td>20.9</td>
</tr>
</tbody>
</table>

Source: ADB (2010b); UNDP (2011); Transparency International (2010); Bertelsmann Stiftung (2012)

In these difficult financial, social and political circumstances the four Melanesian central banks of the Reserve Bank of Fiji (RBF), Bank of Papua New Guinea (BPNG), Central Bank of Solomon Islands (CBSI) and Reserve Bank of Vanuatu (RBV) have struggled to maintain monetary stability, with robust inflation rates in 2008 occurring in the Solomon Islands - 23.5 per cent (CBSI, 2008), Papua New Guinea – 10 per cent (AusAID, 2011), Fiji – 7 per cent (RBF, 2008) and Vanuatu - 5.8 per cent (RBV, 2008).

Establishing central bank independence has also proved problematic in transition economies (Cukierman, Miller and Neyapati, 2002; Mas, 1995) but is particularly acute in the Melanesian region. The passing of the Central Banking Act...
2000 (DFAT, 2004) and the adoption by BPNG adoption of international accounting standards (BTI, 2010) restored some independence of the BPNG after the IMF (2000) found the BPNG had been used so extensively for financing the fiscal deficit but weaknesses in the BPNG’s payments and settlements systems and operational and financial statement reporting still exist (IMF, 2011a). The IMF (2011b) also called for greater independence of the RBF, with the call for improved timeliness of meetings and supervisory work.

The RBF publishes annual financial statements, albeit with some delay, that are both prepared and audited in accordance with internationally recognized standards. The assessment confirmed, however, that the level of autonomy of the RBF is very low, with the legislation supporting a wide scope of political interference (IMF, 2011b, p. 10).

Political interference has also eroded the independence of the RBV (Jayaraman, 2001) and the CSBI (ADB, 2010a). In a recent reflection of government interference in the CBSI, the ADB (2010a) warned that

the government must stay away from central bank financing of deficit spending to avoid undermining tighter monetary policy. Monetary financing of a budget deficit, which has not yet occurred, would exacerbate inflationary and balance of payments pressures (ADB, 2010a, p. 37).

In response to these concerns, some commentators, in understanding the interplay between development and the environment, have considered integration and cooperation of these four Melanesian central banks in order to improve macroeconomic performance through regional peer group surveillance, liquidity management, central bank independence and monetary integration (Hou and Jayaraman, 2002; Jayaraman, 2001). Indeed, the Pacific Islands Working Group, at the request of the four Melanesian central bank governors and two other Pacific Island central bank governors have contemplated the case for greater central bank cooperation, coordination and interconnections between countries in the region (AFI, 2011).

This paper extends this idea of joint Melanesian central bank cooperation by constructing Melanesian central bank combination reporting from the financial statements of the four autonomous Melanesian central banks for detection of operational efficiencies. Financial statements are customarily used as an instrument of monetary policy performance by central banks (Curdia and Woodford, 2011; Sullivan, 2005) but with the power of international business combination reporting this study uses combined financial statement reporting as a medium of
gauging other possible Melanesian central bank (in)efficiencies. Accordingly, the following research question is posed:

*Using the instrument of combination reporting as a measure of performance, what potential operational central bank efficiencies may arise from the construction of a unified Melanesian central bank?*

This is an important study because it examines not only whether it is possible to construct Melanesian central bank combination reports but also whether there is evidence of evincing potential operational efficiencies from these reports. Reporting is a critical aspect of accountability in an emerging country context (Lodhia and Burritt, 2004), but it is the power of business combination reporting analysis in a central bank milieu that may off unique insights of performance measurement in this exploratory study.

These considerations of a united central bank, through a regional system of central banks (Angelon, 1999), are particularly important in terms of the development of a region’s financial system. Central banks play a role in the microfinance of the Pacific (ADB, 2000) to meet the needs of Pacific people (Cornford, 2002). The financial system, together with the role of the central bank, is crucial for economic development (Levine, 1997). This has been recognised by other united central banks such as the *Banque Centrale des États de l’Afrique de l’Ouest*¹ (BCEAO, 2012), *Banque des États de l’Afrique Centrale*² (BEAC, 2012) and European Central Bank. The central bank not only safeguards the payment system but also lends as a last-resort. Hermes et al (2000) emphasise the importance of central banks’ independence from central government (or within it), particularly in restraining central banks from financing government budget deficits. This independence may be enhanced by improving accountability and transparency in central bank financial statement reporting (KPMG, 2009).

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¹ *The Banque Centrale des États de l’Afrique de l’Ouest* (The Central Bank of West African States) serves the eight west African countries that comprise the West African Economic and Monetary Union, including Benin, Burkina Faso, Cote d’Ivoire, Guinea Bissau, Mali, Niger, Senegal and Togo. Here, the BCEAO possess the sole right of currency issues throughout the eight west African member countries through a Council of Ministers. The BCEAO also manages monetary policy of the eight African members, regulating and supervising the west African banking system (BCEAO, 2012).

