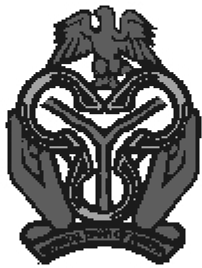

BULLION

PUBLICATION OF THE CENTRAL BANK OF NIGERIA

Volume 26 No. 1

January/March 2002

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THE EVOLUTION OF MONETARY MANAGEMENT IN NIGERIA AND ITS IMPACT ON ECONOMIC DEVELOPMENT

BY
CHIEF (DR.) J. O. SANUSI*

Chief (Dr.) J. O. Sanusi

It is an honour and a great privilege to be invited to deliver a Convocation Lecture in an institution such as this and before an audience of distinguished scholars from virtually all areas of academic disciplines. I will, therefore, seize this opportunity to express once again, my sincere appreciation for giving me the opportunity. This event is particularly noteworthy, being an occasion set aside to celebrate academic excellence whereby only the worthy are honoured. I sincerely rejoice and celebrate with the graduands.

In exercising the freedom of choice given to me on the subject of my address, I have chosen to speak on money, which regulates the heartbeat of modern economies and is the hallmark of central banking. More specifically, the title of my lecture today is "The Evolution of Monetary Management in Nigeria and its Impact on Economic Development". I do not intend to bore you with much details on the nitty-gritty of the theoretical issues on the subject matter. Rather, I want to share with you some lessons of experience, with the belief that it would stimulate further research work on the subject and induce new initiatives that could enhance the effectiveness of monetary policy in Nigeria.

To put the lecture in proper perspective, the paper has been divided into six sections. Following this introductory part, Section 2 briefly discusses the relationship between monetary management and economic development. In Section 3, Nigeria's experience with monetary management is reviewed, while Section 4 assesses the implications for incentive structure, macroeconomic stability and economic development. Section 5 outlines the problems and challenges of monetary management in an increasingly liberalised financial environment, while the final section presents my concluding remarks.

2. MONETARY MANAGEMENT AND ECONOMIC DEVELOPMENT

Monetary management is commonly defined as the mechanism for regulating the supply and cost of money at optimum levels that will ensure the attainment of desired national economic objectives, including price stability, sustainable output and employment growth, and external viability. The question as to whether monetary policy can or cannot, indeed, achieve these objectives is at the centre of the controversy between the Monetarist and Keynesian Schools of Thought, which is not the subject of this lecture. The monetary policy strategy for the achievement of these goals in any economy is often influenced by the stage of development of the economy and its financial infrastructure. In the early stages of economic development, central banks typically rely on direct instruments of monetary policy, notably administrative controls of bank credit and interest rates. With these instruments, they attempt to control directly the balance sheets of commercial banks. As the economy develops and the financial system becomes more sophisticated, the central bank relies on indirect instruments to influence the level of bank reserves through the financial markets.

However, the effectiveness of monetary policy in an under-developed financial environment is often questioned because of the perceived structural and institutional rigidities in the economy and the poorly developed money and credit markets. Besides, there is usually the pervasive and highly unorganized, often externally dependent and spatially fragmented informal or curb

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This paper was delivered at the 13th Convocation Lecture of Ogun State University.

financial market. In addition, most financial intermediaries are often apathetic towards channeling resources to productive investment even in the face of lower interest rates. All these factors have been cited as limiting the performance of monetary policy in developing countries. Thus, severe 'structural' supply constraints are deemed to inhibit expansion of output even when the demand for it increases. An expansionary monetary policy, consequently, often results in inflation rather than output growth. Therefore, in practice, central banks continuously search for that elusive optimal quantity of money supply that would support non-inflationary economic growth and development.

In the quest for economic development, it is observed that the pursuit of multiple and, sometimes, conflicting objectives requires a delicate balance between macroeconomic and sector-specific policies. In particular, it often involves difficult trade-offs among conflicting objectives in order to maximize the overall benefits to the society. The art of monetary management, therefore, entails a careful and skillful resolution of these conflicts and trade-offs in the course of the design and implementation of monetary and other economic policies.

3. A REVIEW OF NIGERIA'S MONETARY MANAGEMENT EXPERIENCE, 1959 TO DATE

An overview of the evolution of monetary management in Nigeria, shows that it has metamorphosed from an era of administrative controls and regulation to a market-based mechanism. An attempt will be made to summarize the actions of the monetary authorities and assess the outcomes during the period. For this purpose, the period 1959 to date has been divided into four phases, viz.: (i) the formative years, 1959 to 1969; (ii) the oil boom era, 1970 to 1979; (iii) the collapse of the oil boom, 1980 to 1985; and the Structural Adjustment Programme (SAP) era, beginning from 1986 to date. It is instructive to note that the first three periods represents the era of controls and regulation.

(i) The Formative Years, 1959 to 1969

Following the establishment of the Central Bank of Nigeria (CBN) in 1959, monetary management at the initial stage was propelled by the doctrine of 'cheap money-policy' and the use of credit control. This was attained through the 'Nigerianization of the credit base' via the creation of local currency, money and capital market instruments, development finance institutions (DFIs), and through keeping interest rates low for targeted sectors of the economy. This approach was particularly favoured during the period following the adoption of the First National Development Plan, the prosecution of the civil war and the collapse of the consortium arrangement for financing the Nigerian export produce in 1968. Consequently, the Central Bank embarked on the development of domestic money and capital markets, which were the main financial infrastructure on which monetary management would rely. The main financial assets introduced include Federal Government Development Stocks in 1959, Nigeria Treasury Bills (NTBs) in 1960, Produce Bills and the CBN operated Call Money Scheme in 1962.

Interest rates on those debt instruments were administratively determined while the CBN, as the underwriter, absorbed the unsubscribed portions and provided refinancing facilities. Interest rate policy was not used as an active instrument of monetary policy because of these limitations. Rather, it provided a channel for the supply of cheap credit to government and the private sector for domestic investments. For example, NTB's rate was progressively reduced from 6.625 per cent in 1962 to 3.5 per cent in 1964.

Cheap money policy resulted in rapid monetary expansion. Between 1960 and 1964 the narrow and broad measures of the money stock (M1 and M2) rose by 29.7 and 44.0 per cent, respectively. The major source of monetary expansion in that period was the accelerated growth in bank credit to the domestic economy, which grew almost ten folds from N33 million to N306 million. In order to restrain monetary expansion between 1965 and 1966, the CBN imposed a ceiling on aggregate bank credit expansion and raised interest rates. However, those measures were prematurely reversed in 1967 because of the need to prosecute the civil war. Thus, the minimum rediscount

rate (MRR) was revised downward to signal a general decline in the structure of interest rates. Concomitantly, the statutory limit on government borrowing through TBs was, between 1968 and 1970, progressively increased from 85 to 150 per cent of estimated revenue of the Federal Government. The result was an accelerated growth in the money stock with the broad measure (M2) rising by up to 47.2 per cent by 1970, while bank credit to government rose by 84.9 per cent. There was thus, the crowding out of the private sector whose credit contracted by 24.3 per cent from the end-December, 1968 level. The inevitable results were the emergence of high inflationary pressures, deterioration of the balance of payments position and depletion of foreign exchange reserves.

(ii) The Oil Boom Era, 1970 to 1979

This period continued to be characterized by fiscal dominance and severe macroeconomic imbalances. However, the main expansionary factor was the monetization of foreign exchange receipts from crude oil exports as against the rapid growth in bank credit to government of the preceding years. The absence of a mechanism for sterilizing the proceeds of excessive earnings from crude oil exports resulted in inflationary pressures, with rate reaching 33.9 per cent in 1975 compared with 13.4 per cent of the preceding year. Following the Report of the Anti-Inflation Task Force in 1975, importation was liberalised resulting in massive importation of food, raw materials and other consumer goods. This was exacerbated by the commitment of government to promote development through cheap money policy with emphasis on subsidy on agriculture, protection of domestic industry and widespread intervention in production, infrastructure and service enterprises by government. The rapid build-up of external reserves and the pegging of exchange rate during the period helped to stabilize the external value of the naira. The fiscal authorities, which over expanded public sector expenditures in response to the initial gains from higher petroleum prices could not respond to the need to contract such expenditures when the oil fortunes started to decline. By 1976 fiscal operations began to record deficits, which were financed mainly by the CBN, thereby compounding the problem of monetary management. Whereas the accelerated growth in money supply in 1970 - 1974 was attributable to monetization of crude oil export earnings through government spending, the main expansionary factor in 1975 - 1979 was the explosion in bank credit, especially to the government sector.

The concern of the monetary authorities during this era focussed mainly on how to optimally channel credit to stimulate investment and output growth in Nigeria. Hence, credit was allocated to the preferred sectors of the economy at concessional interest rates. At the same time, concerted efforts were made to contain the growth in aggregate demand through the imposition of special deposits, especially on import demand.

(iii) The Collapse of the Oil Boom Era, 1980 to 1985

The continued over-valuation of the naira, even after the collapse of the oil boom, engendered significant economic distortions in production and consumption which created a bias towards import dependency and put pressures on the balance of payments. Nigerian importers, buoyed by local purchasing power and government intrinsic guarantee, were able to enter into irrevocable commitments and importations were done on open accounts as well as by letters of credit. After the collapse of oil prices in the early 80s and subsequent fall in foreign exchange earnings, these obligations accumulated and crystalized into what is today known as the Paris Club debts, promissory notes and par bonds. The Paris Club debt component, which was a mere $5.39 billion in 1983, graduated to $21.6 billion by 1995 before adjusting slightly downwards to $20.5 billion in 1999. Thus, the powerlessness of the Central Bank to appropriately adjust exchange and monetary policies, compounded by the relative inability of the domestic economy to curtail imports, marked the beginning of Nigeria's external debt trap/burden.

In the face of these developments, monetary management continued to rely on credit ceilings and selective credit controls. The maintenance of low yields on TB bolstered the existing CBN

under-writing of the unsubscribed debt issues (put at about 90 per cent of total issues) which resulted in the injection of high-powered money into the banking system. The outcome was that narrow and broad money, grew by 50.1 and 46.1 per cent, respectively in 1980. The subsequent decline to 7.6 and 10.6 per cent annual growth rates of M1 and M2, respectively, in the 1981-85 period was at the expense of a rapid depletion of the foreign assets (net) of the banking system. Thus, the maintenance of monetary stability was a dilemma for the CBN. Controls over interest rates and the direction of credit were excessive. The repression of the financial system and deposit money banks intensified, while non-bank financial sector had been neglected. The need for reform was obvious.

(iv) The Structural Adjustment Programme (SAP) Era, 1986 to date

The focus of monetary management during this period was to realign prices through policy and institutional reforms after many years of distortions introduced by control regimes. There was urgent need to move towards the institutionalization of market-based instruments of control as against erstwhile direct control and economic regulation. The main cornerstone of the new policy thrust was exchange rate policy reform, aimed at finding the appropriate external value of the domestic currency. Foreign exchange controls and allocations were outrightly abolished and concerted efforts were made towards the implementation of a Dutch auction market-based exchange rate mechanism. This was accompanied by deregulation of interest rates and de-emphasising of the use of credit allocation and control policies followed by the introduction of indirect tools of monetary management, anchored on Open Market Operations (OMO). The reform of the entire financial sector was also undertaken, while the size and involvement of government in the economy were rolled back, paving the way for increased role for the private sector.

The stance of monetary policy remained tight in 1986, with growth in M2 decelerating to 3.4 per cent. However, by 1987, there was widespread concern over the adverse consequences of the liquidity squeeze, especially the restrictive budgetary stance on output and employment growth. Thus, a reflationary policy stance was adopted, which resulted in rapid monetary expansion, averaging about 42.0 per cent per annum during 1990 and 1994. The main source of the monetary growth was expansionary fiscal operations, financed mainly by the banking system. Fiscal deficits rose from about 8.4 per cent of GDP in 1988 to 11.0 per cent in 1991, but moderated somewhat to 7.2 per cent in 1992 before peaking at 15.5 per cent in 1993 (see Table 1). The crowding out effect was demonstrated by changes in the direction of bank credit flows. For instance, the share of the private sector out of a total of approximately N10.8 billion banking systems' credit to the economy in 1980 was 67 per cent while 33 per cent went to government. The allocation was reversed in 1992 when the shares of the government and private sectors were in the order of 60 and 40 per cent, respectively (see Figure 1).

The need to reverse this unsustainable trend and ensure allocative efficiency of financial resources informed the upward review of the interest rate structure. The minimum rediscount rate (MRR) and NTB issue rate rose from 12.75 and 11.75 per cent in 1987-88, to 18.5 and 17.5 per cent in 1989-90, and subsequently peaked at 26.0 and 26.90 per cent, respectively, in 1993. During these periods, however, the spread between deposits and lending rates began to widen and became an issue of concern to the monetary authorities. For instance, beginning from 1989, when the savings rate was about 16.4 per cent, the prime-lending rate reached 26.8 per cent, representing a spread of 10.4 percentage points, as against the stipulated limit of 7.5 percentage points. The further widening of the spread in 1993, arising mainly from high lending rates, reflected the oligopolistic character of the banking system. These unacceptably high lending rates were adjudged to be a disincentive to borrowing for productive investments. Efforts to deal with the situation elicited the re-introduction of measured controls on interest rates in 1994, with the maximum lending rate pegged at 21.0 per cent. The MRR was lowered during 1999 and 2000. The further

lowering of the MRR, beginning from the last quarter of 1999, was aimed at inducing a downward movement of bank lending rates with the hope of stimulating private sector investment and economic growth.

Moreover, the transfer of deposits of the Federal Government and its agencies from the CBN to the commercial and merchant banks had the effect of injecting additional liquidity into the banking system, with the expectation that it would douse the escalating lending rates. However, experience so far has shown that the action, rather than ease credit for productive investment, exerted pressures on the foreign exchange market, and enhanced banks' investments in NTBs. Moreover, while it influenced the collapse of savings deposits rates to between 3-5 per cent during the period, lending rates remained high, reflecting the delicate trade-offs associated with monetary management.

4.0 IMPLICATIONS FOR INCENTIVES STRUCTURE, MACRO-ECONOMIC STABILITY AND ECONOMIC DEVELOPMENT

Sustainable economic development depends not only on good planning and sound investment decisions but also on the establishment and maintenance of a solid foundation for sound and prudent macroeconomic management that will promote domestic price stability and external sector viability, as well as financial sector reforms designed to enhance efficiency in resource allocation. An appraisal of performance of monetary policy in Nigeria up until 1993 shows that despite the initial appeal offered by direct instruments of monetary control, particularly the ease of implementation in an economy with rudimentary and non-competitive financial system, the costs are high in terms of inefficiency in resource allocation and ineffectiveness arising from circumvention and inequity that direct controls entail. The shift to market-based management approach since 1993, on the other hand, appears to be more effective at addressing the root causes of monetary instability and financial distress. Nonetheless, it is not exactly clear to what extent reliance on market mechanism has contributed towards economic development, as there appears to be lingering structural or supply-side rigidities that impeded optimal performance of the economy during the period.

(a) Appraisal of Implicit Incentives Inherent on the Monetary Management Strategies

An appraisal of the behaviour of three key prices, namely, exchange rate, interest rate and ultimately consumer prices, which monetary management attempted to stabilize as a way of fostering economic growth and development clearly shows the emergence of a conflicting structure of economic incentives for development.

With regard to actions taken to maintain the external value of the naira, evidence shows that these resulted in exchange rate over-valuation and economic distortions. While the objective of keeping domestic inflation low was largely achieved in the 1970s, the naira exchange rate was allowed to appreciate against the US dollar, thereby encouraging growth in import demand and discouraging the growth of non-oil exports. Also, during 1981-85, the naira exchange rate was allowed to depreciate by only 7.3 per cent at a time that domestic inflation averaged 19.4 per cent, annually, compared with about 2.5 per cent for international inflation.

Thus, efforts at stabilizing the value of the naira was not guided by the purchasing power parity, but were set below market levels, thereby implying a significant subsidy on imports at the expense of exports. In the face of excessive growth in domestic liquidity, resort to foreign exchange controls and rationing through import licensing became inevitable.

These adverse trends were reversed with the adoption of SAP. Since then, rapid devaluation of the domestic currency took place, while the adoption of foreign exchange allocation through market mechanism eliminated rent-seeking behaviour associated with import licensing.

Furthermore, the pegging of interest rates at levels below the inflation rates, which made them negative in real terms, imposed implicit taxes on savers and intermediaries. Financial intermediaries either chose to pay penalties for defaults with regard to compliance with credit allocation policies or sometimes favoured rent-seeking behaviour.

However, with interest rate deregulation, savings rate were positive for some years, but lending rates diverged far from savings rate, and tended to serve as a disincentive to borrowing.

(b) Macro-Economic Stability and Economic Development

The intermediate goal of monetary management is to foster desirable balance among the cost (price), sources and uses of both internal and external financial resources of a nation. The objective is to strike a balance such that the demand for funds, especially foreign resources, does not reach unsustainable levels capable of upsetting macroeconomic stability. Monetary management, therefore, becomes a major strategy for macroeconomic stabilization designed to curtail aggregate demand, especially unsustainable government consumption expenditures.

The immediate impact of the easy money policies was very prominent in the outcome of fiscal operations over the period. Deficit as per cent of GDP rose from about 5.0 per cent in 1961-65 to 8.7 per cent in 1970. While effort was made to maintain a surplus, which amounted to 2.6, 1.5 and 9.8 per cent of GDP in 1971, 1973 and 1974, respectively, this was reversed, thereafter, with unsustainable deficits of 7.8, 8.5, 11.0 and 15.5 per cent of GDP in 1978, 1990, 1991 and 1993, respectively. It subsequently declined to 7.7 and 4.7 per cent of GDP in 1994 and 1998, respectively.

Fiscal authorities resorted to both internal and external borrowing to support the rather unsustainable expenditure profile. Nigeria's external debt stock rose from N1.8 billion in 1980 to N544.3 billion in 1992, while the external debt service rose from N0.5 billion to N27.6 billion. Total external debt stock as a proportion of GDP that stood at 3.7 per cent in 1980 rose to a peak of 114.6 per cent in 1990 and fluctuated to 87.2 per cent in 1998 (see Figure 2).

The trends in basic macro-economic aggregates such as the GDP, inflation, unemployment rate, balance of payment and debt profile clearly pointed to the relatively high degree of macro-economic instability experienced in Nigeria from 1980 to date. Indeed, Nigeria's real GDP (at 1984 constant factor cost), estimated at about N70.4 billion in 1981 declined by 0.3, 3.8 and 3.4 per cent in 1982, 1983 and 1984, respectively. There was apparent recovery beginning from 1988 after the commencement of SAP as the real GDP grew by an average growth rate of 6.1 per cent in 1988 to 1992. It, however, relapsed again into a decline since 1993, reflecting mainly policy reversals and lack of economic infrastructure. Trends in inflation also suggested relative macroeconomic instability during the period. Inflation rates exhibited high cyclical trends (see Table 1) as it initially rose from 9.9 per cent in 1980 to 20.9 per cent in 1981. Thereafter, it fell to 7.7 per cent in 1982 but accelerated to 39.6 per cent in 1984. It moderated to a single digit with the adoption of SAP but rose subsequently to a high of 72.8 per cent in 1995, reflecting largely the lagged impact of fiscal indiscipline (see Figure 3). Available data indicated that there was disguised and rising unemployment among school leavers.