Findings from this study would be of interest to a great many internal and external stakeholders of the four Melanesian central banks. Central banks’ financial statements are used by a plethora of stakeholders including, taxpayers with an interest in the central banks’ use of public money, governments, with a keen interest in calculations of annual dividend to be paid to the government, commercial banks who look for appropriate and practices of financial statement disclosure, external suppliers and lenders who are interested in the central bank’s ability to meet its obligations to them, credit rating agencies and financial market investors and purchasers of central bank services (Sullivan, 2005).

There are a number of limitations and assumptions inherent in the paper. The study makes no recommendations as to how a joint Melanesian central bank combination could be set up through legal and political channels. This is beyond the remit of the paper. The administration of the Eurosystem, for example consisting of the European Central Bank and national central banks of the European Union Member States was carried out in accordance with the Treaty on the Functioning of the European Union and the Statute of the European System of Central Banks and of the European Central Bank. This required legislative and political will. This study makes the assumption, in accordance with Goodfriend (1999), that if reporting analysis bears stimulating innovative thinking or solutions on operational questions of joint central bank performance, then this specialised accounting information might be of interest to legislators and politicians of the Melanesian countries.

The paper is structured as follows. The following section offers a literature review of central bank integration and the case for a Melanesian Central Bank. This is followed by a section devoted to the methods of the paper. Results of the foreign analysis are then presented before the section entitled Implications and Conclusion.

**Literature Review**

In the quest to promote public sector accountability of entities in emerging countries (Lodhia and Burritt, 2004), classic modernization theory emphasises the establishment of centre-periphery, top-down economic entities directing from a developing country’s administrative centre to the country’s periphery (Gegeo and Watson-Gegeo, 2002). Thus, for example, Melanesian central banks, guided
by legislative enactments\textsuperscript{3} from the centre, promote their monetary policy from
the administrative centre to the periphery (situated mostly in the rural areas),
where the vast majority of Melanesians live\textsuperscript{4}. A difficulty with classic moderniza-
tion theory, as recognised by the theory of Indigenous alternatives (Curry, 2003),
is that important groups, such as Indigenous customary leadership groups\textsuperscript{5}, that
are not part of the administrative centre (Roughan, 1997; Gegeo, 1998) are often
left out of the key decision-making processes (Gegeo and Watson-Gegeo, 2002;
Gegeo and Watson-Gegeo, 1999)\textsuperscript{6}.

It would appear ‘Pan-Pacific’ Melanesian regional groups, comprising Melane-
sian people (including Indigenous and non-Indigenous, chiefly and non-chiefly
representatives) who are attracted to Pacific-wide regional organisations and who
have an interest in the integration and harmony of the Melanesian agenda (Cro-
combe, 1989), might also be considered on the periphery as the notion of a close
political union of the four Melanesian countries has taken second stage to do-

testic policies and economic agendas.

Nevertheless, the Melanesians’ awareness of social, development and economic
similarities across the four independent has given rise to a Melanesian voice of
integration, perhaps best exemplified by the ‘Pan-Pacific’ Melanesian Countries
Spearhead Group

that promotes and strengthens inter-membership trade, exchange of Mela-
nesian cultures, traditions and values, sovereign equality, economic and
technical cooperation, between the states and alignment of policies in or-

\textsuperscript{3} The RBF is governed primarily by the RBF Act (Amended) (1985) [CAP 210], BPNG by the Cen-
tral Banking Act 2000, RBV by the Central Bank of Vanuatu Act (Revised) 2002 [CAP 125] and
CBSI by the Central Bank of Solomon Islands Act (Revised) 1996 [CAP 49].

\textsuperscript{4} Most Melanesian people live outside the administrative centre (most of the Melanesian popula-
tion resides in rural communities: 87.5 per cent in Papua New Guinea, 85 per cent in Solomon
Islands, 79 per cent in Vanuatu and 60 per cent in Fiji (Cox, 2009; Moore, 2007).

\textsuperscript{5} All four Melanesian countries possess some form of indigenous elite system of social organising
and property relations through an hierarchical chiefly system (Davie, 2000; 2005) (Gegeo and
Watson-Gegeo, 1999).

\textsuperscript{6} This is a weakness of classic modernization theory because according to the theory of Indig-
enous alternatives, indigenous knowledge and wisdom offers alternative voices for development
that can help shape social formations (Curry, 2003). Under this theory, if traditional groups
such as the chiefly councils (Bolton, 1998), are engaged in the development of imposed institu-
tions, such as central banks, then they are not merely seen by many Melanesians as imposed
colonial administrations and post-colonial entities but also as something to be engaged with
(Manu and Walker, 2006; O’Donnell and Turner, 2005) by Melanesian people.
der to further MSG members’ shared goals of economic growth, sustainable development, good governance and security (MSG, 2007, Article 2).

These similarities stem from a number of historical factors encountered by the four Melanesian countries. Their independence arose within a decade of each other: Fiji (1970), Papua New Guinea (1975), Solomon Islands (1978) and Vanuatu (1980). They all possess introduced Westminster systems of government and legal systems alongside customary law systems (Anckar, 2007; Care, 2001; Corrin, 2008; Jowitt, 2005; Brown, 2005) based on Melanesian chieftain leadership (Cox, 2009). They all use English as their official language (French is also used in Vanuatu) alongside strong local-language oral traditions (Pouwer, 1988). In addition, they all have relied on some form of outside assistance (Feeny, 2007).

Indeed, the opportunities for economic and technical integration in ‘the Melanesian family of nations’ (Pacific Policy, 2011) and, more specifically, ‘Pan-Pacific’ Melanesian regional groups has been considered both at the monetary and political levels (Jayaraman, 2004; Hou and Jayaraman, 2002; Jayaraman, 2001), with Jayaraman (2004), for example, canvassing a single currency for the Pacific Island Countries (which includes the four independent Melanesian countries), and Hou and Jayaraman (2002) detecting economic and technical integration as a means of attracting much-needed capital, facilitate technical transfer and encourage intraregional trade.

Economic integration through bank combination (a form of bank consolidation) has the potential to generate potential economic benefits is the use of financial institutional consolidation or combination (Hughes, Lang, Mester and Moon, 1999). Consolidation or combination enables financial entities to become large enough through unification to become noticed by out-of-region financial entities, to spread overhead costs over a larger base, to provide a uniform set of services, to smooth out potential agency problems between managers and owners of the entity, to improve knowledge of new products and services, to gain access to cost-savings technologies, to allow the merged entity to enter new markets, to

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7 Solomon Islands with the Australian-led Regional Assistance Mission to Solomon Islands deployed in 2003 (Goldsmith and Dinnen, 2007; Hameiri, 2009, McDougall, 2004; Atkinson, 2009; Morgan and McLeod, 2006); PNG with donations from Australia, China, Germany, Japan, Korea, Kuwait, New Zealand, USA, Asian Development Bank, Commonwealth Fund for Technical Cooperation European Union, International Fund for Agricultural Development, United Nations World Bank (Hnanguie, 1997); Fiji with long term assistance from Australia’s AusAID (AusAID, 2012); and Vanuatu with extensive funds from the United States Millennium Challenge Corporation (Jayaraman and Ward, 2006). Three out of the four Melanesian countries have Australia as their patron economy (Japan is the patron economy of Vanuatu) (Bertram, 2004).
improve managerial efficiencies (Beetsma and Giuliodori, 2010; Hughes, et al. 1999; Amel, Barnes, Panetta and Salleo, 2004). Hughes et al., 1999 note the rationales for merging may stem from the opportunities for diversification of assets and liabilities that reduce the costs of risk management and increase potential revenues.

In the European context, Rother, Shucknect and Stark (2010) found that the benefits of fiscal consolidation are particularly acute with the presence of debt, government cross-border commitments within the region, economically and financially interlinked environment. Fiscal consolidation aids fiscal sustainability, promotes international solidarity, strengthen spending efficiencies, reduce unsustainable public liabilities (Rother, et al. 2010).

Inherent in any central bank unity is the issue of sound financial reporting. The central bank balance sheet is an important document that indicates both the economic resources under the control of the central bank (a mix of domestic and foreign currency assets) and its economic and legal obligations (liabilities and equity), providing information on the central bank’s financial structure, liquidity and solvency (Caruana, 2011). The central bank income statement reflects the central bank’s profitability and spending patterns although it is not a complete measure of central bank performance, which is normally assessed through its track record on monetary policy and its influence on interest and inflation rates (Sullivan, 2005). The bank’s statement of changes in equity and reserves gives account of the bank’s equity and reserves, distribution to shareholders (normally the government), changes of equity through retained earnings or losses, and changes in reserve accounts.

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8 Mishkin (1999) and Amel et al (2004) note however, that unification often raise complications, particularly in terms of complex structures, performance and systematic risk of the merged entity but can be mitigated by vigilant prudential supervision. Differences in regulations, institutions and market structures across countries mean that conclusions drawn from analysis of one country should be generalize to others only very carefully (Amel et al., 2004; p. 2496).