The trend in Nigeria's balance of payments also reflected the degree of the country's international financial distress. The balance of payments, which was in surplus of N2,402.2 million on overall accounts in 1980, declined substantially to a deficit of N3,020.8 million in 1981, and deteriorated further up to 1983. With the adoption of SAP, while there was an improvement in the current account position beginning from 1989 to 1992, the overall account remained in deficit due to huge outstanding deficit on the capital account, reflecting the severity of external debt service burden. The external reserve position also reflected this trend. In 1980, external reserves stood at N5,446.6 million ($9,957.2 million) and could support 7.2 months of imports. By 1981, the reserves could only support 1.05 months of import, a situation that improved only marginally to 2.8 months of import in 1985, as it was artificially kept high while reneging on payments of external debt service obligations.

5. PROBLEMS AND CHALLENGES OF MONETARY MANAGEMENT

The analysis so far shows that monetary management, evolved from era of control to liberalization, with limited degree of success at consistently attaining macroeconomic stability. There is the need, therefore, to examine the underlying factors

that militated against the effectiveness of achieving the set targets over time. Among these factors were weak data base for monetary management; poor response of the financial system to monetary control measures; poor coordination of monetary and fiscal policies; undue influence of external shocks on the economy; and weak domestic economic structure.

(i) Weak Database For Monetary Management

One of the major challenges to the successful implementation of monetary management is the ability to predict with some degree of accuracy, aggregate level of money supply and likely response of economic agents to policy stimulus. This requires the use of a model capable of mirroring the relationship between the overall objectives, instruments and operating procedures and accurate data for its evaluation. The experience in Nigeria so far shows that the database for guiding monetary management over the years has been very weak in terms of accuracy, timeliness, consistency and reliability. The attitude of economic agents, including governments, to record-keeping, undermines policy design and implementation. This is a major challenge to all stakeholders in the economy, if we are to move this economy forward.

(ii) Poor Response of the Financial System to Monetary Policy Control Measures

The experience in Nigeria is that the control of bank reserves either through interest rates or reserve-operating procedures poorly met the expectations in recent times for three major reasons. The first is associated with the structure of base money, which is the basic instrument the Central Bank targets. The money multiplier theory posits that banks do expand money in multiple of reserves available to them and, as such, central banks ability to influence these reserves can cause contraction or expansion in money supply. This is premised on the belief that reserves with deposit money banks formed a significant proportion of the monetary base. However, in Nigeria currency outside banks forms a significant proportion of base money, which suggests that actions based on the data tended to over-state the money creation ability of deposit money banks. The higher the rate at which such money finds itself outside the control of the banking system, the less effective it would imply for monetary control. The second relates to the portfolio investment practice of financial intermediaries. In general, deposit money banks, which are expected to provide the financial needs of the real sectors of the economy, are generally reluctant and selective to advance credit to the sectors because of the perceived high risks involved. Rather, banks invest loanable resources in treasury securities, which are risk free, give short-term self-liquidating loans for general commerce and speculate on foreign exchange. Such credit apathy do not allow for the full effect of monetary policy measures on the economy.

The third, which is related to the second, has to do with lack of transparency in the operations of financial intermediaries. The experience so far shows that the overriding motive for profit may have informed the adoption of sharp practices and circumvention of prudential and other monetary control guidelines by a good number of intermediaries. It is common knowledge that bank returns on their operations to the CBN could be window-dressed and sometimes do not reflect a true account of their actual transactions. With the recent formal introduction of the strict code of ethics in the banking industry, I hope this problem will abate.

(iii) The Coordination of Monetary Control Measures with Actions of the Fiscal Authorities

CBN autonomy relates to the level of freedom it enjoys in determining the course of actions for attaining the primary objective of maintaining price stability. Experience worldwide suggests that, where there is a relative degree of autonomy, the risk of fiscal dominance that constrain effective conduct of monetary policy is considerably reduced, if not completely eliminated. However, in Nigeria, prior to 1998 when instrument autonomy was granted to the CBN, monetary policy actions were often undermined by the actions of the fiscal authorities. Until recently, there was excessive reliance on monetary financing of large fiscal deficits through Ways and Means Advances from the CBN, which far exceeded the statutory

limit of 12.5 per cent of expected revenue. Moreover, such loans were simply rolled over and not liquidated at the end of the fiscal year, as provided in the CBN Act. The effect of such action compromised CBN effort to contain the growth in money supply at a level consistent with the absorptive capacity of the economy. The large injections of liquidity into the economy through expansionary fiscal operations, thus, resulted in monetary growth that was substantially out of line with money demand, with adverse implications for domestic price and exchange rate stability. It is encouraging to note that since the inception of this Administration, the Federal Government has pursued prudent fiscal stance and has also had a listening ear to the CBN. However, problem still remains with the other tiers of government because of the unusual situation arising from the Excess Crude Account. This is addressed in the next section.

(iv) Domestic Monetary Implications of External Shocks or Windfall Gains

It would, perhaps, be relevant here to identify the main factors that influence changes in money supply, using the balance sheet identity .The identity shows that monetary expansion (contraction) can result from either rapid increase (fall) in (NFA) or (NDC) or both. The experience in Nigeria is that NFA is strongly influenced by boom or shocks in petroleum export market and the reserve and exchange rate management strategy adopted for its monetization. Monetary management effort is often hampered, in an era of boom, as fiscal authorities adopt a policy of rapid monetization of foreign exchange earnings through increased spending in a bid to improve public welfare. This action has the potential of causing rapid monetary expansion far above the absorptive capacity of the domestic economy, thereby leading to macroeconomic instability. In fact, this is the major problem facing monetary management in Nigeria today.

The Federal Government has, in recent past, attempted to moderate the effect of the windfall in the petroleum export market by setting aside, earnings in excess of a stipulated benchmark of oil prices as savings. This is a prudent management approach, which has been adopted by most of the other major oil exporters, in view of the volatility of oil prices in the world market. However, this prudent management approach subsequently become counter-productive when attempt is made to deplete the reserves prematurely and to bunch the release of what has been saved into the system in a manner that can unduly accelerate the growth of domestic liquidity and destabilise the economy. In fact, a regular inflow into the banking system would have been more manageable for the monetary authorities. While the Federal Government has been more understanding and co-operative on this issue, the other tiers of government do not seem to appreciate the macro-economic implications of such bunched releases. The release of the balance on this account for June - December 2000 has now been made to other tiers of government and measures are being taken to moderate the adverse effects. For monetary policy to have its full benefit, co-operation is required from all stakeholders.

(v) Weak Domestic Economic Structure

The Nigerian financial market, the key channel for the implementation of monetary policy, is characterized by structural dualism - the existence of a formal financial system operating side by side with relatively informal, unorganized and fragmented curb financial market. The curb financial market usually caters for the needs of the informal sector, reputed for their preference for informal credit as well as cash transactions. The larger the size of this sector, the more likely that efforts at monetary control would be less effective. Also related to the above, is the poor state of infrastructure that imposes heavy transaction costs on patrons of urban financial markets.

6. CONCLUDING REMARKS

A review of the Nigerian experience in monetary management shows that the interventionist policy stance dominated monetary management in the first two and half decades after which an era of liberalisation and deregulation

*1 **dM2 = dM + dQM = dDC + dNFA+dQA where "d" stands for change in M2 = broad money supply** M1 = narrow money supply QM = quasi money (savings and time deposits) NFA = net domestic and QA = Other Assets (net)*

of the financial sector followed. Among the instruments employed during the period included direct credit control and allocations (aggregate and selective), and direct interest rates regulation, open market operations, variable rediscount rate, moral suasion, reserve control such as reserve requirements (cash, liquid assets reserves and supplementary reserves). The shortcomings of direct instruments of monetary policy are well known and have been documented here and elsewhere. However, despite the considerable progress made in building the financial infrastructure and use of market-based instruments for the conduct of monetary policy, a more robust policy outcome was largely constrained by a number of factors including the absence of fiscal discipline for a greater part of the period, lack of Central Bank independence until recently, frequent policy changes and wide-spread distress in the financial sector. Moreover, there is need to enhance the efficiency of the payment and settlement system as well as establish a credible data base on which effective conduct of monetary policy depends.

In order to strengthen monetary management towards stimulating economic development; the CBN:

(i) is currently addressing the quality and timely data problem through the on-going restructuring exercise that involves the provision of a complete IT solution to central banking operations.

(ii) has mounted aggressive campaigns for savings habits and promotion of the use of cheques and other near monies for transactions.

(iii) has sought the co-operation of the fiscal authorities to ensure continued co-ordination and consistency in monetary and fiscal policy pursuits.

(iv) has instituted many studies to enhance a better understanding of how the informal sector works.

I must not end this lecture without making reference to the recent initiative of the CBN in creating the Monetary Policy Forum (MPF). We fully appreciate that, like war which is too important to be left alone to the generals, we believe that the formulation and implementation of monetary policy should be a collaborative endeavour between the CBN and all informed stakeholders, even though responsibility is on the former. We have, therefore, established a Monetary Policy Forum (MPF) which, at periodic intervals, assembles knowledgeable individuals from all spheres of the economy to brain-storm on monetary policy issues. This provides opportunity for the CBN to explain the rationale behind policy decisions and for the other stakeholders to have input into the policies being implemented or those to be implemented by the CBN. So far, we have found the MPF very useful and I am using this opportunity to inform the Ogun State University academic community that we may, from time to time, invite some of you to participate in the Forum.

In conclusion, it is worthy to note that isolating the impact of monetary management policies on economic development is usually difficult. However, there is no doubt that the pursuit of monetary stability, as an aspect of macro-economic stabilization or adjustment, is a pre-requisite for the achievement of a long-term growth objective.

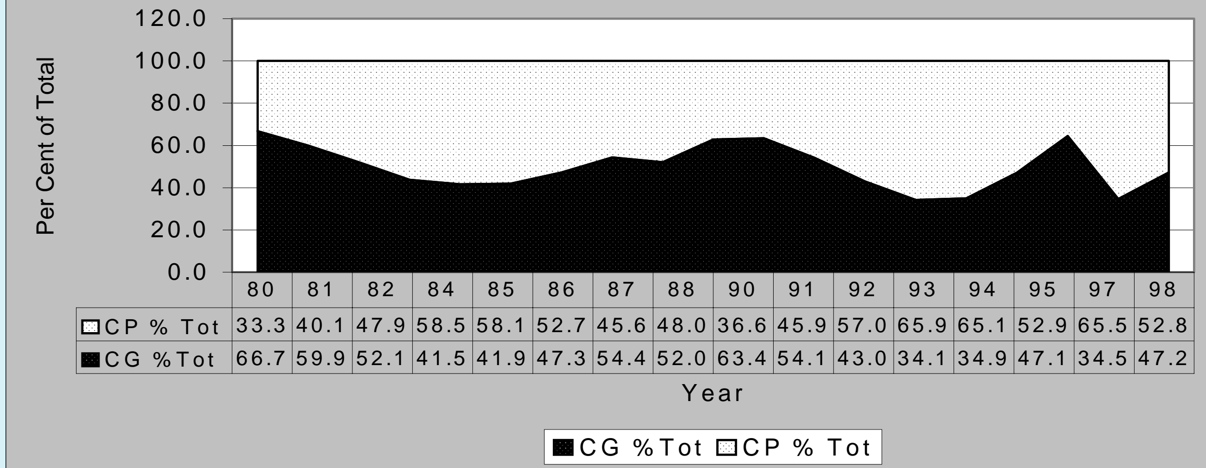

Figure 1: Share of Government and Private Sectors in Banking Systems' Credit to the Economy

	80	81	82	84	85	86	87	88	90	91	92	93	94	95	97	98
CP % Tot	33.3	40.1	47.9	58.5	58.1	52.7	45.6	48.0	36.6	45.9	57.0	65.9	65.1	52.9	65.5	52.8
CG %Tot	66.7	59.9	52.1	41.5	41.9	47.3	54.4	52.0	63.4	54.1	43.0	34.1	34.9	47.1	34.5	47.2

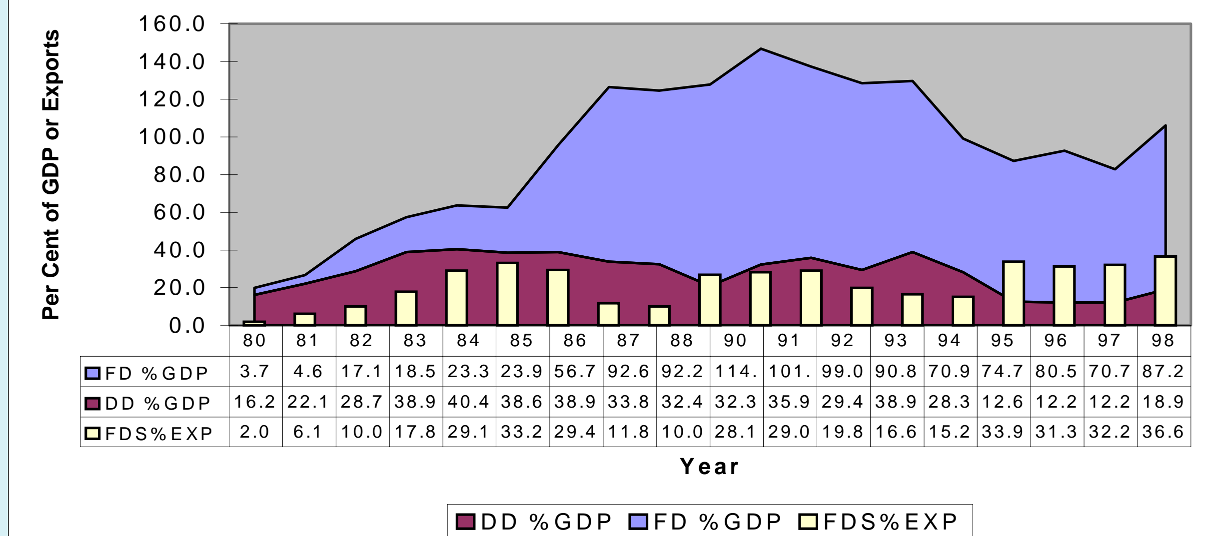

Figure 2: Domestic (DD) and Foreign Debt (FD) Stock as Per Cent of GDP and Exports (EXP)

	80	81	82	83	84	85	86	87	88	90	91	92	93	94	95	96	97	98
FD %GDP	3.7	4.6	17.1	18.5	23.3	23.9	56.7	92.6	92.2	114.	101.	99.0	90.8	70.9	74.7	80.5	70.7	87.2
DD %GDP	16.2	22.1	28.7	38.9	40.4	38.6	38.9	33.8	32.4	32.3	35.9	29.4	38.9	28.3	12.6	12.2	12.2	18.9
FDS%EXP	2.0	6.1	10.0	17.8	29.1	33.2	29.4	11.8	10.0	28.1	29.0	19.8	16.6	15.2	33.9	31.3	32.2	36.6

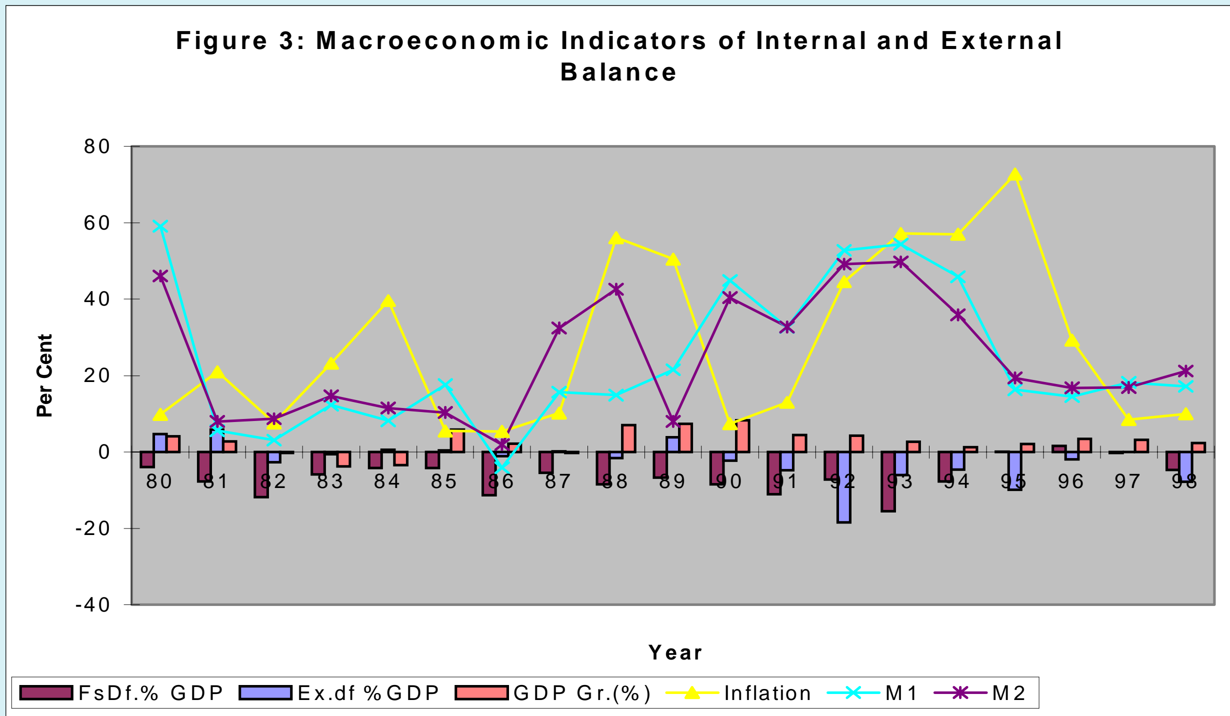
Figure 3: Macroeconomic Indicators of Internal and External Balance
80
60
40
20
0
-20
-40
Per Cent
80 81 82 83 84 85 86 87 88 89 90 91 92 93 94 95 96 97 98
Year
FsDf.% GDP
Ex.df %GDP
GDP Gr.(%)
Inflation
M1
M2

THE ROLE OF THE CENTRAL BANK OF NIGERIA IN THE EFFECTIVE IMPLEMENTATION OF THE IMF CODE OF GOOD PRACTICES ON TRANSPARENCY IN MONETARY AND FINANCIAL POLICIES

BY
J. O. Aderibigbe*

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INTRODCUTION

The last four and half years witnessed increased calls, within the international financial community, for greater transparency among its membership, in the conduct of macroeconomic policy in general, and monetary and financial policies in particular. The impetus for these calls was perhaps connected with the aftermath of the financial crisis that ravaged the international financial markets during the second half of the 1990s, which many observers believed could have been avoided if there was adequate transparency in the dissemination of relevant financial information. Another development that prompted increased calls for greater transparency was the rapidly changing international environment, particularly with regard to globalization and greater integration of financial markets.

It is within context that, the need for universally accepted standards, or codes of good practices, was underscored and a number of international financial institutions were mandated to develop such standards or codes. The general argument is that the adoption of the internationally recognized standards, or codes of good practices, can help to improve economic policymaking and strengthen the international financial system. Consequently, the international community had to call upon the IMF and other standard setting agencies to develop standards/codes covering a number of economic and financial areas, including data dissemination, fiscal, monetary and financial policy transparency, banking regulation and supervision, securities and insurance regulation, accounting, auditing, bankruptcy and corporate governance.

The objectives of this paper are essentially twofold: to familiarize seminar participants with the code of good practices as it relates to transparency in the conduct of monetary and financial policies; and to examine the role of the Central Bank of Nigeria (CBN) in ensuring the effective implementation of the Code in Nigeria particularly, against the backdrop of the international acceptability of the Code as a standard for gauging how transparent monetary and financial policies are in the member countries of the international financial community. For ease of exposition, the paper is divided into four parts. Following this introduction, part II of the paper presents the background and elements of the Code, highlighting the rationale for each element. In part III, we discuss the role of the CBN in the effective implementation of the Code in Nigeria while the paper ends with some concluding remarks in part IV.