9 In contrast to the financial statements prepared by private sector entities, central bank financial statements are more difficult to use in assessing the overall performance of central banks, such as whether they have achieved their objectives (KPMG, 2009). However, these statements are useful for assessing a central bank’s spending and accountability. All banks are also charged with supervision of financial institutions, providing banking, registry and foreign exchange services, and as a lender of last resort to their government. Some are charged with anti-money laundering duties.

10 The central bank financial statements also contain notes, schedules and other information relevant to the accounts.
Central bank financial statements involve a number of considerations. Variation may exist in accounting methodologies for recording central bank assets and liabilities (Dellas, 2011), which may impact on the central bank’s profit and loss. KPMG (2009) note that central banks may book unrealized profits from foreign currencies, gold and other securities to the income statement, or directly to equity or special liability account in the balance sheet, or not at all. It is not uncommon for central banks to intervene in foreign exchange markets (Bhattacharya and Weller, 1997; Snowden, 1997). KPMG (2009) also note that central banks may vary in their treatment of: capital, in some cases making provisions for unrealized gains not included in the capital element of the balance sheet; the method of distributing or retaining profits and losses; disclosures of their relationship with government; and, their risk management; their appointment of auditor.

Given the potential arguments for central bank integration in the Melanesian region, this paper turns to the method of the combination reporting analysis that underlies the research question of this study.

Method

Annual reports for the year ending 2008 from the cities of Suva, Port Moresby, Honiara and Port Vila were gathered to conduct textual analysis of the annual reporting of RBF, BPNG, CBSI and RBV. These resources were also available online. The central banks have also reported their operations on a relatively timely basis in a difficult financial reporting milieu (Dixon and Gaffikin, 2009; Chand and White, 2007; Davie, 2004; Haurisi and Davey, 2009; McKibbin, 2009), although it is important to note that at the time of writing the latest annual report available from the Reserve Bank of Vanuatu was the 2008 annual report. Thus, the analysis was confined to financial year ending 2008. In recent times, the absence of an Auditor-General in Vanuatu and the scarcity of Auditor-General reports may have contributed to the publication and dissemination of more up-to-date publicly available annual reports. The Reserve Bank of Vanuatu website does have up-to-date monthly financial and economic news bulletins (RBV, 2012).

There is a statutory obligation for the four Melanesian central banks to report. Annual reporting requirements are covered by Part X of the RBF Act (Amended) (1985) [CAP 210] – Accounts and Statements for the RBF; Part VI (Finance) of the Central Banking Act 2000 for the BPNG; Part 9 – Accounts, Audit and Reports – of the Central Bank of Vanuatu Act (Revised) 2002 {CAP 125} for the RBV; and, Part VI – Accounts and Statements - of the Central Bank of Solomon Islands Act (Revised) 1996 [CAP 49] for the CBSI.
The annual report provides an important means by which to communicate accountability of an entity to a wide audience (Boyne and Law, 1991; Coy et al., 2001; Ryan, et al., 2002). Textual analysis was facilitated by a form of business combination reporting analysis which focused on accounting, auditing and investigative skills to form a basis of exploratory investigation of the final accounts and statements of the four central banks in terms of their performance. In this way, the study is able to express an opinion on the credibility of the accounts. A large part of the exploratory analysis was based on the evidence of the phenomena of final accounts to form opinions on the accountability and value of the accounts.

Although there is no binding international standard for central bank financial reporting (KMPG, 2009), it appears the four Melanesian central banks have adopted IFRS (CBSI, 2008; RBF, 2008; RBV, 2008; BPNG, 2008). They have also employed a fairly uniform central bank balance sheet structure. Translation of the accounts of all four central banks from the local currency into USD was conducted as a significant amount of their foreign assets and liabilities were in that currency. For assets and liabilities in the statement of financial position, we used the rate on the last trading day of the year. The Kina (PNG’s currency) appreciated against the USD in 2008, but the other currencies fell against the USD.

The rate used to translate the elements of equity at 2007 year end on 31/12/2007 was the rate on that date. Any additions to equity were translated at the closing rate. This meant that the amount in the combined statement of financial position as at 2008 year end on 31/12/2008 would not be the amount in the local currency multiplied by the closing rate. This method enables a translation gain/loss to be calculated to show the accounting effect of exchange rate movements. It also preserves the original elements of equity at their original amounts. This is in line with IAS 21 Translation of Foreign Currencies. Items in the statement of Comprehensive Income were translated at the closing rate as it was impossible to ascertain the timing of these transactions. This is at variance with the revised treatment in IAS 21 Translation of Foreign Currencies, which states the profit items should be translated at the time of occurrence. The rates used are to translate the currencies of the Melanesian countries (PNG kina, Fijian dollar, Solomon Islands dollar and Vanuatu vatu) into United States dollars were available on exchange rate websites and calculated, as shown in Table 2.
Table 2: Exchange Rates of Melanesian Currencies into US Dollars

<table>
<thead>
<tr>
<th></th>
<th>USD/Kina</th>
<th>USD/Fiji Dollar</th>
<th>USD/SBD</th>
<th>USD/Vatu</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 31, 2007</td>
<td>0.363583</td>
<td>0.642901</td>
<td>0.130548</td>
<td>0.010256</td>
</tr>
<tr>
<td>December 31, 2008</td>
<td>0.385907</td>
<td>0.568586</td>
<td>0.125000</td>
<td>0.008692</td>
</tr>
</tbody>
</table>

It was assumed that there were no inter-Melanesian country transactions between the four Melanesian central banks and no one central bank held assets and liabilities of the other three countries. These are reasonable assumptions given that most of the assets are in the major currencies, particularly, the USD. This means we combined the accounts rather than consolidated them. The two standards used were IAS 21 Translation of Foreign Currencies and IAS39 Accounting for Financial Instruments.

Results

As shown in Table 3, a number of accounting issues had to be considered in light of International Accounting Standards (IAS) and central bank treatment of gains/losses on conversion of holdings of foreign currencies into the domestic currency, unrealised fair value gain/loss on revaluation of securities, gains/losses on the revaluation of property, plant and equipment (PPE), gold revaluation and profit distribution. Table 3 lists the most important accounting issues and states the recommended IAS treatment. It then describes the treatment of the issue by each central bank, contrasting the treatment to IAS recommended practice.

An initial major problem arising from the results of analysis was in determining whether the treatment of BPNG’s proposed payment of a dividend to the PNG government in 2007 and the subsequent reversal of that transaction in 2008 to help cover losses was appropriate. It is not clear either from the accounts or the notes to the accounts why this was done. The effect of this reversal was to require a conversion of a liability to equity in 2008. A further problem arising from the analysis in terms of the BPNG’s account was it was impossible to separate fair value and exchange rate gains/losses. It was assumed that these should be treated as exchange gains/losses.
Table 3: Analysis of Accounting Treatment

<table>
<thead>
<tr>
<th>Accounting Issue</th>
<th>IAS recommended treatment</th>
<th>Reserve Bank of Fiji</th>
<th>Central Bank of Solomon Islands</th>
<th>Bank of Papua New Guinea</th>
<th>Reserve Bank of Vanuatu</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unrealized fair value gain/loss on revaluation of securities.</td>
<td>Included in the calculation of profit for held-for-trading financial assets. In a reserve for available-for-sale financial assets.</td>
<td>Included in available-for-sale reserve.</td>
<td>No foreign denominated securities held. No market for domestic government securities.</td>
<td>Included in profit. Included in retained profit in statement of changes in equity.</td>
<td>Financial assets are carried at fair value with gains/losses through profit except for available-for-sale assets which are included in the fair value reserve.</td>
</tr>
<tr>
<td>Gains/losses on the revaluation of PPE.</td>
<td>Included in SCI as other comprehensive income.</td>
<td>Included in the asset revaluation reserve.</td>
<td>Included in SCI but reversed out of retained profit in the statement of changes in equity. Included in the gold revaluation reserve.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gold revaluation.</td>
<td>Included in SCI as other comprehensive income.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit distribution,</td>
<td>Shown in the statement of changes in equity – in retained earnings.</td>
<td>100% to government. Becomes a liability.</td>
<td>50% to the general reserve; 25% to the capital asset reserve; 25% to the government.</td>
<td>100% to the government when a profit is made. Liability was cancelled in 2008 when loss made and returned to the bank. Treated as an injection of capital.</td>
<td>90% to the government. Becomes a liability. 10% to the general reserve</td>
</tr>
</tbody>
</table>

Central banks typically earn income from interest on government obligations, credit to and foreign exchange holdings (Beckerman, 1997). As depicted in Table 4, the combined statement of comprehensive income, all Melanesian central banks made operating profits for year-ending 2008, but both CBSI and BNPG made substantial net losses. CBSI’s USD 10,151,000 loss on holdings of foreign currency meant that its USD 9,449,000 net loss represented over 150 per cent negative return on total operating revenue of USD 6,289,000, a cause for considerable concern. BPNG’s USD 274,127,000 loss on holdings of foreign currency together with its USD 24,872,000 loss on currency trading, manifested in a USD...
259,295,000 net loss (over 27 times CBSI’s net loss) represented over 190 per cent return on its total operating revenue, again raising a cause for major concern. In contrast, RBV made over 100 per cent return on total operating revenue after a positive gain on holdings of foreign currencies. RBF also made an operating profit of USD11,969,000 and a net profit of USD18,299,000.