II. BACKGROUND AND ELEMENTS OF THE CODE OF GOOD PRACTICES ON TRANSPARENCY IN MONETARY AND FINANCIAL POLICIES[1]

In the aftermath of the financial crises that devastated the world financial markets, particularly in Asia and Latin America between 1996 and 1998, the international community felt the need to strengthen the architecture of the international monetary and financial system. Moreover, there are other developments that also prompted central banks and financial agencies to practice greater transparency in the conduct of their affairs. First, the notion of transparency has gained popularity among the public, and thereby evoking increasing calls by different interest

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groups on central banks and financial agencies to become more open about their policies, operations and activities. Second, the recognition by policymakers that globalization in general, and international integration of financial markets and products in particular, requires a greater degree of transparency of monetary and financial policies and of regulatory regimes and processes, in order to contain market volatility. Third, the shift in the ultimate objective of monetary policy by a number of central banks to inflation targeting, which required public disclosure of how these targets are being met so as to establish credibility, shape expectation, and thereby, strengthen the effectiveness of monetary policy. Fourth, the adoption of the General Agreement on Trade and Services, which placed greater attention on the conduct of financial services. Finally, revolutionary advances in communication, which greatly reduced the difficulties, costs, and time delays of disseminating information to the public.

Underlying the desire for a more robust and strengthened international monetary and financial system, were the consensus that, inadequate transparency contributes to financial crises; markets are highly vulnerable to instability in the absence of adequate, reliable and timely information; without adequate information about the economy and the financial system, policymakers cannot make good policies and react promptly to unforeseen developments; and uncertainty about the economy and government policies leads to abrupt and destabilizing market behaviour. Thus, greater transparency and better accountability was considered capable of helping to reduce the frequency and severity of financial crises by encouraging policy adjustments to begin earlier and occur more smoothly, and resolving crises by reducing uncertainty.

Against the foregoing, the IMF, in collaboration with the Bank for International Settlements (BIS), and in consultation with a representative group of central banks, financial agencies, other relevant international and regional organizations, and selected academic experts, developed the Code in the context of the development of standards and codes for public disclosure and transparency practices designed to strengthen the international monetary and financial system. It should be noted that, calls for greater transparency extend across a wide spectrum — to commercial banks, securities and insurance firms, and other institutions and participants in financial markets, to government and their policies, and to multinational institutions, including the IMF. The adoption of the Code of Good Practices on Transparency in Monetary and Financial Policies is, therefore, part of a larger focus on transparency. The Code was approved by the IMF Executive Board on July 9, 1999 and adopted by the International Monetary and Financial Committee (formerly *Interim Committee*) of the Fund on September 26, 1999, as a guide for members to increase transparency in the conduct of these policies. In adopting the Code, the Committee, urged "all [Fund] members to implement the new Code ....." The code is analogous to the *Code of Good Practices on Fiscal Transparency* earlier developed by the Fund and endorsed by the Interim Committee in April 1998. The objective of the Monetary and Financial Policies Code is to improve transparency of the objectives and operational processes governing monetary and financial policies.

In the context of the Code, transparency refers to an environment in which the objectives of policy, its legal, institutional, and economic framework, policy decisions and their rationale, data and information related to monetary and financial policies, and the terms of agencies' accountability, are provided to the public on an understandable, accessible and timely basis. The argument for transparency of monetary and financial policies is hinged on two principles. First, monetary and financial policies can be made more effective if the public understands the goals and instruments of policy and if the authorities make a credible commitment to achieving these goals. The import of this is that, by making available more information about monetary and financial policies, good transparency practices promote

[1]*Materials in this section are drawn largely from two documents: Code of Good Practices on Transparency in Monetary and Financial Policies (IMF, July 9, 1999) and Supporting Document to the Code of Good Practices on Transparency in Monetary and Financial Policies (IMF, July 24, 2000).*

the potential efficiency of markets. Second, good governance calls for central banks and financial agencies to be accountable, particularly where the monetary authorities and financial agencies are endowed with a high degree of autonomy. The code is thus expected to assist in achieving the expectations of the stakeholders. And when conflicts arise between or within government units in which responsibilities are shared, transparency in the mandate and clear rules and procedures in the operations of the agencies can help in their resolution, strengthen governance, and facilitate policy consistency.

The Code contains a listing of broad principles related to transparency for monetary and financial policies that central banks and financial agencies should seek to achieve. A *Supporting Document to the Code of Good Practices on Transparency in Monetary and Financial Policies*, has been developed by the Fund and approved by its Executive Board on July 24, 2000, to facilitate the implementation of the Code. The Supporting Document, which is a reference source as well as an implementation guide, provides a fuller description of each transparency practice embodied in the Code, its rationale in the context of transparency, where and how it is practiced and some of the practical considerations in the implementation of the Code. While the Code itself expressed the practices in general terms, the Supporting Documents articulated the principles and guidance provisions to implementing the Code and hence, could be viewed as a systematic presentation of a variety of ways central banks practice transparency.

The *Code of Good Practices on Transparency in Monetary and Financial Policies* covers two sets of policies and institutions — monetary policies/central banks and financial policies/financial agencies.[2] Though the two sets of policies are interrelated and mutually reinforcing, the division is to cater for the differences in the institutional arrangements for these policies. The elements of the Code are drawn from a review of good transparency practices employed in a number of countries and discussed in the professional literature. It is, therefore, a formalization of the existing practices in most central banks and financial agencies. It identifies desirable transparency practices for central banks in their conduct of monetary policy and for central banks and other financial agencies in their conduct of financial policies. The Code contains four (4) broad elements, namely:

* clarity of roles, responsibilities, and objectives of central banks for monetary policy and of financial agencies for financial policies;

* open process for formulating and reporting monetary policy decisions by the central banks and of financial policies by financial agencies;

* public availability of information on monetary and financial policies; and

* accountability and assurances of the integrity by the central banks and financial agencies.

The Code demands that rules and policies be clear and transparent while relevant financial information are expected to be comprehensive and discussed promptly.

(i) On matters relating to the roles, responsibilities and objectives of central banks and financial agencies, the Code recommends that key features be clearly specified in the authorizing legislation (e.g. a central bank law) while the relationship between the various operations/agencies or any agency role performed on behalf of government be clearly defined or publicly disclosed. A clear statement of the ultimate objectives and institutional framework of monetary and financial policies identifies the mandate and the extent of responsibilities of the relevant agencies. Specifying these in the legislation gives them particular prominence thereby, avoiding ad hoc and frequent changes to these important aspects of central banks and relevant financial agencies. Furthermore, the public will be in a position to

[2]The term "central bank" in the Code refers to the institution responsible for conducting monetary policy, which may or may not be a central bank while "financial agencies" is used to refer to the institutional arrangements for the regulation, supervision, and oversight of the financial and payments systems, including markets and institutions, with the view to promoting financial stability, market efficiency, and client-asset and consumer protection.

compare outcomes with goals and hold the parties with responsibilities for achieving specific objectives accountable for their attainment.

(ii) With regard to issues pertaining to the open process for formulating and reporting monetary policy decisions and financial policies, the Code, among other guidelines, recommends that the framework, instruments and targets that are used to pursue the objectives of monetary policy should be publicly disclosed and explained and the case of financial policies, the conduct of policies by financial agencies should be transparent, compatible with confidentiality considerations and the need to preserve the effectiveness of actions by regulatory and oversight agencies. Changes in the setting of monetary policy instruments (other than fine-tuning measures) and significant changes in financial policies should be publicly announced and explained in a timely manner. Public consultations within an appropriate time period should be undertaken for proposed substantive technical changes to the structure of monetary and financial regulations. Periodic public statements on progress toward achieving monetary policy objective(s) as well prospects for achieving them are to be issued by central banks and in the case of financial agencies, the reports should focus on how their overall policy objectives are being achieved. In addition, the regulations on data reporting by financial institutions to the central banks for monetary policy purposes should be publicly disclosed.

(iii) On the issue of public availability of information on monetary policy, the Code recommends that presentations and releases of central bank data should meet the standards related to coverage, periodicity, timeliness of data and access by the public that are consistent with the IMF's data dissemination standards.[3] In addition, the Code encourages central banks to publicly disclose its balance sheet on a pre-announced schedule and, after a pre-determined interval, publicly disclose selected information on its aggregate transactions. Texts of the regulations issued by the central bank should be readily available to the public while public information services should be established and maintained by the central bank. In this context, the central bank should have a publication schedule, including an Annual Report and senior central bank officials should be ready to explain their institution's objective(s) and performances to the public and, in addition, release the text of the statements to the public. The same principles apply in the case of public availability of information on financial policies with slight modifications to take account of differences in institutional arrangements. In this regard, financial agencies are encouraged to issue periodic public reports on the major developments of the sector(s) of the financial system for which they carry designated responsibility; they should seek to ensure that, consistent with confidentiality requirements, there is public reporting of aggregate data related to their jurisdictional responsibilities on a timely and regular basis; and where there are deposit insurance guarantees, policy-holder guarantees, and any other client asset protection schemes, information on the nature and form of such protections, on the operating procedures, on how the guarantee is financed, and on the performance of the arrangement, should be publicly disclosed.

(iv) Regarding the fourth element on accountability and assurances of integrity by central banks and financial agencies, the Code advocates that officials of the central bank and relevant financial agencies should be available to appear before a designated public authority to report on the conduct of monetary and financial policies, explain the policy objective(s) of their institutions, describe their performance in achieving/pursuing their objective(s), and, as appropriate, exchange views on the state of the economy and financial system. In addition, audited

[3]See Special Data Dissemination Standard (SDDS), (IMF, March 1996), and General Data Dissemination System (GDDS), (IMF, December 1997). The SDDS serves to guide countries that have, or that might seek, access to international capital markets in the dissemination of economic and financial data to the public and encourages (Fund) member countries to follow good statistical practices in four dimensions relating of data coverage, periodicity and timeliness of data disseminated; access by the public; integrity; and quality. The GDDS serves to: guide countries in the provision to the public comprehensive, timely, accessible and reliable economic, financial and socio-demographic data; encourage member countries to improve data quality; and provide a framework for evaluating needs for data improvement and setting priorities in this respect. The framework of the GDDS is also built around the same four dimensions as the SDDS.

financial statements of their operations should be publicly disclosed on a pre-announced schedule while operating expenses and revenues should be publicly disclosed annually. Public disclosure of standards for the conduct of personal financial affairs of officials and staff and rules to prevent exploitation of conflict of interest, including any general fiduciary obligations is also recommended by the Code.

Transparency and Disclosure Limits

It is pertinent at this juncture to draw attention to the potential limits to transparency, which the Code has fully recognized. Thus, the adoption of the codes should be weighted against the potential costs and, in particular, required adaptation to individual country circumstances, taking into account the benefits and limitations of transparency that could be affected by specific policy and institutional circumstances. Consequently, limits on transparency are allowed where increased transparency could undermine the effectiveness of policies or decision-making or be potentially harmful to market stability. For example, extensive disclosure requirements about the internal policy discussion on key operations of the central bank, such as money and foreign exchange market operations, might disrupt the markets, constrain the free flow of discussion by policymakers or prevent the adoption of contingency plans and near-term implementation tactics. Thus, it may be justifiable for the central bank not to disclose its internal deliberations and documentation, contingency plans, near-term implementation tactics, and information on foreign exchange operations. Similarly, in order to maintain access to sensitive information from market participants, there is also need to safeguard the confidentiality and privacy of information on individual participants in the market.

III. THE ROLE OF THE CBN IN THE EFFECTIVE IMPLEMENTATION OF THE CODE IN NIGERIA

Although, the implementation of the Code in member countries of the Fund is voluntary, it is pertinent to note that, as a member of the international financial community, it is in our best interest to adopt the Code and ensure its effective implementation within the limits practicable. Its adoption in Nigeria is even more compelling now than at any other time, as the country is warming up to the international community and canvassing for increased flow of financial resources to it to enable it to revamp its ailing economy. I envisage that greater Transparency is likely to play a significant role in facilitating investment flows in future to the extent that investors may begin to view the issue seriously in their investment decisions, even though the implementation of the Code is not mandatory. The recent agreement reached with the Fund on a Stand-by Arrangement, has further reinforced the need for CBN to seriously emphasize the adoption and implementation of the Code particularly with respect to the issue of data dissemination standard. With CBN having overall responsibility for the supervision of all financial institutions in the country, under the amended Act, the role of the Bank in the effective implementation of the code of good practices in monetary and financial policies cannot be overemphasized.

Having highlighted the main elements and salient features of the Code in the preceding section, let me now turn attention to how the CBN will facilitate the effective implementation of the Code in Nigeria. Essentially, I see the role of the CBN as that of a facilitator because to a large extent, some of the good practices recommended in the Code are already in place, either in the authorizing legislation (as may be necessary) or in the actual conduct of affairs by the CBN. With regard to the main elements of the Code, I will particularly, like to refer you to Parts I, IV, V-VIII of the Central Bank of Nigeria Decree No. 24 of 1991, as amended, which have to some degree, accommodated some of the good practices that have been identified in the Code and the Supporting Document. This is, however, not to suggest that there is no room for improvement in how things are currently being done in the Bank.

In general, meaningful transparency depends on the means of disclosure and the quality of transparency. Effective transparency calls for concerted efforts on the part of national authorities to build public understanding of the objectives of policy, the nature of responsibilities of the authorities, and the policy process. Promoting public understanding of these issues involves the authorities

being active in developing and conveying information, using various means available to these institutions to disclose information, and customizing the message according to the needs of the particular audiences. The role of the CBN in the effective implementation of the Code in Nigeria could, therefore, be discussed under the following subheadings: means of disclosure, quality of transparency, data, facilitator, and internal operations of the Bank.

(a) Means of Disclosure

The CBN with its assigned roles and responsibilities, as defined in the Act establishing it and the Banks and Other Financial Institutions (BOFI) Decree 25 of 1991, as amended, needs to enhance its involvement in developing and conveying information to the public. In this regard, the existing channels through which the Bank communicates with the public should be improved and made readily accessible to the public. For example, the CBN Act, which supposedly, is a public document is not readily available and/or accessible to the public while the language texts of the legislation and regulation are often technical and complex. To make transparency effective, the CBN may consider it expedient to post the text of the laws and regulations on its website when this is established. The import of this is that the CBN Act and the BOFI Decree contain explicit description of the roles, responsibilities, and objectives of Central Bank of Nigeria for monetary policy and financial policies. Making them readily available and accessible will help the public appreciate the Bank's role and assist them in assessing the performance and credibility of the Bank.

Other means of disclosure currently available to the CBN for effective implementation of transparency in Nigeria and which needs to be improved include the various official publications (half-yearly, quarterly or monthly reviews or bulletins), annual reports, press releases, statutory reports to the legislature (National Assembly) and the public on aspects of its policies and functions. Public release of the memorandum of understanding (MOU) between CBN and other institutions particularly where there are overlapping responsibilities and relationships between and among different institutions including consultancy arrangements (such as between CBN and NDIC in the area of bank examination, amongst others) is another means of disclosure and, hence, transparency. However, the disclosure of any MOU should take cognizance of the sensitive nature of the issues involved, which may limit its disclosure. The CBN can also improve transparency by publicly releasing and readily making available its mission statement and/or regular discussion and explanation in the Bank's various publications, public statements and public appearances, and/or putting it on the web site.

It is pertinent to note that, effective transparency requires the use of more than one of these forms of disclosure and whatever means are adopted, their timeliness is more fundamental. This is perhaps where the web sites become indispensable tools of communicating to the public.

(b) Quality of Transparency

Related to the form of transparency is the quality of information disclosed. It is the content, clarity and accessibility of the information or data that are being disclosed that transforms "disclosure" into "transparency". Thus, creating effective transparency requires more than just making information available about policy objectives, responsibilities, policy decisions, and performance results. The CBN has an important role to play in the effective implementation of the Code by ensuring that the quality of information is such that the credibility of the Bank is not questioned. Thus, the Bank's role should be to ensure that statements and reports contain meaningful and relevant information and should be released on a timely basis. The content of the disclosure is critical for the efficient functioning of markets, which will only increase in importance as changes in international trading and financial arrangements evolve and markets become more sophisticated. Failure to present public statements and reports on monetary and financial policy issues with appropriate content could undermine the credibility of the CBN and thus become counter-productive.

The CBN should focus attention on the tangibility and relevance of the information being provided to the public. The objective of transparency would not be met

if reports released offer contradictory assessments, multiple reports are issued, or if regulations are written in highly technical or arcane language. Similarly, inconsistent application of transparency practices (like reversing previously applied transparency practices in unfavourable situations), would go against the spirit and intent of transparency and could weaken credibility. Thus, the CBN's role in this regard would be to guard against issuing statements and reports that are ambiguous and subject to different interpretations by different individuals and/or groups. In addition, it should avoid issuing multiple and contradictory reports/regulations or applying transparency inconsistently so as not to undermine its credibility. Overall, for monetary policy transparency, the CBN should condition the scope for being transparent and the nature of transparency by the nature of the monetary policy regime.

(c) <u>Data</u>

Another area where CBN's role is crucial for the effective implementation of the Code in Nigeria is related to data disclosure, which is an important aspect of the *Code of Good Practices on Transparency in Monetary and Financial Policies*. The CBN should champion the adoption of the guidelines and procedures of the IMF's data dissemination standards and other standards developed by different international organizations and associations aimed at presenting readily accessible data in an orderly and timely basis, with emphasis on reliability. Without adequate, reliable, accurate, quality and timely data, efforts at greater transparency would come to naught and wrong information would be disseminated to stakeholders. Data problems in Nigeria are perhaps the single most important potential threat to the effective implementation of the Code. In the past, reservations about the quality and reliability of Nigeria's data related to all sectors, except the financial sector. In recent times, however, doubts have been cast on the quality of monetary and financial data, including CBN own's balance sheet data. It is worth mentioning at this point that, if the Bank loose grip on providing credible data in its area of primary responsibilities, then all hope is lost because CBN is probably the only institution in the country on which users of statistics and/or stakeholders rely.

The CBN collects and compiles various statistics for the purpose of appraising its policies and conducting research into financial and economic conditions. Based on the understanding that "statistics are public goods" the CBN's role should be to provide reliable statistics in a timely manner, and every efforts should be directed toward achieving that goal. This is particularly important because the structure of the economic and financial sectors has changed substantially and new initiatives in information technology have been developed to spread information quickly. Moreover, the environment surrounding monetary and economic statistics has also transformed rapidly. Under these circumstances, expectations are increasing, mainly of statistics users, for the expansion and improvement of statistics to enhance the convenience of their use. In view of the above, the CBN has a role to play in enhancing the quality statistics it provides by, among others:

(i) providing accurate statistics that portray the true conditions of the economy precisely;
(ii) enhancing the convenience for users, with increased emphasis on timeliness, by establishing a web site, which provides access to a wide range of users, so that users can grasp the economic situation at an early stage;
(iii) improving efficiency of collecting and compiling statistics through on-line system thus, reducing the burden on respondents;
(iv) increasing transparency by disclosing the entire process of collecting, compiling and releasing statistics. In this regard, the rules on releasing statistics, and disclosing the survey and estimation methods of the statistics should be clarified and where appropriate schedule for releasing statistics be established;
(v) tightening security with respect to confidential information; and
(vi) maintaining a neutral stance when releasing statistics, that is, policy judgments or interpretations should not be added.

Furthermore, since the Bank is also a major user of statistics generated by other data-generating agencies, it has a stake in ensuring the quality and consistency of data generated by these other agencies. In this respect, the Bank needs to collaborate with these other agencies and if possible provide technical assistance such that statistics provided by them are consistent with the underlying economic conditions that informed changes in monetary and financial policies.

(d) Facilitator

The CBN also has a facilitator's role to play in ensuring the effective implementation of the Code of good practices on transparency in monetary and financial policies. The CBN, as Chairman of the Financial Services Regulation Coordinating Committee (FSRCC), should provide effective leadership in ensuring efficiency in the discharge of the responsibilities assigned to the Committee.[4] It is a matter of concern that since its establishment, the Committee is yet to make its impact felt in terms of the envisaged coordination of regulatory and supervisory activities. Each member institution appears to be heading in a different direction without regard to the effects of its activities on the activities of the other members. This should be corrected. In addition, the CBN should embark on a public enlightenment campaign through seminars/workshops on transparency and involving the various institutions in the financial sector that have a stake in enhancing transparency practices by the Bank through information/data provided by them. In this way, the Bank would have succeeded in sensitizing these institutions on the Code and on the need to provide accurate, reliable and good quality data to the supervising agencies. This could be complemented by sponsoring annual conferences on topical economic issues, as is done by most central banks. Participation in such conferences should be extended to the academia, economic practitioners and policymakers to elicit cross-fertilization of ideas and interactions outside the CBN on national economic issues. Finally, the CBN should encourage the fiscal arm of the government to also adopt the Code of Good Practices on Fiscal Transparency to complement the adoption of the MFP Transparency Code in Nigeria.

(e) Improvement in CBN's Internal Operations

CBN's role in the effective implementation of the Code would be enhanced if the Bank embarks on improving its internal operations through the adoption of appropriate technology, particularly IT, in addition to establishing a functional web site that is readily available and accessible to the public. Let me, however, quickly acknowledge that these issues are currently receiving attention under the ongoing restructuring and re-engineering exercise, code-named "Project EAGLES", of the present CBN management.

IV. CONCLUDING REMARKS

The focus of the Code is on transparency. It is directed essentially at the transparency practices of central banks and financial agencies and, not on the transparency procedures relating to firms and individual institutions. While good transparency practices for the formulation and reporting of monetary and financial policies help to contribute to the adoption of sound policies, the Code is not designed to offer judgments on the appropriateness or desirability of specific monetary and financial policies or frameworks that countries should adopt. In addition, transparency is not an end in itself nor is it a substitute for pursuing sound policies, rather it complements sound policies. The Code recognizes that the implementation of the transparency practices differ between countries, reflecting the peculiarities of individual country's environment, both economic and regulatory. This should be implemented with flexibility and with due regard to peculiar circumstances.

The adoption of the Code should enhance the effectiveness of monetary and financial policies in Nigeria. With the instrument autonomy granted to the CBN, the Code should help the Bank meet the expectations of the stakeholders. Similarly, transpar-

[4] *See Part VII (38A and 38B) of the CBN Decree No. 24 of 1991, as amended, for the membership and objectives of the Committee.*

ency by financial agencies should contribute to policy effectiveness by financial market participants to assess the impact of financial policy, thereby reducing uncertainty in their decision-making. By enabling market participants and the general public understand and evaluate financial policies, transparency is likely to contribute to making good policies. This would help to promote financial and systemic stability as well as reduce the potential for moral hazards. Transparency, however, has its potential limitations, which should be accommodated in evolving transparency practices.

The role of the Central Bank of Nigeria in the effective implementation of the Code in Nigeria cannot be overemphasized. The role transcends various frontiers including evolving alternative means of disclosures, quality of transparency, data enhancements, timeliness of disclosure and dissemination of information, public education/enlightenment on what transparency entails and the benefits that are derivable from greater transparency. In addition, improvement in the internal operations of the CBN through the adoption of appropriate IT, including establishing a web site, is critical to the effective implementation of the Code in Nigeria. Finally, regular self-assessment and evaluation study on where the Bank stands vis-à-vis the Code that can be easily assessed by the public will go a long way in facilitating the effective implementation of the Code.

This paper was originally delivered to the participants at the 2000 Executive Policy Seminar jointly organised by the Research and Personnel Departments, Central Bank of Nigeria on "Governance and the Economic Policy Environment: Nigeria's Experience," held in Enugu, September 4 - 8, 2000. The contributions of Charles N. O. Mordi in the preparation of this paper are gratefully acknowledged.

FISCAL DECENTRALIZATION AND THE CHALLENGES OF MACROECONOMIC STABILIZATION AND DEBT MANAGEMENT

BY
O. J. Nnanna*

INTRODUCTION

Fiscal decentralization consists of reassigning expenditure functions and revenue sources to the lower tiers of government with a view to decentralizing fiscal policy making and implementation, across government levels. The central argument for decentralization is based on the premise that it allows a closer match between the preferences of the population and the bundle of public goods and services chosen by government (Tanzi, 1997).

The degree of expenditure decentralization is measured as the proportion of government expenditures executed by sub-national governments.

It is also measured in terms of the autonomy, which the state and local governments have in deciding how much to spend as well as the composition of that expenditure. Obviously, the move towards greater decentralization has consequences for fiscal performance especially, government deficits. Related to this is the assignment of revenues to fund the provision of services. Where the funds have been insufficient to cover expenditure responsibilities, there has been recourse to borrowing to finance deficits, which have posed serious problems including inflationary pressures and exchange rate depreciation. Conversely, when the governments experience buoyancy in their revenues, fiscal profligacy would be the case, as unplanned expenditure would be undertaken. Thus, the big challenge is how to implement fiscal decentralization without causing macroeconomic instability or worsening debt management.

O. J. Nnanna (Ph.D)

The objective of the paper is to review the challenges of fiscal decentralization in Nigeria with special focus on macroeconomic stabilization and debt management as well as to identify the outstanding issues which require both research and policy attention. The paper is organized into five sections. Following the introduction, the rationale for fiscal decentralization is examined in section II. The practice of fiscal decentralization in Nigeria is reviewed in section III; while the challenges posed by fiscal decentralization is covered in section IV. Section V covers the prospects and the outstanding issues that require urgent research and policy attention. The paper is then summarized and concluded in section VI.

2. RATIONALE OF FISCAL DECENTRALIZATION

The clamour for fiscal decentralization is largely predicated on the fact that the provision of public services to the citizens cannot be left entirely to the market. Hence, the issue is who should provide these services and at what level of government? In a federal system like Nigeria, the division of responsibilities between the central government and its component units is provided for in the constitution. Those functions that are performed only by the federal government are itemized in the exclusive legislative list. There are however, functions which can be performed simultaneously by both tiers of government in the concurrent list. The central argument for decentralization is based on the premise that it allows a closer match between the preferences of the population and the bundle of public goods and services chosen by the government (Tanzi, 1997).

It is also argued that there are efficiency gains in the devolution

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of power to the lower level governments because the local population is in a better position to discipline local public officials. To the extent that the local services are financed by the jurisdiction's own revenues, a strong incentive to monitor the local authorities will prevail. This is the essence of accountability.

There is a growing recognition on the part of policy-makers that fiscal decentralization may aggravate fiscal imbalances and consequently endanger overall macroeconomic stability, unless sub-national governments are committed to fiscal discipline and prudence in debt and expenditure management. Successful fiscal decentralization therefore depends to a large extent, on the availability of expertise at sub-national levels and the ability of the sub-national governments to handle increased resources and ensure effective expenditure management. The devolution of power demands that efforts be made to encourage revenue mobilization at lower levels of government as their expenditure needs often exceed their revenue capacities. On the other hand, there has been a counter argument that generally, the lower level governments have less capacity to manage resources, in which case the gains may not be real. Besides, it is apparent that in several lower level governments, decision-making is not participatory and non-performing politicians can only be removed during elections, when such elections are free and fair, which is not the case in some developing countries.

The recent clamour for reform of the revenue allocation formula arises from the perceived injustice and inequity of the present arrangements. First, actual disbursement to the Federal Government has been much higher than the approved statutory provisions because of various devices introduced by the federal authorities such as the deduction made for first charges in respect of external debt service, Joint Venture Cash Calls, NNPC priority projects, national priority projects and excess crude oil earnings. Secondly, there is widespread dissatisfaction with the horizontal distribution of revenue, especially, with the use of such principles as landmass and terrain. Finally, the declining weight assigned to the derivation principle has been the source of agitation for resource control by the oil producing states.

3. FISCAL DECENTRALIZATION IN NIGERIA

As a federation, Nigeria has a central government, 36 states and 774 local government councils. The role of the public sector and each tier of government is spelled out in the constitution. At independence in 1960 Nigeria had only a central government and 3 regional governments, namely, the North, East and West. The need to bring governance closer to the people informed the creation of additional states, the first one, in 1963. Thereafter, the number has risen continually, until the present 36 states were created in 1997 (See Table 1).

However, during the long years of military rule in Nigeria, the debate regarding the functions to be performed by each level of government and the allocation of revenue in support of the effective delivery of public goods and services was muted. The Aboyade Presidential Commission on Revenue Allocation (1977) stated it poignantly as follows:

"The defacto federal superiority vis-à-vis the states and the huge autonomous increases in revenue accruing to the Federal Military Government resulted in arbitrary aggregation of functions on the part of the center which normally are matters of constitutional debates and agreement. In addition to legislative measures, executive actions over a number of matters such as the universal primary education, agriculture, higher education, roads, the setting up of ministries of water resources, housing, urban development and environment and social development youth and sports illustrate the development of this system".

Since the colonial days, the Federal Government has from time to time set up various commissions (Phillipson, 1946; Hicks, 1952; Chick,1954; Raisman,1958) to advise it on the best ways and principles for allocating revenue vertically between the federal and the lower level government as well as horizontally among those within a tier. A quick review of some of the highlights of the commissions will be quite instructive.

The various commissions recommended the principles of derivation, national interest, and

fiscal independence for allocating revenue from the Distributable Pool Account (DPA). Fixed regional proportional shares were also guaranteed. In 1964/67, the Binns Commission recommended the allocation of revenue as follows: the East 30%, North 42%, Midwest 8% and West 20%. The Aboyade Technical Committee on Revenue Allocation was set up in 1977. The recommendations of the committee represented a break from the past as it recommended that all federally collected revenues, without distinction be paid in the Federation Account. The proceeds of the Account was to be shared among the Federal Government, the states and for the first time, local government councils in the order of 60.0%, 30% and 10% respectively. It also created a Special Grants Account (3% from the Federal Government share) to be administered by the Federal Military Government for the benefit of mineral producing areas and areas in need of rehabilitation from emergencies and disasters. Its recommendations were not implemented as the principles were considered to be too technical and difficult to implement. In 1979, the Okigbo Revenue Allocation Commission was set up to examine the existing formula for revenue allocation having regard to such factors as national interest, derivation, population, even development, equitable distribution and the equality of states as well as recommend new proposals considered necessary for revenue allocation between the Federal, State and Local Governments. The commission recommended that all federally collected revenue should be paid into a Federation Account. It recommended that the Federation Account be shared as follows: Federal Government (53 %); State Governments (30%); Local Governments (10%); and Special Funds (7%). It was further recommended that 7% of the federation account be applied as follows:

* Initial development of the Federal Capital Territory (2.5%)
* Special problems of the mineral producing areas (2.0%)
* Ecological and similar problems like soil erosion, desert encroachment, flood control etc (1.0%)
* Revenue equalization fund (1%).

The Government accepted its recommendations but were later declared ultra vires by the Supreme Court.

Since 1980, some changes have taken place in the vertical revenue allocation formula. The statutory share of the federal government declined from 55 per cent in 1980 to 50 per cent in 1990 and 48.5 per cent in 1993. Similarly, the share of state governments from the federation account declined from 34.5 per cent in 1980 to 30 per cent in 1990 and 24 per cent in 1993. By contrast, the share of local governments increased progressively from 8 per cent in 1980 to 15per cent in 1990 and 20 per cent in 1993.

Section 162 (1) of the 1999 constitution provides that all federally collected revenues must be paid into the Federation Account. The revenue so collected is distributed among the three tiers of government according to a revenue allocation formula as follows: Federal Government (48.5%) State Government (24.0%) Local Governments (20.0%) and Special Funds (7.5%). Since the inception of civil administration, "resource control" as a principle has received some boost as 13% of mineral revenue is deducted and paid to mineral producing states. Revenue from Statutory Allocation constituted about 60% of the revenue accruing to state governments in the last two years. The figure for the local government is above 70%. Internally generated revenue of the state governments has been about 20% of total revenue and for local governments it has been about 7.0 % (See table 4).

Whenever there is a fall in revenue as a result of the weakening of the oil market, most states and local governments resort to borrowing in order to bridge their budgetary gaps with implications for monetary stability. It will be recalled that part of the external debt service payment that are currently deducted as a first line charge against the federation account was incurred by some state governments who over-borrowed and overspent and had to shift the burden to the central government. It is for this reason that the Federal Government had to set limits on how much external debt states can incur. As regards domestic debt, the central bank was

concerned about the manner in which state governments were pledging their future earnings and had to issue guidelines to banks on the provisioning for credits extended to the three tiers of government in view of the implications of such borrowing on the safety of the banking system.

In the year 2001, the management of liquidity was daunting, because of the high liquidity of the banking system as a result of the sharing of excess crude oil receipts which led to a rapid growth of monetary aggregates and the consequent inflationary pressures. This was even compounded by the distribution of proceeds from the sale of Global System Mobile Communications proprietary rights.

4. IMPLICATIONS OF FISCAL DECENTRALISATION FOR MACROECONOMIC STABILIZATION AND DEBT MANAGEMENT

The implications of fiscal decentralization on macroeconomic stabilization have been a source of debate in the literature. Earlier writers maintained that stabilization was the responsibility of the national government and could be pursued better in a centralized environment, because the central government would have better and efficient tools for pursuing a stabilization policy. In recent years, however, the discussion on stabilization policy has changed from counter-cyclical Keynesian fiscal policy objective, to one of ensuring fiscal equilibrium. In this connection it has been argued that a decentralized fiscal arrangement renders it more difficult to correct fiscal and structural imbalances especially, when the sub-national governments have access to borrowing and can put political pressure on the national government to bail them out when they run into difficulties (Tanzi, 1995).

The decentralization of a large share of public expenditure can have significant implications for macroeconomic management. Even if the overall level of expenditures of sub-national governments was effectively constrained by limits on their taxation and borrowing powers, changes in the composition of their expenditures can affect aggregate demand in ways that may run counter to the stabilization objectives of the central government. The recent use of excess crude oil receipts by state and local governments in Nigeria supports this thesis.

Another area in which decentralization can affect macroeconomic stability is when the transfer of financial resources to the lower level governments forces the central government to engage in monetary financing of fiscal deficits. Empirical evidence has shown that a nation that finances its fiscal deficit from the non-bank public, can achieve a lower rate of inflation than those that rely on monetary financing. Indeed, while the centerpiece of Nigeria's monetary policy is the achievement of price stability and sustainable growth, nevertheless, the money demand model used for the forecast of optimal liquidity, given the policymaker's projections of output and inflation (conditional on an interest rate path), is very sensitive to fiscal shocks which have characterized fiscal decentralization in Nigeria over the years. As a result, the economy has continued to experience increasing level of macroeconomic instability, as evidenced by high and volatile interest and exchange rates, double digit inflation rate and sluggish output growth, despite the proclaimed objectives of monetary and fiscal policy by the government. As a result of fiscal shocks, arising from fiscal decentralization, the average Naira/Dollar exchange rate has worsened progressively. From N8.0378 to the dollar by end 1990, the exchange rate depreciated to N22.0468 in 1993, N70.3632 in 1995 and to N113 by end-December 2001. Rising fiscal deficit is also inherent in fiscal decentralization especially, in developing countries that are yet to adopt appropriate legislative measures to restraint the fiscal authorities. In Nigeria, the level of deficit as percentage of GDP has averaged over 6.0 percent over the years (see chart).

In developing countries and in an increasing number of industrial countries, the basic macroeconomic objective is to ensure a fiscal adjustment that reduces chronic fiscal imbalances. The issue then is the relationship between decentralization and structural fiscal deficits. The experience of many developing countries has shown that sub-national governments are likely to contribute

significantly, to the aggravation of macroeconomic imbalance. In several cases, sub-national governments have spent more than they have raised in revenue thus increasing their debt. At other times, political forces compel sub-national governments towards higher spending or lowering of taxes. This is compounded by poor public expenditure management systems, which make it difficult to control spending.

5. OUTSTANDING POLICY ISSUES

The review of fiscal decentralization in Nigeria shows that there are a number of outstanding issues that need to be dealt with, including issues of equity, transparency, accountability and capacity building.

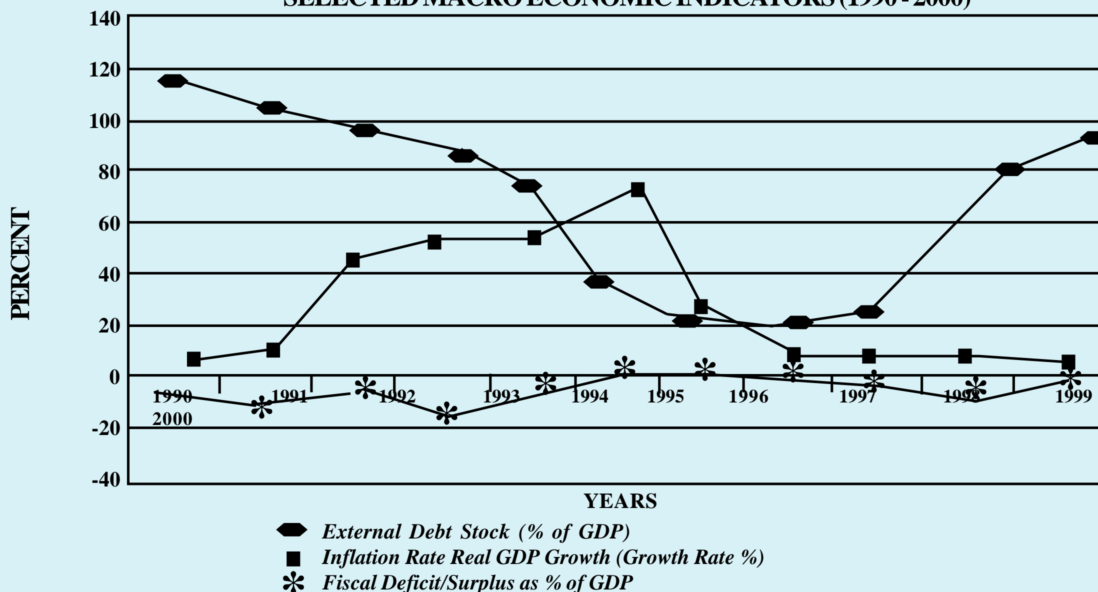
In the case of equity issues, there are two strands. First, is in respect of vertical distribution of revenue. Presently, a lot of resources are concentrated in the hands of the federal government, which can be better utilized at the local levels. For instance, the debate on resource control derives from the premise that derivation, as a principle of revenue allocation has not been given its appropriate weight. In other words, equity requires that those who suffer the externalities associated with oil exploration should be adequately compensated. This leads directly to the issues of transparency and fiscal accountability. It has been observed that local governments spend the bulk of their resources on recurrent expenditures, as the chairmen and other officials undertake frequent overseas trips under the pretext of understudying local government operations in the industrialized world. As can be readily seen, such expenditures have serious implications for the balance of payments.

The lack of transparency and accountability also has implication for fiscal discipline. There is insufficient access to information on the fiscal operations of state and local governments. The result is that lower level governments have displayed over the years, indiscipline in the management of their resources.