The final column of Table 4, headed Combined Melanesian Central Bank (MCB), shows the results of the MCB’s statement of comprehensive income. MCB’s net loss of USD 244,246,000 clearly shows the far-reaching contribution of losses on holdings of foreign currency by BPNG and CBSI.

Table 4: Combined Profit Statement for Combined Central Melanesian Bank

<table>
<thead>
<tr>
<th>Comprehensive income for four central banks year ending December 31, 2008</th>
<th>Reserve Bank of Fiji</th>
<th>Central Bank of Solomon Islands</th>
<th>Bank of Papua New Guinea</th>
<th>Reserve Bank of Vanuatu</th>
<th>Combined Central Melanesian Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD ('000)</td>
<td>USD ('000)</td>
<td>USD ('000)</td>
<td>USD ('000)</td>
<td>USD ('000)</td>
<td>USD ('000)</td>
</tr>
<tr>
<td><strong>REVENUE</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest revenue</td>
<td>27,861</td>
<td>5,327</td>
<td>107,412</td>
<td>5,835</td>
<td>146,435</td>
</tr>
<tr>
<td>Fees, royalties, commissions</td>
<td>735</td>
<td></td>
<td>6,044</td>
<td></td>
<td>6,779</td>
</tr>
<tr>
<td>Realized net gain on securities</td>
<td>745</td>
<td>81</td>
<td>15,624</td>
<td></td>
<td>16,450</td>
</tr>
<tr>
<td>Other revenue</td>
<td>729</td>
<td>146</td>
<td>7,194</td>
<td>300</td>
<td>8,369</td>
</tr>
<tr>
<td><strong>TOTAL OPERATING REVENUE</strong></td>
<td>29,335</td>
<td>6,289</td>
<td>136,274</td>
<td>6,135</td>
<td>178,033</td>
</tr>
<tr>
<td><strong>EXPENSES</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest expense</td>
<td>1,756</td>
<td>266</td>
<td>73,609</td>
<td>608</td>
<td>76,239</td>
</tr>
<tr>
<td>Personnel expenses</td>
<td>6,716</td>
<td>3,054</td>
<td>7,362</td>
<td>2,046</td>
<td>19,178</td>
</tr>
<tr>
<td>Other expenses</td>
<td>3,497</td>
<td>2,267</td>
<td>15,599</td>
<td>1,140</td>
<td>22,503</td>
</tr>
<tr>
<td><strong>TOTAL OPERATING EXPENSES</strong></td>
<td>11,969</td>
<td>5,587</td>
<td>96,570</td>
<td>3,794</td>
<td>117,920</td>
</tr>
<tr>
<td>Operating profit</td>
<td>17,366</td>
<td>702</td>
<td>39,704</td>
<td>2,341</td>
<td>60,113</td>
</tr>
<tr>
<td>Currency trading losses</td>
<td>(48)</td>
<td>(24,872)</td>
<td>(24,920)</td>
<td></td>
<td>(24,920)</td>
</tr>
<tr>
<td>Gains/losses on holdings of foreign currency</td>
<td>981 (10,151)</td>
<td>(274,127)</td>
<td>3,858</td>
<td>(279,439)</td>
<td></td>
</tr>
<tr>
<td><strong>Net profit</strong></td>
<td>18,299</td>
<td>(9,449)</td>
<td>(239,295)</td>
<td>6,199</td>
<td>(244,246)</td>
</tr>
</tbody>
</table>

Table 5 reveals results of the central banks’ statement of financial position. By total assets, BPNG is the largest central bank, comprising almost 75 per cent of the joint MCB’s total assets and over 80 per cent of the MCB’s total foreign assets. Indeed, BPNG has over 17 times as many foreign assets as it does have domestic assets. BPNG’s foreign asset holding represents over 93 per cent of those combined for the MCB foreign asset holding. However, BPNG’s foreign liabilities represent less than 2 per cent of its own total liabilities. BPNG is the only Melanesian central bank with government deposits and has issued a significant amount of
domestic securities (USSD 854,762,000), the RBV being the only other institution to issue them (USD 11,084,000).