6. SUMMARY AND CONCLUSION

In this paper an attempt has been made to review the implications of fiscal decentralization on macroeconomic stability and debt management. It is noted that the propensity to run fiscal deficits is inherent in the framework of fiscal decentralization, especially, in developing countries. In Nigeria, fiscal decentralization has been typically prone to fiscal shocks, which undermine monetary policy objectives of price stability and sustainable growth. It was further observed that fiscal deficits give rise to rapid growth in debt and in debt service charges, which in turn exacerbates the pressure on the budget. Overall, fiscal decentralization can result to positive externalities if the burden of macroeconomic adjustment can be equitably shared amongst the federating units. This is not the case in Nigeria.

CHART 1
SELECTED MACRO ECONOMIC INDICATORS (1990 - 2000)



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MONETARY, CREDIT, FOREIGN TRADE AND EXCHANGE POLICY GUIDELINES FOR 2002/2003

BY
CENTRAL BANK OF NIGERIA*

INTRODUCTION

The central Bank of Nigeria (CBN) will, with effect from 2002 fiscal year, adopt a medium-term perspective monetary policy framework. Unlike earlier programmes, which were designed for one year, the new programme is for a two-year period, beginning January 2002 to December 2003. The shift is in recognition of the fact that monetary policy actions affect the ultimate objectives of policy with a substantial lag. Thus, the current shift will free monetary policy implementation from the problem of time inconsistency and minimise over-reaction due to temporary shocks.

This circular outlines the Monetary, Credit, Foreign Trade and Exchange Policy Guidelines applicable to banks and other financial institutions in Nigeria in 2002/2003. In particular, monetary and credit policy will be implemented within the framework of the medium-term programme. The guidelines will be subject to fine-tuning in the light of developments in monetary and financial market conditions, as well as the performance of the economy, which would be conveyed to the relevant institutions in supplementary circulars as necessary. The circular contains four major sections and four appendices. Following the introduction, which is section 1, section 2 reviews the developments in the economy and policy environment in 2001 and thus provides the background to the policy measures for 2002/2003. Section 3 outlines the monetary and credit policy measures and guidelines for implementation by banks and other financial institutions in fiscal 2002, while the foreign trade and exchange policy measures are highlighted in Section 4. The appendices contain prudential guidelines for licensed banks and reporting formats.

2.0 REVIEW OF MACRO-ECONOMIC AND POLICY ENVIRONMENT IN 2001

2.1 Macroeconomic Developments

Major economic indices indicated mixed macroeconomic performance in 2001. The environment for the conduct of monetary policy was largely unconducive, following the continued expansionary fiscal operations of the three tiers of government, as a result of the monetisation of the excess crude oil receipts and the proceeds from the GSM licence later in the year, as well as the monetary financing of fiscal deficits. This resulted in large injections of liquidity into the economy, which induced rapid monetary growth and intensified inflationary pressures. Interest rates were influenced by the state of bank liquidity as well as policy actions aimed at addressing the problem of liquidity overhang. The average naira exchange rate at the official market, however, remained relatively stable for most of the period, while relative improvement was observed in agricultural and industrial production. The outcome of external sector developments remained favourable up to the third quarter of the year. The fourth quarter, however, witnessed a slide in the export price of crude petroleum, with negative implications for export earnings and government revenue.

Growth in real Gross Domestic Product (GDP) was estimated at 3.8 per cent during the first half of 2001, compared with the 5.0 per cent targeted in 2001. The growth in output reflected the increase in both agricultural and industrial production. Aggregate manufacturing capacity utilisation rose marginally by 0.3 percentage point over its level in the first half of 2000 to 35.5 per cent, but was 0.2 percentage point lower than the level in the preceding half year. The upward pressure in inflationary trend, observed since July 2000 continued in the fourth quarter of 2001, with the inflation rate at 18.9 per cent in November, compared with 5.8 per cent in the corresponding period of 2000.

This is the Monetary Policy Circular, No. 36 issued by Central Bank of Nigeria.

The provisional balance of payments for the first half of 2001 indicated an overall surplus of N51.1 billion (US$458.9 million) compared with N78.3 billion (US$782.4 million) in the corresponding period of 2000. This development reflected the surplus in the current account, which more than offset the deficit in the capital and financial account. The current account position was buoyed mainly by enhanced earnings from crude oil exports, occasioned by high prices of crude oil in the international petroleum market. The value of non-oil exports, however, fell sharply from N14.8 billion in 2000 to N9.3 billion in June, 2001. Gross external reserves increased from US$9.9 billion (N1,032.5 billion) at end-December 2000 to US$10.6 billion (N1,167.8 billion) in June 2001, and declined marginally to US$10.4 billion (N1,152.2 billion) by November.

The naira exchange rate vis-a-vis the U.S. dollar was relatively stable in the IFEM for most of the year. After the depreciation in the first four months, from N110.05 to N113.59 = US$1.00, the average IFEM rate appreciated steadily from N113.07 = US$1.00 in May to N111.60 = US$1.00 in September and remained at that level in October, 2001. The rate, however, depreciated marginally to N111.99 = US$1.00 in November. Similarly, the average parallel market and bureaux de change rates depreciated from N123.38 and N122.34 = US$1.00 in January to N137.26 and N137.48 = US$1.00 respectively, in May before appreciating consistently to N133.70 and N134.05 = US$1.00 in November, respectively. The relative stability achieved was attributable largely to tight monetary policy, reinforced by the 100 per cent destination import inspection at the ports.

The growth in monetary aggregates accelerated rapidly in the first eleven months of 2001, exceeding the prescribed targets for the year by wide margins. Provisional data indicated that broad money (M_2) rose by 26.8 per cent, as against the programmed target of 12.2 per cent for the year. The expansion in M_2 reflected growths in both the narrow money (M_1) and quasi-money components. M_1 expanded by 19.9 per cent compared with the 4.3 per cent growth stipulated for the whole year. Monetary growth during the period was driven by the increases in bank credit to the domestic economy and foreign assets (net) of the banking system, following the continued monetisation of excess crude oil export proceeds.

Aggregate bank credit to the domestic economy rose significantly by 77.8 per cent, as against the 15.8 per cent growth target for fiscal 2001. The rise reflected the growth in credit to both the government and the private sector. Net claims on Government rose by 132.8 per cent as against the target expansion rate of 2.6 per cent for the entire year. Similarly, credit to the private sector rose by 37.3 per cent, compared with the target of 22.8 per cent for the whole year. The growth in credit to the private sector was, as in the previous year, largely driven by developments in the foreign exchange market.

Reported bank lending rates were generally high during the year, while the deposit rates remained low. By November 2001, the spread between the weighted average deposit[1] and maximum lending rates was 11.6 percentage points while that between the average savings deposit and maximum lending rates was 26.1 points. Most deposit rates remained negative in real terms as inflation rate accelerated. During the year, the CBN tightened its monetary policy to stem the liquidity surge, arising from the expansionary fiscal operations of governments. The Bank progressively raised its minimum rediscount rate (MRR) by 650 basis points, from 14.0 per cent in January to 20.5 per cent in September. Similarly, both the cash reserve requirement (CRR) and statutory minimum liquidity ratio (LR) were revised upward from 10.0 and 35.0 per cent to 12.5 and 40.0 per cent, respectively, during the same period. The CBN also introduced its own intervention instrument, the CBN Certificate, in February 2001, to complement the traditional treasury bills in addressing the problem of liquidity overhang in the banking system.

2.2 Outstanding Macro-economic Problems and Policy Challenges for Fiscal 2002/2003

The effect of fiscal federalism exacerbated the problem of

[1]The weighted average deposit rate includes the cost of mobilising: savings, fixed, time, call and demand deposits of various amounts by deposit money banks during the period.

excess liquidity with adverse implications for domestic price, exchange and interest rates. The persistence of structural bottlenecks in the economy also continued to constrain economic recovery in 2001. While some macroeconomic indicators showed marginal improvements in 2001 relative to 2000, the overall performance of the economy remained below its potential.

Poverty level remained high as the government's poverty intervention programmes were yet to be fully implemented during the period. Although satisfactory progress had been made in the restoration of normal fuel supply, the full rehabilitation of power plants and other infrastructural facilities were still on-going, while public utilities remained deficient, constraining performance in the productive sectors of the economy. The international crude oil market witnessed a lull during the fourth quarter, as a result of the slow-down in economic activities in the industrialised countries and terrorist attack on the USA – the world leading economy. This and the poor performance of the non-oil sector had implications for the overall performance of the domestic economy.

Against this background, monetary, financial and external sector policies, as well as other economic policy measures have been formulated to ensure price stability and reverse the upward trend in inflation rate, to a desirable single digit, recognising that price stability is critical for a sustained long-term economic growth and poverty eradication. In fiscal 2002/2003, the CBN will endeavour to keep the growth in monetary aggregates within targets and sustain the relative stability of the exchange rate. The Bank will also continue to support the Federal Government's poverty reduction initiatives by ensuring adequate credit to the productive sectors, encouraging financial savings and private sector investment growth and improving financial market environment.

3.0 MONETARY AND CREDIT POLICY MEASURES IN 2002/2003

3.1 Objectives and Strategy of Policy

The primary objective of monetary policy in 2002/2003 is the achievement of price and exchange rate stability. Specifically, monetary policy shall seek to subdue inflation to a single digit over the two-year period. Consequently, the central focus will include effective control of anticipated liquidity injections that may arise from excessive government spending during the pre-election years of 2002/2003 in order to minimise their negative effects on domestic price and exchange rate. The stance of monetary policy will be non-accommodating, while a more competitive financial environment will be fostered to enhance greater access to credit for the real sector. Furthermore, continued effort will be made in improving the payments system in order to further strengthen the effectiveness of monetary policy. The broad measure of money supply (M_2) shall continue to be the intermediate target of monetary policy. An average growth in M_2 of about 15.2 per cent during the two-year period, which translates to 15.3 per cent in 2002 and 15.0 per cent in 2003, shall be maintained.

3.2 Policy Measures

The conduct of monetary policy will continue to rely on market-based technique in the management of CBN's balance sheet. The primary instrument of policy will continue to be Open Market Operations (OMO), supported by reserve requirements and discount window operations for enhanced effectiveness. The conduct of OMO will be proactive and will require the co-operation of the Federal Ministry of Finance to ensure consistency between monetary and fiscal policies as well as the stability of the financial markets.

3.2.1 Open Market Operations

Open Market Operations (OMO) will be conducted weekly in the secondary market, mainly in short-term government securities of varying maturities, in order to meet the various preferences of participants in the market. OMO will be complemented by reserve requirements and discount window operations, including Repurchase Agreements (REPOs) while discount houses will continue to play the role of principal dealers in the market.

3.2.2 Reserve Requirements

Reserve requirements shall continue to serve prudential and liquidity management policy objectives.

3.2.2.1 Cash Reserve Requirement (CRR)

As in the preceding years, the cash reserve requirement will be used to complement OMO in achieving monetary policy objectives. In this regard, the authorities recognise the need to reduce the current high CRR in order to moderate banks' cost of funds and thus bring down bank lending rates. However, this can be achieved only in the medium to long-term when the monetary conditions would have improved. Meanwhile, the existing ratio of 12.5 per cent will remain in force in 2002. As in 2001, the calculation of the CRR will be based on deposit money banks' total deposit liabilities (i.e. demand, savings and time deposits), certificates of deposits, promissory notes held by the non-bank public, and other deposits item[2]. The CBN will continue to ensure efficient administration of the CRR. In this regard, the lag for debiting banks' accounts to meet the specified CRR will not exceed two weeks. For this purpose, the mid-month returns by banks will complement the monthly returns. As amended in 2001, all deposit money banks will be subjected to CRR in 2002. The CBN will continue to impose strict sanctions for non-compliance. However, in order to moderate the adverse effects of CRR on cost of funds of banks, the current policy of paying interest on deposits above the 8.0 per cent rate shall be retained.

3.2.2.2 Liquidity Ratio (LR)

The existing minimum liquidity ratio of 40.0 per cent for all deposit money banks is also retained, but would be reviewed in line with developments in monetary conditions during the programme period. The base for calculating the LR requirement will, as in the previous years, comprise all deposit liabilities (demand, savings and time) as well as certificates of deposits (CDs), promissory notes held by the non-bank public and other deposit items. Placements with and takings from Discount Houses shall be offset against each other and any surplus of assets or liabilities shall be applied as the case may be in computing the LR requirement. Only inter-bank placements, which are fully collateralised by eligible instruments and readily rediscountable at the CBN, shall qualify as eligible liquid assets. Uncollateralised placements as well as money-at-call shall not constitute part of liquid assets, but shall continue to be treated as loans and advances. The mandatory deposits with the CBN to meet the CRR shall not qualify for inclusion in computing the LR. The requirement that discount houses should invest at least 60.0 per cent of their total deposit liabilities in treasury bills will continue in 2002.

3.2.3 Discount Window Operations

In line with the objective of maintaining monetary stability and promoting the development of the money market, the CBN shall, in 2002 and 2003, continue the use of discount window operations as a policy instruments to signal the desired direction of interest rates and in accordance with its role as lender-of-last-resort. Transactions will be conducted in the form of short-term overnight loans, collaterilsed by the borrowing institutions' holdings of government debt instruments and other eligible instruments as stipulated by the CBN. Changes in the rediscount rate will continue to be made in a dynamic manner to complement other policy initiatives and to reflect developments in the money market.

3.2.4 CBN Certificate

CBN certificates were issued for the first time in 2001 to mop up the excess liquidity, which was generated by the rapid monetisation of the windfall gains from crude oil receipts. In 2002, CBN certificates will be issued as the need arises, to complement traditional monetary policy tools to contain growth in liquidity to the desired level.

3.2.5 Interest Rate Policy

In 2002, interest rates will continue to be market-driven. In this regard, the CBN will influence the level and direction of interest rate movements through changes in its Minimum Rediscount Rate (MRR) to reflect the prevailing market condition. The current spread between the deposit and lending rates of banks is unacceptably wide and has serious implications for savings and investment growth. To address this problem, a more competitive financial environment will be engendered, through improved enlightenment of the investing public on alternative investment

[2]Other deposit items will include revenue collections not remitted to CBN within the stipulated period.

opportunities in the financial market. Furthermore, the CBN shall vigorously pursue initiatives to strengthen community banks, finance houses and development finance institutions (DFIs) with a view to enhancing the efficiency and public confidence in those institutions for the promotion of financial savings.

Specific procedures on interest rate policy to be observed by banks in 2002 are as follows:

a) Banks shall continue to pay interest on current account deposits at rates of interest negotiated between them and their customers. Where deposits for special purposes are held for more than seven days, banks shall pay interest on such deposits and the rate of interest shall also be subject to negotiation between then and their customers.

b) The reducing balance method shall continue to be used for calculating interest charges on loans repayable installmentally. The use of any other method, whatsoever, for loans payable in agreed installments such as the discount method or the simple interest straight line method that would result in a higher effective rate than the contracted rate, is disallowed.

c) Statements of account to each current account holder shall be rendered promptly on monthly basis and shall include the following:

i) Commission on turnover (COT); and

ii) Rate of interest on over-drawn accounts, the amount and the period.

d) Interest on savings accounts shall continue to be calculated on the customer's account as at the end of each quarter and accrued interest paid shall be reflected at the time of calculation.

e) The amount of deposits in a personal savings account on which the interest is payable shall not be subject to any ceiling.

f) Banks shall continue to design their pass books in such a way that the following information will be clearly shown when calculating the interest earned on savings deposits: interest rate applied, the amount of savings on which the calculation is based and the period for which interest is calculated.

g) The Inspectorate Department of each bank shall continued to have the responsibility for cross-checking bank charges and interest rates payable on deposit accounts. Where the Inspectorate Department of a bank discovers non-payment or under-payment of interest on deposits or other entitlement or excessive interest and bank charges, a return thereon shall be made to the Central Bank. Under-payment and/or excessive interest and other charges shall be refunded with interest at the prevailing CBN minimum rediscount rate, along with a letter of apology to the customer within two weeks. Any bank which fails to refund excess charges or under-payment of interest on deposits within two weeks of the discovery of such error shall, in addition to the refund to the customer, be liable to a penalty amounting to 100 per cent of the amount involved.

h) Banks shall, in accordance with the provisions of BOFI Act No. 25 of 1991, as amended, and amendments to Monetary Policy Circular No. 30 of 1996, continue to display at their offices their current lending and deposit rates, as well as publish such rates in the national newspapers.

3.2.6 Remittance of VAT and Duty Collections

It has been observed that some banks do not comply with the requirements that they should remit VAT and custom duties collected on behalf of the federal government to the CBN within the stipulated seven day. These sources of cheap funds have influenced banks to discourage small savers by insisting on unrealistic minimum deposit base while constituting a leakage in the monetary transmission process. With effect from 2002, banks which keep these deposits for more than the stipulated seven days shall pay interest on such deposits as directed by the CBN. In addition, such deposits which are not remitted within the stipulated period shall form

part of banks' deposit base for the purpose of computing their cash reserve requirement (CRR).

3.2.7 Framework for determining Banks' Cost of Funds

In accordance with best international banking practice, banks are required to adopt the weighted average cost of funds computation framework from 2002 fiscal year. Thus, the existing simple average method of computing cost of funds is hereby discontinued. The cost items in the new framework will include banks' interest cost for the different types of deposit liabilities, borrowings from the inter-bank funds market, payment in respect of deposit insurance premium and cost due to cash reserve requirement. For the avoidance of doubt, the new framework excludes banks' overheads. The guidelines for the computation of weighted cost of funds framework will be issued in due course.

3.2.8 National Savings Certificate

The introduction of the National Savings Certificate (NSC), a medium to long-term security, will be vigorously pursued in 2002. The NSC, whose yield will be market-determined, is intended to broaden and offer alternative investment options to the investing public, including banks and the non-bank public, thereby supplementing current efforts at managing, on a more sustainable basis, the persistence excess liquidity in the economy, while facilitating savings and investment growth.

3.2.9 Federal Government Development Stocks

Initiatives to resume the floatation of Federal Government Development Loan Stocks, suspended since the 1980s, shall continue to be explored. Besides, the reintroduction of this instrument would encourage government to source its long-term financing need from the capital market.

3.2.10 Minimum Balances on Personal Savings and Current Accounts

The minimum amount required for savings account by most banks has remained unduly high and out of tune with present personal income realities in Nigeria. The observed trend has the potential to discourage savings and the banking habit, and is in inconsistent with the desired macroeconomic objective of promoting savings and investment growth. Although the CBN has since discontinued with the policy of stipulating a mandatory minimum amount for opening a savings deposit account in line with the prevailing deregulated financial market environment, there is an urgent need to prevent a reversal of the progress made over the years to promote savings and enhance the savings culture. Banks are, therefore, enjoined to reduce their minimum savings deposit required to N5,000.00 from 2002 fiscal year.

3.2.11 Other Policy Measures

a) Financing the Development of SMEs

The role of Small and Medium-scale Enterprises (SMEs) in employment generation, skill acquisition, output growth, enhancement of local technology and the mitigation of rural-urban drift cannot be over-emphasised. In this regard, the Federal Government initiated and actualised some policy measures for the attainment of these goals. These included the establishment of sector-specific development finance institutions (DFIs). During year 2001, the Federal Government approved the merger of the Family Economic Advancement Programme, People's Bank of Nigeria and the Nigeria Agricultural and Co-operative Bank (NACB) into a single bank – Nigerian Agricultural, Co-operative and Rural Development Bank (NACRDB) and Nigerian Industrial Development Bank (NIDB), Nigerian Bank for Commerce and Industry (NBCI) and National Economic Reconstruction Fund (NERFUND) into a new Bank for Industry.

In addition, the Bankers' Committee decided that 10.0 per cent of profit before tax of every bank would be set aside and channeled to equity investment in small and medium-sales industries. To ensure the effectiveness of the programme, banks are expected to identify, guide and nurture enterprises to be financed under the scheme. The Small and Medium Industries Equity Investment Scheme (SMIEIS) was launched in August 2001. The activities targeted under the scheme include agro-allied, information technology, telecommunications, manufacturing, educational establishments, services, tourism and leisure, solid minerals and construction.

With the introduction of the scheme, it is expected that improved funding will facilitate the achievement of higher economic growth. Banks are required to render to the CBN, on quarterly basis, their investment report under the scheme.

b) CBN Rediscounting and Refinancing Facility (RRF) for Medium to Long-term Credit

Available statistics on the maturity structure of deposit money banks' credit to the domestic economy revealed that the bulk of aggregate credit was short-term, and such loans were channeled mainly to general commerce and trade. The need to encourage medium to long-term lending to the productive sectors of the economy has, therefore, become very compelling, if the production base of the Nigerian economy is to be expanded and diversified.

In this regard and consistent with the provision of Section 27 (1) (c & d) of the CBN Act 1991, as amended, the CBN will, with effect from January 2002, adopt a refinancing facility at concessionary interest rate to support medium to long-term bank lending to the productive sectors of the economy.

Under the facility, deposit money banks can issue Promissory Notes, based on their loans and advances with maturities of not less than 5 years, for agricultural production, semi-manufacturing and manufacturing, solid minerals and information technology. The characteristics of the RRF are as follows:

i) The Promissory Notes shall be issued by banks that have complied fully with prudential requirements.

ii) The Notes shall have a maximum maturity of 90 days, exclusive of days of grace from the date of acquisition.

iii) The Notes shall be rediscountable at the CBN at a rate which is two percentage points below the minimum rediscount rate (MRR).

iv) The Notes shall bear two valid and authorised signatures acceptable to the CBN.

v) The banks shall access up to 60.0 per cent of qualifying loans.

vi) The RRF will apply to loan portfolio that must have been held for not less than one year.

vii) Access to the facility shall be limited to once in 12 calendar months.

The RRF is designed to provide temporary relief to banks which face liquidity problems as a result of having committed their resources to long-term financing of the specified productive sectors.

c) Revitalising the Community Banks

The community banking initiative is part of the intervention action aimed at redressing the lack of adequate and efficient facilities for the mobilisation of savings for productive activities among the less privileged members of the society. However, the operations of the banks have been undermined by both endogenous and exogenous factors. In order to address these problems through proper institutional and regulatory framework, the CBN took some measures which included the creation of the Other Financial Institutions Department (OFID). Furthermore, the CBN will continue to support capacity-building in Community Banks by providing free training for their personnel from 2002.

d) Orderly Development of the Banking System

The CBN will sustain efforts at facilitating the orderly development of the financial sector and will continue to involve the operators in the conduct of monetary policy, in support of policy objectives. To this end, the following measures shall apply in 2002 fiscal year:

i) Increase in Minimum Paid-up Capital Requirement

The minimum paid-up capital requirement for new banks was raised from N1.0 billion to N2.0 billion in 2001 fiscal year. Accordingly, existing banks are required to raise their capital base to N1.0 billion by end-2002 in order to strengthen their operations.

ii) Transparency in Banking Operations

In order to promote transparency

in banking sector, the CBN shall in 2002 intensify the process of regular monitoring of the operations of the banks to ensure compliance with regulations. The CBN will continue to encourage self-regulation in the banking industry in order to enhance ethical standards and transparency in banking operations. It is hoped that the recently-published code on banking ethics will facilitate the sanitisation of the system. Appropriate sanctions will be imposed on erring banks and other financial institutions in line with the provisions of BOFI Act and other relevant legislations.

iii) Moral Suasion

The CBN will continue to engage in moral suasion through regular dialogue with banks and other financial institutions, under the aegis of the Bankers' Committee and other communication channels, in order to encourage enhanced efficiency in the financial sector, especially with respect to interest and exchange rate management.

e) Improving the Payments System

i) Introduction of higher currency denomination

In order to ease the problem of cash transactions in the economy, the CBN in 1999 identified the need for adequate supply of fifty naira (N50) currency notes, as well as the introduction of higher denominations. Consequently, a one hundred naira note (N100) was introduced into the system in the third quarter of 1999, while a two hundred naira note (N200) was launched in November 2000 and five hundred naira note (N500) introduced in the first half of 2001. The monetary authorities will continue to ensure that the security and quality of the notes are of high standards.

ii) Improving the use of Cheques

As in 2001, the CBN will continue to promote the use of cheques towards the improvement of the payments system and enhancement of business transactions. Government will be encouraged to lead in popularising the use of this instrument, by accepting cheques for debt settlements in all government ministries and parastatals. In this regard, the CBN will, in consultation with the Accountant-General of the Federation (AGF), encourage government agencies to accept cheques for services rendered as practiced all over the world.

3.2.12 Bank Credit Expansion

Only banks, which meet the following criteria, shall be permitted to grant new credit facilities in 2002/2003.

a) specified cash reserve requirement;
b) specified liquidity ratio;
c) prudential guidelines;
d) statutory minimum paid-up capital requirement;
e) prescribed capital adequancy ratio; and
f) sound management policy.

The position of each bank shall continue to be examined on a monthly basis with respect to the above criteria, and banks which fail to meet the requirements will not be allowed to grant further credit until compliance is achieved.

3.2.13 Grace Periods on Loans to Agriculture

Without prejudice to the on-going liberalisation in the financial sector, there is need for financial institutions to continue to observe appropriate grace periods on agricultural loans in recognition of the differences in gestation periods of various agricultural products. In this regard, banks are enjoined to always allow borrowers adequate grace periods for repayment on agricultural loans.

3.2.14 Prudential Guidelines for Licensed Banks

All the existing prudential guidelines on early recognition of losses and adequate provision for bad and doubtful debts shall remain in force in 2002 and 2003. Accordingly, banks are enjoined to continue to strictly observe the prudential guidelines outlined in CBN Circulars No. BSD/DO/23/VOL.1/11 of 7th November 1990 and No BSD/CS/23/VOL.1/8 of 15th May 1991 (Appendix 1). Also, the provisioning requirement on credit accommodation to all tiers of government (by which banks are required to make a 50 per cent provision on performing credits and 100 per cent for classified credits) as contained in CBN Circular No. BSD/DO/CIR/Vol.1/2001/13 of 10th July 2001, shall remain in force in 2002 fiscal year.

3.2.15 Capital Funds Adequacy

In keeping with international standards, the minimum ratio of capital to total risk-weighted assets shall remain at 8.0 per cent in 2002 and 2003. Furthermore, at least 50.0 per cent of the components of a bank's capital shall comprise paid-up capital and reserves, while every bank shall maintain a ratio of not less than one to ten (1:10) between its adjusted capital funds and its total credit net of provisions.

3.2.16 Abolition of Foreign Guarantees/Currency Deposits as Collateral for Naira Loans

The abolition of foreign guarantees for naira-denominated loans as contained in the Monetary Policy Circular No. 23, Amendment No. 3 of April 1989 is lifted in fiscal 2002 and 2003. However, any request for such guarantees shall be subject to prior approval by the CBN.

3.2.17 Rules for Currency Transactions

Pursuant to the provisions of Section 21 of Foreign Exchange (Monitoring and Miscellaneous Provisions) Act No. 17 of 1995, persons who import currency up to US$10,000.0 and above by cash and lodge such money in a domicilliary account with an authorised dealer, can only make cash withdrawals from the account. Also, by virtue of the provision of Section 22 of the same legislation, no person in Nigeria shall make or accept cash payment, whether denominated in foreign currency or not, for the purchase and acquisition of landed properties, stocks, shares, debentures, all forms of negotiable instruments and motor vehicles. Payments for those items shall be made by means of bank transfer or cheques drawn on banks in Nigeria. In order to ensure full compliance with law, all banks are required, as in the previous year, to appoint Compliance Officers whose duty shall be to ensure that the provisions of the law are complied with. The Compliance Officers shall report all breaches of the law to the CBN, through the Chief Executive Officer of each bank, in such a manner as the CBN may prescribe.

3.2.18 Responsibilities of Bank's external Auditors to the Supervisory Authorities

Existing Central Bank directives to all banks to instruct their auditors to forward two copies of their domestic reports to the CBN not later than three months after the end of the bank's financial year shall remain in force in 2002/2003. In addition, reports on frauds and forgeries committed during the accounting year shall accompany the audited reports. Furthermore, each bank shall continue to communicate to the CBN, the appointment, re-appointment, termination and resignation of the bank's external auditors, stating the reason for such action. Where a bank fails to comply with this requirement, the CBN reserves the right to withhold the approval of such requests, thereby attracting the stipulated penalty for non-compliance. In recognition of the complementary role of external auditors, banks are required to ensure that their external auditors are in attendance at the presentation of Bank Examination Reports to their Board of Directors by the Supervisory Authorities.

3.2.19 Banks Operating Subsidiary Companies Offering Financial Services

Banks with subsidiary companies offering financial and related services shall continue, as in the previous years, to report on the operations of such companies along with their Monthly Returns to the Central Bank of Nigeria.

3.2.20 Public Complaints Desk at the Central Bank of Nigeria

The Central Bank shall continue to maintain a Public Complaints Desk at its head Office and each of its branches to enable the public to lodge any complaints they may have against their banks. Where the case against any bank is proved, the bank shall be required to make necessary amends and pay appropriate penalties. This measure is aimed at encouraging banking habit, promotion of efficiency in the delivery of financial services and, thereby, boost public confidence in the system.

3.2.21 Agricultural Credit Guarantee Scheme (ACGS)

In pursuit of the developmental

role of the Agricultural Credit Guarantee Scheme and to ensure the flow of credit to the agricultural sector, the authorised share capital of the Scheme was reviewed upward from N100.0million to N3.0 billion in 1999. Following the increase, the loan limits under the Scheme were raise from N5,000.0 to N20,000.0 for unsecured loans, and N100,000.0 to N500,000.0 for secured loans to individuals, as well as from N1.0 million to N5.0 million for corporate borrowers. The refinancing scheme adopted by the CBN to cater for the medium and large credit segments shall continue to be pursued in 2002/ 2003.

3.2.22 Returns from Banks

All banks in the country are required to report accurately, faithfully and promptly on their activities in the prescribed formats for the mid-month, monthly, quarterly and semiannual returns. Such designated returns (in diskette and hard copy) shall be forwarded to the Banking Supervision, Bank Examination, Trade & Exchange and Research Departments of the CBN as well as the Nigeria Deposit Insurance Corporation (NDIC), not later than 5 days after the 15th day of each month for mid-month returns, 10 days after the end of each reporting month in the case of monthly returns, and 14 days after the end of each quarter in the case of quarterly returns (see Appendices II, III & IV). Copies of the returns, duly signed, as applicable to the relevant departments, shall be submitted to Directors of Banking Supervision, Research, Bank Examination Departments of the CBN and the Director, Off-Site Supervision Department of the NDIC.

Banks are also enjoined to send monthly and mid-month returns on public sector account balances with them to the CBN Director of Banking Operations.

3.2.23 Penalties for Default

As in the previous years, the CBN shall, in 2002/2003, continue to enforce all the stipulated penalties for non-compliance with the Bank's guidelines and provisions of the CBN Act 1991 and Banks and Other Financial Institutions Act 1991, as amended. In serious cases of default, the CBN may suspend or revoke any licenses issued to the defaulting bank. The Bank shall sustain its surveillance activities during the two-year period and invoke the relevant provisions of the existing laws, as deemed appropriate, in order to enhance the safety, soundness and efficiency of the banking system. For the avoidance of doubt, sanction shall be applied as follows:

i) Banks that do not meet the criteria for the expansion of credit (vide item 3.2.12 of these guidelines), but expand their credit beyond the specified level as at 31st December, 2001, or beyond the current level in the case of erstwhile healthy banks, shall in each case deposit an amount equivalent to the excess with the CBN. Such deposits shall earn no interest and shall not be eligible for inclusion in the defaulting banks' liquid assets holdings for the purpose of meeting the statutory cash and liquidity ratios. Such funds shall be lodged on quarterly basis and held with the CBN for a minimum period of three months, and shall thereafter remain with the Bank for as long as the default lasts.

ii) A bank whose cash reserve ratio falls below the stipulated minimum and any bank whose liquidity ratio falls short of the prescribed minimum, shall be liable to appropriate sanctions under the CBN Act 1991, and the Banks and Other Financial Institutions Act 1991, as amended. Where a bank increases its loan and advances or credit facilities without the approval of the Central Bank during the period of deficiency in the respective reserve ratios, such a bank shall pay a fine as may be determined by the CBN within the provisions of the relevant Acts, as amended. In addition, the CBN shall withdraw all privileges or facilities that are normally accorded to the bank.

iii) A bank shall be liable to appropriate fine, as determined by the CBN or such other penalties as provided under the CBN Act 1991 and the Banks and Other Financial Institutions Act 1991, as amended for:

a) failure to display at its banking hall and publish in the national newspaper its current lending and deposit rates or render information on such rates as specified from time to time by the CBN;

b) failure to send its returns to the CBN 5 days after the 15th day of each month for mid-month returns, 10 days after the last day of each month in the case of monthly returns, and 14 days after the end of each quarter in the case of quarterly returns;

c) failure, without good reason, to supply information within the prescribed period, in such form as the CBN may from time to time direct, relating to or concerning matters affecting the economy of Nigeria;

d) rendition of false information or supplying information recklessly without regard for its accuracy; and

e) publication of audited accounts by the Chief Executive Officer of a bank without prior authorisation by the CBN.

iv) Banks shall be penalised under Section 60 (1) of BOFI Act 1991, as amended, if the credit status of a customer is not sought from the Credit Bureau, under the Credit Risk Management System (CRMS), before credit is granted or when credit is granted to a delinquent customer or if a delinquent credit is not reported.

3.3 Other Financial Institutions

The CBN, in 2001, established a department to oversee the on-site and off-site surveillance of other financial institutions. Finance companies, discount houses, mortgage institutions, development banks, community banks, and bureaux de change operating in the country are hereby reminded that, in conformity with existing regulatory provisions, it is mandatory for them to render regularly to the CBN, accurate and timely returns on their operations, and any other information as may, from time to time, be required by the CBN. The supervisory framework for these institutions will be further strengthened, while other complementary measures necessary to enhance the effectiveness of CBN surveillance activities, and the orderly development of the financial market, will be pursued in the current period. The institutions are also to render to the CBN their audited annual accounts for approval before publication, in accordance with the provisions of the CBN and BOFI Acts and other existing or revised operating guidelines. Specific guidelines that apply to these institutions are outlined below:

3.3.1 Finance Companies

In 2002/2003, continued efforts shall be made to monitor the performance of licensed finance companies with a view to checking further spread of distress in the financial sector, as well as ensure the overall effectiveness of CBN's monetary, credit, and financial policies. Consequently, all licensed finance companies in the country shall continue to submit to the CBN quarterly returns on their operations, including statements of assets and liabilities; total credit granted with details of sectoral utilisation; investments and money market transactions; non-performing credits; and interest rate structure. A copy, each, of such returns shall reach the CBN Director of Other Financial Institutions and Director of research, in Lagos and Abuja, or the Lagos Liaison Office of the Research Department in Lagos not later than 14 days after the end of each quarter. Bi-annual returns shall also be rendered to the CBN Director of Other Financial Institutions in Lagos not later than 14 days, following the end of each half-year. The directive to the effect that finance companies shall display their daily rates of interest in conspicuous places in their head offices and branches will remain in force in fiscal 2002/2003. Furthermore, finance companies are enjoined to comply with the prudential guidelines as contained in the revised Guidelines of July 1993 and December 1994, respectively.

3.3.2 Discount Houses

Discount houses shall, in fiscal 2002/2003 continue to render daily, weekly and monthly returns on their operations to the CBN, in line with existing operational guidelines as well as the provisions of the CBN Act of 1991 and the Banks and Other Financial Institutions Act of 1991, as amended. Every discount house shall display its daily rates of interest inconspicuous positions in all its offices. Discount Houses shall continue to invest at least 60.0 per cent of their total deposit liabilities in treasury bills.

3.3.3 Development banks

Development banks shall continue to render to the CBN their balance sheet statements quarterly as well as returns on their credit and interest rate operations. These returns, which shall be furnished accurately and in a timely manner on the prescribed forms, as well as other supplementary information as may, from time to time, be required by the CBN, shall be submitted not later than 14 days after the end of each quarter to the Directors of Research and Other Financial Institutions, Central Bank of Nigeria.

3.3.4 Bureaux de Change

The operational framework of the IFEM shall be reformed in 2002 to allow bureaux de change to source their foreign exchange requirements for BTA/ PTA from the IFEM. This further deregulation will enhance public access to foreign exchange and minimise speculative arbitrage. All licensed bureaux de change are, therefore, enjoined to continue to adhere strictly to all existing and revised guidelines on their operations in 2002, to facilitate the achievement of desired objectives.

3.3.5 Primary Mortgage Institutions and Community Banks

The supervisory and regulatory framework for other financial institutions, including primary mortgage institutions and the community banks, has been strengthened, with the take-off of the Other Financial Institutions Department (OFID) in CBN. Efforts will be sustained in 2002/2003 to ensure the viability and soundness of the institutions, as well as enhance their effectiveness.

3.3.6 Penalties for Default

All institutions are enjoined to comply fully with the provisions of the relevant legislations and guidelines. Any financial institution that fails to comply with the existing and revised guidelines issued by the CBN as well as other directives as the CBN may issue from time to time, or fails to furnish within the stipulated time any statistical and other returns as the CBN may, from time to time prescribe, shall be liable to appropriate fines as determined by the CBN or such other penalties as provided for by the enabling law.

3.4 Policy on Transparency in Financial Transactions

In line with the statement of the Basle Committee on Banking Regulations Supervisory Practices, all financial institutions are required to continue to observe the following standards in the interest of transparency in financial transactions.

3.4.1 Customer Identification

Financial institutions are enjoined to intensify efforts to determine the true identity of all customers requiring their services. In particular, financial institutions should not, as a matter of policy, conduct business transactions with customers who fail to provide evidence of their identity.

3.4.2 Compliance with the Law

Licensed banks and other financial institutions shall observe high ethical standards as well as the laws and regulations governing their operations. In particular, banks are required to ensure full compliance with the Guidance Notes and other relevant circulars on Money Laundering Surveillance, issued by the CBN, in order to enhance the effectiveness of the provisions of the Money Laundering Act, 1995. It has been observed that the level of compliance by the institutions with the provision of the Act had been unsatisfactory due largely to lack of understanding of the crucial role of the Act. Efforts should be made to ensure full compliance in terms of disclosure of relevant information of depositors as stipulated in the Act, including strict observance of the "know your customer" principle, to ensure that illegally acquired funds are prevented from being injected into the financial system. Appropriate sanctions have been put in place for breaches of this law.

3.4.3 Co-operation with Law Enforcement Authorities

Banks and other financial institutions are required to give full cooperation to law enforcement authorities within the limits of the rules governing confidentiality. In particular, where financial institutions are aware of facts which lead to a reasonable presumption that the funds lodged in an account or transactions being entered into derive from criminal activity or intention, they should observe the stipulated procedures for disclosure of the suspicious transactions in reporting to the law enforcement authorities.