Table 5: Combined Statement of Financial Position for Central Melanesian Bank

<table>
<thead>
<tr>
<th>Combined statement of financial position for four central banks year ending December 31, 2008</th>
<th>Reserve Bank of Fiji</th>
<th>Central Bank of Solomon Islands</th>
<th>Bank of Papua New Guinea</th>
<th>Reserve Bank of Vanuatu</th>
<th>Combined Central Melanesian Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>FOREIGN ASSETS</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>95,972</td>
<td>267,277</td>
<td></td>
<td></td>
<td>361,249</td>
</tr>
<tr>
<td>Short-term commercial paper</td>
<td>48,248</td>
<td>12,035</td>
<td></td>
<td></td>
<td>60,283</td>
</tr>
<tr>
<td>Marketable securities and investments</td>
<td>139,693</td>
<td>1,879,230</td>
<td></td>
<td></td>
<td>2,018,923</td>
</tr>
<tr>
<td>Term deposits</td>
<td>76,019</td>
<td></td>
<td></td>
<td></td>
<td>76,019</td>
</tr>
<tr>
<td>Gold</td>
<td>727</td>
<td>38,322</td>
<td></td>
<td></td>
<td>39,049</td>
</tr>
<tr>
<td>IMF accounts</td>
<td>119,200</td>
<td>15</td>
<td>115</td>
<td>5,735</td>
<td>125,065</td>
</tr>
<tr>
<td>Other foreign assets</td>
<td>5,684</td>
<td>621</td>
<td>25,551</td>
<td>1,076</td>
<td>32,932</td>
</tr>
<tr>
<td>TOTAL FOREIGN ASSETS</td>
<td>407,524</td>
<td>88,690</td>
<td>2,210,495</td>
<td>6,811</td>
<td>2,713,520</td>
</tr>
<tr>
<td>DOMESTIC ASSETS</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>344</td>
<td>53</td>
<td>204</td>
<td>59,418</td>
<td>60,019</td>
</tr>
<tr>
<td>Domestic securities</td>
<td>91,213</td>
<td>20,670</td>
<td>70,629</td>
<td>47,221</td>
<td>229,733</td>
</tr>
<tr>
<td>Loans &amp; advances</td>
<td>21,901</td>
<td></td>
<td></td>
<td></td>
<td>21,901</td>
</tr>
<tr>
<td>Property, plant &amp; equipment</td>
<td>13,503</td>
<td>7,931</td>
<td>19,228</td>
<td>10,526</td>
<td>51,188</td>
</tr>
<tr>
<td>Other assets</td>
<td>13,196</td>
<td>2,256</td>
<td>17,381</td>
<td>12,780</td>
<td>43,713</td>
</tr>
<tr>
<td>TOTAL DOMESTIC ASSETS</td>
<td>116,256</td>
<td>30,910</td>
<td>129,443</td>
<td>129,945</td>
<td>406,554</td>
</tr>
<tr>
<td>TOTAL ASSETS</td>
<td>523,780</td>
<td>119,600</td>
<td>2,339,938</td>
<td>136,756</td>
<td>3,120,074</td>
</tr>
<tr>
<td>FOREIGN LIABILITIES</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IMF SDR allocations</td>
<td>10,749</td>
<td>1,015</td>
<td>15,429</td>
<td>27,193</td>
<td>27,933</td>
</tr>
<tr>
<td>Derivatives</td>
<td>27,509</td>
<td></td>
<td></td>
<td></td>
<td>27,509</td>
</tr>
<tr>
<td>Other foreign liabilities</td>
<td>7</td>
<td>2,388</td>
<td>478</td>
<td>2,873</td>
<td></td>
</tr>
<tr>
<td>TOTAL FOREIGN LIABILITIES</td>
<td>10,756</td>
<td>3,403</td>
<td>42,938</td>
<td>478</td>
<td>57,575</td>
</tr>
<tr>
<td>DOMESTIC LIABILITIES</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Demand deposits</td>
<td>37,565</td>
<td>35,220</td>
<td></td>
<td></td>
<td>72,785</td>
</tr>
<tr>
<td>Domestic securities issued</td>
<td>854,762</td>
<td>11,084</td>
<td>865,846</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Currency in circulation</td>
<td>222,268</td>
<td>34,983</td>
<td>328,383</td>
<td>43,545</td>
<td>629,179</td>
</tr>
<tr>
<td>Statutory reserve deposits</td>
<td>107,403</td>
<td>298,960</td>
<td>37,144</td>
<td></td>
<td>443,507</td>
</tr>
<tr>
<td>IMF-notes currency subscription</td>
<td>83,148</td>
<td></td>
<td></td>
<td></td>
<td>86,922</td>
</tr>
<tr>
<td>Government deposits</td>
<td>747,507</td>
<td></td>
<td></td>
<td></td>
<td>747,507</td>
</tr>
<tr>
<td>Payables to government</td>
<td>18,781</td>
<td>176</td>
<td>26,191</td>
<td>45,148</td>
<td></td>
</tr>
<tr>
<td>Other domestic liabilities</td>
<td>1,770</td>
<td>12,301</td>
<td>18,977</td>
<td>2,886</td>
<td>35,354</td>
</tr>
<tr>
<td>TOTAL DOMESTIC LIABILITIES</td>
<td>470,935</td>
<td>82,680</td>
<td>2,248,009</td>
<td>124,624</td>
<td>2,926,248</td>
</tr>
<tr>
<td>TOTAL LIABILITIES</td>
<td>481,691</td>
<td>86,083</td>
<td>2,290,947</td>
<td>125,102</td>
<td>2,983,822</td>
</tr>
<tr>
<td>NET ASSETS</td>
<td>42,089</td>
<td>33,517</td>
<td>48,991</td>
<td>11,654</td>
<td>136,251</td>
</tr>
</tbody>
</table>
The combined equity statement of the four Melanesian central banks reveal that, by capital, BPNG is by far the largest central bank and the only bank with gold reserves, a distributable profits reserve and retained loss. It is also the only bank that made a translation gain. The change in equity from 1 January 2008 to 31 December 2008 also highlights BPNG’s USD 274,127,000 loss on holdings of foreign currency, which substantially contributed to its negative change in total equity. Realized foreign exchange losses also impacted on BPNG’s cash flow statement, contributing to negative cash flows from operations of USD 262,874,000. RBV total cash flows from investment are also negative (USD 15,7999,000), due in large part to losses on short term commercial paper (USD 9,326,000) and advances to commercial banks (USD 5,650,000). Principally, on the back of deposits, both RBF and CBSI had negative cash flows from financing. Both RBF and RBV had negative total cash flows.