Any contravention of the above stated guidelines by any financial institution shall attract penalties as stipulated in the Banks and Other Financial Institutions Act, 1991, as amended, or the Money Laundering Act, 1995, as appropriate.

4.0 FOREIGN TRADE AND EXCHANGE POLICY MEASURES

4.1 New Policy Measures for 2002

4.1.1 Inter-bank Foreign Exchange Market (IFEM)

In a continued effort to stabilise the exchange rate, as well as ensure a single exchange rate for the naira, the IFEM is further deregulated in 2002. To this end, the operational framework of the IFEM shall be reformed to allow bureaux de change to source their foreign exchange requirements (in TCs) from the IFEM. Details of the reform package will be issued in due course.

Furthermore, incentives will be extended to non-oil exporters to boost autonomous foreign exchange supply. The current port reform and the re-introduction of destination inspection will not only ensure that goods imported into the country attract the appropriate duty rates; they are expected to diminish the incentives to patronise the parallel foreign exchange market as well as minimise the arbitrage premium.

The other new measures are as follows:

I) The initial validity of Form 'M' established in respect of plant and machinery made to specification shall be one year subject to extension for another 180 days by the processing bank without recourse to the CBN. Thus, the maximum life span of an approved Form 'M' for importation of machinery, plant and equipment is one and half years (540 days)

II) Approval for duty exemption shall be obtained before shipment of relevant consignment to avoid unnecessary delay and transit of goods at the ports.

III) Payment of import duty and other charges shall be made through the processing bank provided that it is a designated bank.

4.2 Existing Policy Measures Retained/Amended in 2002

4.2.1 Two-way Quote System

The two-way quote system introduced in October, 1999 shall remain in force in 2002 fiscal year.

4.2.2 Inter-bank Foreign Exchange Market (IFEM)

i) The Inter-bank Foreign Exchange Market (IFEM) shall continue to operate freely. However, no individual or organization shall deal in foreign exchange except as provided by the relevant laws and regulations.

ii) Foreign exchange purchased from CBN at IFEM shall be used for eligible transactions and is not transferable in the Inter-bank Foreign Exchange Market.

iii) Mixing of funds purchased from the CBN with any other acquired from the IFEM shall be allowed, provided they are duly segregated and properly recorded to ease reconciliation. Consequently, banks shall continue to render appropriate returns on sources of funds and utilisation to the CBN.

iv) Holders of ordinary domiciliary account shall continue to have unfettered access to funds in their accounts. In other words, the instructions of the account holder shall be sufficient to access funds in the account irrespective of the payment mode required.

v) Utilisation of funds in the Non-Oil Export domiciliary accounts shall continue to be subject to eligible transactions.

vi) All oil and oil service companies shall continue to sell their foreign exchange brought into the country to meet their local expenses to any bank of their choice, including the CBN. Monthly returns

by both the oil companies and banks on such sales and purchases shall be rendered to the CBN, using the approved format.

vii) All applications whether or not valid for foreign exchange, visible or invisible trade transactions shall continue to be approved by banks, subject to stipulated documentation requirements, before remittance of funds.

viii) Current transactions involving the use of bills for collection shall be allowed provided relevant documents are passed through Authorised Dealers. Transactions executed on private sector initiative, shall carry no government guarantee or obligations. The remittances may be made through the IFEM subject to the prevailing conditions for payment. For the avoidance of doubt, the use of Open Accounts is hereby abolished.

ix) The payment of Bills for collection transactions shall continue to be limited to 180 days from the date of Bill of Lading.

x) Payment of interest in respect of (ix) above shall continue to be on the tenor of the Bill but not exceeding 180 days at a maximum of 1% above the prime lending rate prevailing in the country of the beneficiary (e.g. LIBOR in the UK).

xi) The maximum amount which bureaux de change can sell is retained at US$5,000.00 per transaction.

xii) Foreign exchange transactions shall continue to be subject to minimum documentation requirements, largely for statistical purposes.

xiii) All requests for foreign exchange by the public sector shall continue to be processed by the CBN in accordance with existing guidelines.

xiv) Funding of Business Travel Allowance (BTA) and Personal Travel Allowance (PTA) shall be eligible in IFEM, subject to the maximum ceiling of US$2,500.00 per quarter for BTA and US$2,000.00 per six months (twice a year) for PTA for beneficiaries above 12 years old. Relevant documents (i.e. passport and ticket) should be endorsed accordingly. For travels to countries in the ECOWAS sub-region, BTA and PTA should be issued in ECOWAS Travelers' Cheques.

4.2.3 Form 'M' Procedure

i) The initial validity of an approved Form 'M' for general merchandise shall be 180 days. The validity of approved Form 'M' and related Letters of Credit may be extended more than once by Authorised Dealers provided that, with the extension, the validity of the Form 'M' does not exceed the maximum life span of 360 days.

ii) Charges for services rendered by non-resident experts in respect of the design, installation and commissioning of projects shall continue to be treated as an integral part of the total cost of such projects and the prescribed procedures for Form 'M' shall apply. They shall also be subject to verification by the National Office for Technology Acquisition and Promotion (NOTAP). No direct or separate remittances on Form 'A' in respect of such charges shall be allowed.

4.2.4 Pre-shipment Inspection

i) All goods, except personal effects, used motor vehicles and perishables, i.e. day-old chicks, human eyes, human remains, vaccines, yeast, periodicals/ magazines, imported into the country shall be subject to pre-shipment inspection in the country of supply and issuance of an appropriate Clean Report of Inspection (CRI).

ii) Whether exempted from pre-shipment inspection or not, **importation of all goods into the country shall require the completion of Form 'M'**

iii) To minimise price variations, Authorised Dealers and importers are to ensure that the invoices submitted at the time of registration of the Form 'M' are "valid" and remain so as at the date of shipment of goods.

4.2.5 Import Duty Payment Procedures

i) Import duty payable on all registered Form 'M' transactions, whether or not valid for foreign exchange shall be calculated on the basis of the prevailing exchange rate in the IFEM on the day preceding the inspection of goods.

ii) The banks designated to receive import duty payments shall continue to be used for that purpose on confirmation of the completion and registration of Form 'M' for the imports.

iii) Payment of import duty shall be on the basis of bank cheque/draft duly issued by the importer's bank and made payable to the **"Federal Government Import Duty Account"**. All such cheques and drafts shall, in the first instance, be paid to any of the designated banks and cleared before receipt evidence payment is issued and other relevant shipping documents are released to the importers.

iv) The designated banks are required to transfer all Customs revenue collected by them to the nearest CBN Branch or Currency Center on the Monday following the week collection was made, using CBN cheques.

4.2.6 Export Trade and Promotion

i) Repatriated non-oil export proceeds and other inflows shall be held in Domiciliary Accounts maintained with Authorised Dealers. Banks shall continue to maintain two types of Domiciliary Accounts, namely, Exports Domiciliary Accounts and Ordinary Domiciliary Accounts. Holders of Domiciliary Accounts shall continue to have easy access to the funds maintained therein subject to the existing guidelines.

ii) Exporters and other foreign exchange earners are permitted to sell their export proceeds and other foreign currencies to Authorised Dealers at agreed rates. Moreover, exporters are allowed to sell their export proceeds to banks other than those where they maintain Exports Domiciliary Accounts.

iii) Payment for exports from Nigeria shall continue to be by means of Letter of Credits or any other approved international mode of payment. However, whatever the mode of payment adopted, the relevant proceeds shall be repatriated within 90 days of the date of shipment of the goods to a stated Exports Domiciliary Account.

iv) Efforts at enhancing non-oil receipts through the use of incentive schemes like the new Manufacture-in-Bond Scheme and the Negotiable Duty Credit Certificate (NDCC) shall be sustained.

4.2.7 Invisible Trade Transactions

i) The remittable fees for licence (trademarks, patent, etc) or technical services agreements shall range between 1.0 and 5.0 per cent of net sales value or profit before tax where net sales value is not applicable. Similarly, permissible management service fees in respect of projects where no profit is anticipated during the early years shall range from 1.0 to 2.0 per cent net of sales during the first three to five years only. In the case of Hotel services, a basic fee or lump sum not exceeding 12% of Gross Operating Profit (GOP) shall be applicable. The certificate of registration issued by NOTAP shall be one of the documentation requirements for the purpose of procuring foreign exchange for these types of transactions.

ii) Remittable consultancy fees shall be a maximum of 5.0 per cent of project cost and limited to projects of very high technology content for which indigenous expertise is not available. Service agreements for such high technology joint ventures shall continue to include a schedule for the training of Nigerian personnel for eventual take-over. In addition, Nigeria professionals shall be involved in the project implementation from inception.

iii) Permissible royalty in respect of know-how, patents and other industrial property rights shall range from 1.0 to 5.0 per cent of net sales.

iv) Foreign exchange remittance in the IFEM shall be allowed in respect of bona-fide Nigerian students pursuing courses of GCE 'A' level and above in overseas institutions based on the prescribed documentation, including the Embassy/High Commission letter.

v) Authorised Dealers are required to exercise prudence and scrutinise all requests for Personal Travel Allowance by residents and Business Trip Allowance by companies incorporated in Nigeria and ensure that only valid transactions are entertained.

vi) Foreign nationals may remit 100% of their income net of tax as Personal Home Remittances (PHR) subject to the usual documentation requirements.

4.2.8 Miscellaneous Policy Measures

i) The declaration on Forms TM & TE of foreign currency imports and exports, respectively, of U.S. $5,000.00 (Five thousand US dollars) and above or its equivalent is required for statistical purposes only.

ii) Travellers entering and leaving Nigeria are required to declare any amount above N10,000.00 (Ten thousand Naira only) in their possession at the time of arrival in or departure from the country.

iii) All contracts entered into in Nigeria shall continue to be denominated in Naira only.

vii) Only hotels registered as Authorised Buyers shall receive from foreign visitors payment of hotel bills in foreign currency. However, payment of such bills in foreign currency shall be optional and at the discretion of the foreign visitors making the payment.

APPENDICES
APPENDIX 1
PRUDENTIAL GUIDELINES FOR LICENSED BANKS

Without prejudice to the requirements of the Statements of Accounting Standard on Accounting by Banks and Non-Banks Financial Institutions (Part 1) to be issued by the Nigerian Accounting Standards Board (NASB) in the near future, all licensed banks shall be required to adhere to the prudential guidelines enunciated in this circular for reviewing and reporting their performances, with immediate effect. In view of the international nature of banking, the guidelines are based on practices endorsed by reputable international financial institutions and regulatory authorities. These guidelines should be regarded as minimum requirements and licensed banks, which already have more stringent policies and practices in place, are encouraged to continue with them.

2. Credit Portfolio Classification System

2.1 Licensed banks should review their credit portfolio continuously (at least once in a quarter) with a view to recognising any deterioration in credit quality. Such reviews should systematically and realistically classify banks' credit exposures based on the perceived risks of default. In order to facilitate comparability of banks' classification of their credit portfolios, the assessment of risk of default should be based on criteria which should include, but are not limited to, repayment performance, borrower's repayment capacity on the basis of current financial condition and net realisable

value of collateral.

2.2 Credit facilities (which include loans, advances, overdrafts, commercial papers, bankers' acceptances, bills discounted, with a bank's credit risks) should be classified as either "performing" or "non-performing" as defined below:

a) a credit facility is deemed to be performing if payment of both principal and interest are up to date in accordance with the agreed repayment terms.

b) a credit facility should be deemed as non-performing when any of the following conditions exists:

i) interest on principal is due and unpaid for 90 days or more.

ii) interest payments equal to 90 days interest or more have been capitalised, rescheduled or rolled over into a new loan (except where facilities have been reclassified in 2.3 below)

2.3 The practice whereby some licensed banks merely renew, reschedule or roll-over non-performing credit facilities without taking into consideration the repayment capacity of the borrower is objectionable and unacceptable. Consequently, before a credit facility already classified as "non-performing" can be reclassified as "performing", the borrower must effect cash payment such that outstanding unpaid interest does not exceed 90 days.

2.4 Non-performing credit facilities should be classified into three categories namely, sub-standard, doubtful or lost on the basis of the criteria specified below:

a) Sub-standard

The following objective and subjective criteria should be used to identify sub-standard credit facilities:

i) Objective criteria: facilities as defined in 2.2(b) on which unpaid principal and/or interest remain outstanding for more than 90 days but less than 180 days.

ii) Subjective criteria: credit facilities which display well defined weaknesses which could affect the ability of borrowers to repay such as inadequate cash flow to service, undercapitalisation or insufficient working capital, absence of adequate financial information or collateral documentation, irregular payment of principal and/or interest, and inactive accounts where withdrawals exceed repayments or where repayments can hardly cover interest charges.

b) Doubtful

The following objective and subjective crieteria should be used to identify doubtful credit facilities:

i) Objective criteria: facilities on which unpaid principal and/or interest remain outstanding for at least 180 days but less than 360 days and are not secured by legal title to leased assets or perfected realisable collateral in the process of collection or realisation.

ii) Subjective criteria: facilities which in addition to the weakness associated with sub-standard credit facilities reflect that full repayment of the debt is not certain or that realisable collateral values will be insufficient to cover bank's exposure.

c) Lost Credit facilities

The following objective and subjective criteria should be used to identity lost credit facilities:

i) Objective criteria: facilities on which unpaid principals and/or interest remain outstanding for 360 days or more and are not secured by legal title to leased assets or perfected realisable collateral in the course of collection or realisation.

ii) subjective criteria: facilities which in addition to the weakness associated with

doubtful credit facilities, are considered uncollectible and are of such little value that continuation as a bankable asset is unrealistic such as facilities that have been abandoned, facilities secured with unmarketable and unrealisable securities and facilities extended to judgement debtors with no means of foreclosable collateral to settle debts.

2.5 Banks are required to adopt the criteria specified in paragraphs 2.1 to 2.4 to classify their credit portfolios in order to reflect the true accounting values of their credit facilities. Licensed banks should note that the Central Bank of Nigeria reserves the right to object to the classification of any credit facility and to prescribe the classification it considers appropriate for such credit facility.

3. Provision for Non-performing facilities

3.1 Licensed banks are required to make adequate provisions for perceived losses based on the credit portfolio classification system prescribed in paragraph 2 in order to reflect their true financial condition. Two types of provisions (that is specific and general) are considered adequate to achieve this objective. Specific provisions are made on the basis of perceived risk of default on specific credit facilities while general provisions are made in recognition of the fact that even performing credit facilities harbour some risk of loss no matter how small. Consequently, all licensed banks shall be required to make specific provisions for non-performing credits as specified below:

i) For facilities classified as Sub-standard, Doubtful or Lost:

* Interest overdue by more than 90 days should be suspended and recognised on cash basis only.

* principal repayments that are overdue by more than 90 days should be fully provided for and recognised on cash basis only.

ii) For principal repayments not yet due on non-performing credit facilities, provision should be made as follows:

* Sub-standard Credit Facilities: 10% of the outstanding balance.

* Doubtful Credit Facilities: 50% of the outstanding balance.
* Lost Credit Facilities: 100% of the outstanding balance.

3.2 For prudential purpose, provisioning as prescribed in 3.1 should only take cognisance of realisable tangible security (with perfected legal title) in the course of collection or realisation. Consequently, collateral values should be recognised on the following basis:

i) For credit exposure where the principal repayment is in arrears by more than six months, the outstanding unprovided principal should not exceed 50% of the estimated net realisable value of the collateral security.

ii) For credit exposure where the principal repayment is in arrears by more than one year, there should be no outstanding unprovided portion of the credit facility irrespective of the estimated net realisable value of the security held.

For a credit exposure secured by a floating charge or by an unperfected or equitable charge over tangible security, it should be treated as an unsecured credit and no account should be taken of such security held in determining the provision for loss to be made.

3.3 General Provision

Each licensed bank is required to make a general provision of at least 1% of risk assets not specifically provided for.

4. Credit Portfolio Disclosure Requirement

i) Each licensed bank is

required to provide in its audited financial statements, an analysis of its credit portfolio into "performing" and "non-performing" as defined in paragraph 2.2 and 2.4

ii) The amount of provision for deterioration in credit quality (that is, losses) should be segregated between principal and interest.

iii) A maturity profile of credit facilities based on contracted repayment programme, should be provided along with the maturity profile of deposit liabilities in the financial statement.

5. Interest Accrual

5.1 It is the responsibility of bank management to recognise revenues when they are earned or realised and make provision for all losses as soon as they can be reasonably estimated. However, experience revealed a wide diversity amongst licensed banks on income recognition. While few banks cease accruing interest on non-performing credit facilities after three months, some after six months or one year, some do not appreciate the need to suspend interest on such facilities.

5.2 In order to ensure the reliability of published operating results, the following criteria should be adopted by all licensed banks for the treatment of interest on non-performing credit facilities:

i) All categories of non-performing credit facilities should automatically be placed on non-accrual status, that is, interest due thereon should not be recognised as income.

ii) All interest previously accrued and uncollected but taken into revenue should be reversed and credited into suspense account specifically created for this purpose which should be called "interest in suspense account" unless paid in cash by the borrower. Future interest charges should also be credited into same account until such facilities begin to perform.

iii) Once the facilities begin to perform, interest previously suspended and provisions previously made against principal debts should be recognised on cash basis only. Before a "non-performing facility" can be re-classified as "performing", unpaid interest outstanding should not exceed 90 days.

6.0 Classification of Other Assets

6.1 The term "Other Assets" relate to those asset items not shown separately in the balance sheet of a bank. Those items include, Impersonal Accounts (of various descriptions), Suspense Accounts such as frauds and cashiers' shortages, cheque purchased, uncleared effects and inter-branch items. More often than not, the accounts usually grouped together as "Other Assets" contain fictitious or intangible assets. The accounts could contain many long outstanding items, the origins of which had been long forgotten, untraceable as well as unreconciliable. In situation like these, the items if not material should be written off and where material (i.e. at least 10% of aggregate balance of Other Assets) should be classified as below. It should be noted that items enumerated below are by no means exhaustive:

a) Sub-standard

- Cheques purchased and uncleared effects outstanding after the permissible clearing period.
- Fraud cases of up to 6 months old and under police investigation regardless of the likely outcome of the cases.
- Inter-branch items of between 2 months to 3 months.
- All other intangible suspense accounts existing in the books for up to 3 months.

A minimum provision of 10 per cent should be made for "Other Assets" items classified as sub-standard.

b) Doubtful

The above listed features must

have been aggravated and are likely to result in losses higher than recommended for sub-standard items. Items for doubtful classification should include, but are not limited to the following:

- Cheques purchased of between 3 to 6 months old but which had been withdrawn or cancelled and substituted with new ones. Similar treatment should be accorded to uncleared effects for which values had been given.

- Outstanding fraud cases of 6 to 12 months old and with slim chances of full recoveries.

- Inter-branch items outstanding for between 3 to 6 months.

- All other intangible suspense accounts outstanding for between 6 months and 12 months.

- A minimum of 50% provision should be made for "Other Assets" items classified as doubtful.

c) Lost

Items for lost classification should include, but are not limited to the following:

* Cheques purchased and uncleared effects over 6 months old and for which values had been given.

* Outstanding fraud cases over 12 months and involving protracted litigation.

* Inter-branch items over 6 months old whether or not the origins are known.

* All other intangible suspense accounts over 12 months old.

Full provision (i.e. 100 per cent) should be accorded to items classified lost.

7.0 Off-balance Sheet Engagements

7.1 A proper appraisal of off-balance sheet engagements should be undertaken with a view to determining the extent of loss a bank may likely sustain. Off-balance sheet items include letters of Credit, Bonds, Guarantees, Indemnities, Acceptances, and Pending or Protracted Litigation (the outcome of which could not be easily determined).