Conclusion and Implications

the results of the analysis of the financial statements of the four Melanesian central banks show that not only is it logistically possible to combine reporting of the four Melanesian central banks as one but also there are clear benefits of using combination reporting analysis as a measure of performance measurement.

Some limitations should be acknowledged. First, in translating the central banks’ accounting into USD terms, so they may be added together, we should note that the nature of the gains/losses on foreign currency holdings, predominantly in USD, changes. For example, if the kina appreciates against the USD by, say 10 per cent, then BPNG makes an unrealised or ‘paper’ loss in kina terms equal to the USDs held in foreign exchange reserves. When measured in USD terms, however, it has made no loss on its USD reserves. Indeed, it would have made a gain, in USD terms, on all the kina-denominated assets if holds, as well as a loss on its kina-denominated liabilities. Nevertheless, this study illustrates the volatility that Melanesian central banks are exposed to in exchange rate fluctuations, particularly in invoking combination reporting which illustrates this volatility more vividly through comparison and contrasts rather than individual central bank accounts appraisals. Combination reporting also provides the contextualisation for the management of foreign exchange reserves to reduce exchange rate losses by emphasising the treatment of foreign currency reserves as assets rather than as potential exchange rate stabilizers.

Second, combination reporting analysis implies that the four Melanesian countries would share a single currency and thus experience the potential for sub-
stantial macroeconomic and financial consequences of such a move. By accepting a common Melanesian currency which, in turn, would mean a common exchange rate with the USD, all four Melanesian countries would experience the same exchange rate movements against the USD over time. As acknowledged earlier, while economic integration through bank combination has benefits, there is a clear need for future research to fully assess these benefits and consider the practical nature of financial mechanisms that could take place to tease out these macroeconomic and financial consequences.

Clearly, there are some central banks that are operating beyond their remit of promoting sound central bank practices. BPNG’s and CBSI’s substantial net losses on the back of substantial holdings of foreign currency suggests a need for a governing body such as the MCB to oversee and reduce high-risk foreign currency holding practices. The whittling down by an MCB of BPNG’s foreign marketable securities of USD 1,879,230,000 could contribute to the reduction of its USD 274,127,000 loss on foreign currency holding.

The BPNG appears not to be at arm’s distance from the PNG government with the BPNG’s payment of a dividend to the government and the subsequent reversal of this practice a year later. An MCB could distance itself from government interference and ensure that central bank independence is maintained. Local expertise does not appear to be able to resist the urges of national governments; an MCB may have greater power to resist.

The MCB’s combined accounts also show that by combining the four banks as one, the MCB becomes larger and thus more noticeable in the Melanesian region. This element of size may attract the level of expertise required to manage considerable overseas assets for a MCB. The lure of a relatively large unified central bank may lure skilled personnel to manage a large foreign asset portfolio. Putting aside the very large sums involved in foreign marketable securities and investments, the MCB could operate with a not-insubstantial amount domestic assets of USD 406,554,000 and spread overhead costs over a larger base.

The idea of a united Melanesian central bank accommodates the tenets of classic modernization theory by providing an internal ‘Melanesian solution’ to the issues faced by these Melanesian central banks through combination reporting analysis. Such analysis sidesteps the need for a foreign power or a foreign advisor (Henderson, 2003), and provides an inexpensive solution for fulfilling accountability issues for end users. Combination reporting also appears to be a novel way for examining potential solutions for the difficulties emerging central banks face in a regional area.
References


The political and cultural dynamics of regional security. Dordrecht: Springer.