7.2 The following factors should be taken into consideration in recognising losses on off-balances sheet engagements.

* Date liability was incurred
* Expiry date
* Security pledged
* Performance of other facilities being enjoyed by the customer, e.g. loans and advances.

Full provisions must be made for any loss that may arise from off-balance sheet transactions.

7.3 Off-balace sheet engagements should not form part of balance sheet totals while their disclosures in note form should distinguish between:

a) direct credit substitutes, such as guarantees, acceptance and standby letters of credit serving as guarantees;

b) transaction-related contingencies, such as bid bonds, performance guarantees and standby letters of credit related to particular transactions;

c) short-term self-liquidating trade related contingencies resulting from the movements of goods; and

d) other contingencies.

APPENDIX II

BANK RETURNS

a) Monthly Returns

i) Profit on Interest Rates;

ii) Statement of Assets and Liabilities;

iii) Break-down of "Other" Liabilities;

iv) Break-down of "Other" assets

v) Report on External Assets and Liabilities;

vi) Schedule of Placements with Other Banks;

vii) Schedule of Takings from Other Banks;

viii) Schedule of Negotiable certificates of Deposit (NCDs) Held;

ix) Schedule of Negotiable Certificates of Deposit (NCDs) Issued;

x) Statement of Maturity Profile of Assets and

Liabilities;

xi) Report on Total Credit Granted;

xii) Report on Credit Allocation by Sectors, Borrowers and Interest Rates;

xiii) Report on Cost of Funds;

xiv) Report on Deposit Ownership;

xv) Report on lending above the Statutory Limit;

xvi) Schedule of Foreign Exchange Purchases from Other Banks;

xvii) Schedule of Foreign Exchange Sales to Other banks;

b) Quarterly Returns

xviii) Profit and Loss Account;

xix) Report on Total Credit Granted;

xx) Report on Structure of Deposits;

xxi) Report on Non-performing Credits;

xxii) Report on Non-performing "Other" Assets;

xxiii) Report on Non-performing Off-Balance Sheet Engagements;

xxiv) Report on Non-performing Credit by Sector;

xxv) Report on Credits to Officers, Director, Principal Shareholders and their related interests;

xxvi) Report on top Users of Funds;

xxvii) Foreign exchange Interest Repatriation and Distribution;

xxviii) Report on Distribution of Naira Proceeds of Interest Repatriated;

xxix) Foreign Exchange Holdings by Authorised Dealers.

c) Semi-Annual Returns

xxx) Report on Investment in Shares;

xxxi) Report on Corporate profile;

xxxii) Report on Branch Network;

xxxiii) Report on Bank's Directors;

xxxiv) Report on Bank's Shareholders; and

xxxv) Report on Management and Top Officers.

APPENDIX III

MID-MONTH RETURNS ON ASSETS AND LIABILITIES - FORM MMBR 100

BANK NAME: **BANK CODE:**

AS AT CODE:	DETAILS	N'000	N'000
92000	**TOTAL LIQUID ASSETS** (as in Liquidity Ratio)		
92100	Vault Cash		
92200	Total balance at CBN:		
92210	Cash Reserve requirement		
92220	Shortfall/Excess Credit		
92230	Other Balance with CBN		
92300	Other Liquid Assets		
92400	**TOTAL DEPOSIT LIABILITIES**		
92410	Private Sector Deposits		
92411	Demand		
92412	Savings		
92413	Time		
92414	Others (including Deposit Certificates, Notes, etc.)		
92420	Government Sector Deposit		

AS AT CODE: N'000	DETAILS		N'000
92421	Demand Deposits of:		
92422	Federal Government		
92423	State Governments		
92424	Local Governments		
92425	Time and Savings Deposit of:		
92426	Federal Government		
92427	State Governments		
92428	Local Governments		
92429	Domiciliary Deposit		
92430	Demand		
92431	Others		
92510	**TOTAL LOANS & ADVANCES**		
92520	Bills Discounted		
92530	Investment		
92531	Treasury Bills		
92532	Treasury Certificates		
92533	Eligible Development Stocks		
92534	Other Investments		
92540	Money at Call Outside Banks, Term Loan, leases & Overdrafts		
92600	**FOREIGN ASSETS & LIABILITIES POSITION**		
92610	Foreign Assets (Gross)		
92620	Foreign Liabilities (Gross)		

APPENDIX IV

MID-MONTH REPORT ON INTEREST RATES FORM MMBR 200

BANK NAME: **BANK CODE:**

AS AT:
Details
Prime Lending Rate
Maximum Lending Rate
Deposit Rates
Savings
Call
Time/Term
7 Days Notice
30 Days Maturity
3 Months Maturity
6 Months Maturity
12 Months maturity
Over 12 Months Maturity
Demand Deposit (Current Account)
Other Deposit Certificates/Notes
7 Days Notice
30 Days Maturity
2 Months Maturity
6 Months Maturity
12 Months Maturity
Over 12 Months Maturity

ECONOMIC DEVELOPMENT IN NIGERIA: A REVIEW OF EXPERIENCE

By
Prof. Olu Ajakaiye*

Prof. Olu Ajakaiye

INTRODUCTION

The national economic development aspiration in Nigeria has remained that of altering the structure of production and consumption activities so as to diversify the economic base, reduce dependence on oil and on imports all in a bid to put the economy back on a path of self sustaining, inclusive and non-inflationary growth, thereby reducing poverty. In other words, in Nigeria, it has always been realised that economic development requires growth with structural and technological change. In considering the Nigerian economic development experience, therefore, it should be instrumental to examine the growth and structural changes in certain major aspects of the economy during the last decade of the 1990s. For the present purposes, therefore, attention is focused on the following aspects of the economy:

* Structure and growth of output, i.e., gross domestic product (gdp);
* Structure and growth of gross domestic income, i.e., value added;
* Structure and growth of gross domestic expenditure;
* Composition of investment expenditure, exports and imports;
* Import intensities of production, consumption and investment; and
* Relationships between savings and investments.

The revelations from these analyses should provide useful basis for policy recommendations.

Accordingly, the rest of this paper is organised as follows. In the next section, the structure and growth of output, proxied by real gdp, are analysed. Section III contains analyses of structure and growth of gross domestic income. Specifically, the shares of compensation of employees (wage income), operating surplus (profit income) consumption of fixed capital (depreciation allowance), indirect business taxes and subsidies are analysed. Also, the growth rates of each of these components are examined in order to gain insights into their character and the implications for the goal of attaining growth with poverty reduction. Section IV focuses on structure and growth of gross domestic expenditure. The shares of government and private consumption expenditure, investment expenditure, exports and imports in total gross domestic expenditure are analysed. Also, the growth rates of each of these components are examined to provide a basis for determining the compatibility of the pattern of expenditure with that required for sustainable growth and development. Furthermore, the composition of investment expenditure, exports and imports as well as the trend of import dependence of production, investment and consumption activities are examined. Finally, in section V, the trend of savings-investment gap, savings rate and investment rates are analysed. The paper is concluded in section VI with summary of findings and policy recommendations.

II STRUCTURE AND GROWTH OF GROSS DOMESTIC PRODUCT

In this section, we are concerned with the analysis of the **structure and growth of output.** For the present purposes, the various activity sectors of the economy are aggregated to three, namely, primary, secondary and tertiary sectors. The **primary sector** is composed of crop agriculture, livestock, forestry, fishing and mining. **Secondary sector** is, composed of manufacturing, utilities and construction activities. **Tertiary sector** is composed of the service activities including

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transport, communication, distributive trade, hotel and restaurant, finance and insurance, real estate and other business services, housing, community, social and personal services as well as government services. In an underdeveloped economy, the expectation is that the contributions of primary sector to output, employment and income will tend to dominate those of

Table 1: Percentage Distribution of Real GDP by Sectoral Groups, 1990 – 99

Sectoral Group	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Primary Sectors (Agriculture)	39.05	38.60	38.26	37.78	38.18	38.75	39.00	39.40	40.07	40.64
Primary Sectors (Mining)	13.18	13.73	13.70	13.38	12.88	12.93	13.35	13.14	12.25	11.46
Total Primary Sectors	52.23	52.33	51.95	51.16	51.06	51.67	52.35	52.54	52.32	52.10
Secondary	10.61	10.94	10.34	9.88	9.77	9.23	9.02	8.89	8.55	8.50
Tertiary	37.15	36.73	37.70	38.96	39.17	39.10	38.62	38.57	39.13	39.40
Total value Added	100	100	100	100	100	100	100	100	100	100
Diversification Index	1.31	1.31	1.31	1.32	1.33	1.34	1.34	1.35	1.36	1.36

Source: Underlying data obtained from Federal Office of Statistics

Table 2: Percentage Growth Rates of Real GDP by Sectoral Groups, 1990 – 99

Sectoral Group	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Primary Sectors (Agriculture)	4.23	3.53	2.05	1.36	2.41	3.66	4.08	4.20	4.04	4.19
Primary Sectors (Mining)	5.51	9.07	2.71	0.30	-2.48	2.51	6.82	1.51	-4.60	-3.97
Total Primary Sectors	4.55	4.93	2.23	1.08	1.13	3.37	4.76	3.51	1.88	2.27
Secondary	7.31	7.96	-2.64	-1.97	0.22	-3.52	1.08	1.63	-1.60	2.11
Tertiary	14.07	3.52	5.72	6.06	1.87	1.96	2.15	3.01	3.80	3.41
Total value Added	8.2	4.73	2.98	2.64	1.33	2.14	3.40	3.15	2.31	2.71

Source: Underlying data obtained from Federal Office of Statistics

secondary and tertiary sectors. As the economy develops, however, the expectation is that the contributions of the primary sector will decline while that of secondary will tend to increase. When the economy becomes advanced, the tendency is for the contributions of tertiary sector to increase, possibly exceeding that of the secondary. In essence, at the initial stages of development, the primary sector could lead in terms of contributions to production, employment and income. As the economy develops, the secondary sector should become the leading contributor to output, employment and income while in an advanced economy, the tertiary sector may become the leading contributor followed by secondary sector. Regardless of the stage of development, each of these sectors should be growing, albeit at differenr rates. A situation in which any one of them declines in absolute terms is inimical to smooth and orderly development of the economy.

II.1 Structure of GDP

Against this background, Nigerian situation can be examined. A look at Table 1 showing the percentage contributions of the three groups of sectors to total output for the period between 1990 and 1999 will reveal that the primary sector of the Nigerian economy was not only dominant but its contribution was, indeed, increasing. As can be seen from the Table, the rising trend of the contributions of the primary sector to output is really a reflection of the rising contribution of agriculture which was 39.05 per cent in 1990 and by 1999, its contribution had exceeded 40 per cent.

Turning to the trend of contributions of the secondary sector to output, the indication from Table 1 is that it had declined from over 10 per cent between 1990 and 1993 to 8.5 per cent by 1999. With respect to Tertiary sector, its contribution increased from around 37 per cent during the early 1990s to over 39 per cent by 1999. Finally, a look at the last row of Table 1 shows that the diversification index has increased systematically from 1.31 during the early 1990s to 1.36 by 1999 implying that, so far, the much desired goal of diversifying the economic base was yet to be reasonably achieved by the end of the 1990s. Indeed, there are indications that the modest gains in terms diversification of the productive base of the economy achieved during the 1970s when the diversification index was as low as 1.13 had been lost by the end of the 1990s.

II.2 Growth of GDP

Table 2 shows the pattern of growth of the economy. Clearly, the leading sector in terms of growth is the agricultural segment of the primary sector followed by the tertiary sector both of which registered positive growth rates throughout the period. A closer look at the Table will reveal that the mining segment of the primary sector registered large negative growth rates in 1994, 1998 and 1999 reflecting the unfavourable developments in the international oil market, especially, in terms of prices of crude petroleum. Growth performance of the secondary sector which was quite impressive in 1990 and 1991 became negative in 1992, 1993, 1995 and 1998. Furthermore, while the overall growth of output far exceeded the estimated population growth rate of around 2.8 per cent only between 1990 and 1992 as well as in 1996 and 1997 implying that it was impossible to sustain growth in per capita income throughout the period. This partly explains the growing poverty situation in the country during this period. Specifically, poverty level rose from 42.7 per cent in 1992 to 65.6 per cent in 1996 and it is projected to have risen to 70 per cent by 1999.

The indication from the structure and pattern of growth of output is that the Nigerian economy was characterised by excessive dominance of the primary sector followed rather closely by the tertiary sector with the secondary sector remaining rather minuscule. With this attribute persisting as at 1999, the indication is that the Nigerian economy has not been developing. Indeed, the fact that the share of agriculture was increasing during the 1990s whereas it should be declining suggests that the Nigerian economy was really undeveloping. Equally important is the indication that by 1999, Nigeria has become a trading outpost for goods produced elsewhere with little domestic transformation of the output of primary sectors by the secondary sectors. This is particularly so since the Nigerian agriculture is really peasantry and the high

contributions of tertiary sector to output suggest that the tertiary sector is not really servicing the Nigerian economy but, indeed, the economies of her trading partners.

III STRUCTURE AND GROWTH OF GROSS DOMESTIC INCOME

For the present purposes, income is decomposed into its components, namely, compensation of employees (wage income) and operating surplus (profit income), consumption of fixed capital (depreciation allowance), indirect taxes and subsidies. Analysis of the contributions of these components of income to the total and growth rates should provide insights into how inclusive the growth process has been. In particular, the relative shares of wages in total income should be indicative of the employment and welfare implications of growth and development of the economy.

III.1 Structure of GDI

Beginning with the structure of factor income, Table 3 reveals that the share of wage income in the total which peaked at 30.6 per cent in 1991 declined rather gradually until 1995 when it plummeted from over 26 per cent in the preceding year to about 11 per cent. It further declined to single digit in 1996 and 1997 before rising slightly to around 16 per cent in 1999. It should be realised that the relatively higher share of wage income in the total value added between 1990 and 1994 is not so much a reflection of rising level of employment but a consequence of the frequent increases in wage rates led by the public sector. The same is true of the slight increase in the share of wage income in total value added in 1999. This situation whereby the share of wages decline soon after increases in wage rates is indicative of an environment where cost-plus pricing is prevalent. Therefore, increases in workers' welfare arising from increases in nominal wage rates are transitory. A more durable increase in workers' welfare is to insist on competition in the long term while resisting temptation and pressures for unbridled price increases, especially those of universal intermediaries and basic social services.

The share of operating surplus (profit income) which was around 67 per cent between 1990 and 1991 increased to over 70 per cent between 1993 and 1994 after which it jumped to over 80 per cent for the rest of the period. The indication is that during this period, functional income distribution was worsened and growth of the economy could not have been inclusive. This situation also explains the rising poverty level during this period as mentioned earlier.

Table 3: Composition of Value Added, 1990–99 (in percentages)

Component	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Compensation of Employees	28.71	30.58	26.21	27.13	26.25	11.31	8.98	8.48	10.15	16.55
Operating Surplus	68.34	68.69	72.05	71.42	72.41	87.71	89.78	90.27	88.50	82.14
Consumption of Fixed Capital	2.73	2.49	1.57	1.29	1.26	0.87	0.68	0.62	0.72	0.68
Indirect Taxes	0.26	0.28	0.18	0.16	0.16	0.15	0.57	0.64	0.64	0.63
Subsidies	0.04	0.03	0.01	0.01	0.07	0.04	0.02	0.01	0.00	0.01
Total Value Added	100	100	100	100	100	100.00	100.00	100.00	100.00	100.00

Source: Underlying data obtained from Federal Office of Statistics

Another look at Table 3 will reveal that consumption of fixed capital (depreciation allowance), indirect taxes and subsidies were really minuscule throughout the period. The very low depreciation allowance suggests that there were no significant additions to national productive asset base and this partly explains the relatively low growth rate of gdp recorded from 1992 onwards. It should be observed that the share of indirect taxes in total income increased dramatically in 1996 and it has remained relatively higher since then. This is attributable to the impact of value added tax. This trend notwithstanding, the share of indirect tax in total is rather too low suggesting that Nigeria is largely under taxed. It also reflects the consequence of a collapsing secondary sector whose outputs are more susceptible to indirect taxation. Recall that agriculture and the tertiary sector, together, accounted for over 80 per cent of real gdp and that agriculture is generally peasantry while the tertiary sector is dominated by distributive trade which is largely informal. Thus, over 80 per cent of output is not susceptible to indirect taxation. In order to increase the contribution of indirect taxes to real income, therefore, all efforts must be made to resuscitate the secondary sector activities in Nigeria. Presumably, if the secondary sector activities are rekindled and the revenue base is thoroughly diversified, the pressure for resource control may subside considerably as oil revenue will account for a relatively small proportion of total government revenue and national income in general.

III.2 Growth of GDI

Turning to the growth rates of wage and profit incomes, shown in Table 4, it can be seen that wage income registered negative growth rates in 1992 and between 1995 and 1997 before recovering in 1998 and 1999 arising from the increase in wage rate. On the other hand, operating surplus grew throughout the period with the exception of 1999. Again, this growth pattern is characteristic of an economy where functional income distribution is skewed in favour of profit income earners and growth cannot be inclusive in such a circumstance.

IV. STRUCTURE AND GROWTH OF GROSS DOMESTIC EXPENDITURE

Analysis of the structure and growth of gross domestic expenditure is considered pertinent because it will further illuminate the structure of the economy as a whole as well as its growth potential. In this connection, the following elements of gross domestic expenditure are examined, viz, private and

Table 4: Growth Rates of Value Added Components, 1990–99 (in percentages)

Component	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Compensation of Employees	13.94	11.55	-11.79	6.24	-2.05	-55.98	-17.50	-2.58	22.50	67.50
Operating Surplus	6.30	2.23	11.18	1.74	2.65	23.76	6.31	3.79	0.310	-4.68
Consumption of Fixed Capital	0.03	-4.36	-35.21	-15.44	-1.46	-29.51	-18.22	-5.70	17.70	-2.58
Indirect Taxes	4.63	13.07	-33.04	-10.25	0.56	-2.75	291.12	15.00	1.95	1.48
Subsidies	-4.69	-5.01	-72.26	-35.47	1201.9	-49.73	-36.99	-61.74	-40.82	48.04
Total value Added	8.20	4.76	-2.90	2.63	1.25	2.17	3.86	3.23	2.31	2.70

Source: Underlying data obtained from Federal Office of Statistics

government consumption expenditure, gross capital formation (investment expenditure), exports and imports. Investment expenditure is further decomposed into building and construction, land development, machinery and equipment, transport equipment and breeding stock. Also, exports are decomposed into the familiar oil and non-oil exports. Imports can be decomposed in a number of ways depending on the purpose. For the present purposes, it is instrumental to decompose imports according to end-use, viz, consumer goods, capital goods, raw materials and miscellaneous items. On the basis of this, it is possible to obtain the following import dependence ratios, namely, import/consumption, import/investment and import/raw material ratios.

IV.1 Structure of GDE

Table 5 shows the composition of gross domestic expenditure. As can be seen from the Table, by far the largest component of Nigeria's gross domestic expenditure is consumption expenditure as this component accounted for well over 80 per cent of total gross domestic expenditure between 1991 and 1999. What is more, private consumption expenditure is really the dominant component of total gross domestic expenditure implying that majority of Nigerians spend a large part of their income on consumption. Recalling that operating surplus (profit income) dominated gross domestic income, this revelation suggests that virtually all classes of Nigerians devote a large part of their income to consumption and a lower part to savings. Table 5 also shows that gross capital formation, a proxy for gross investment, accounted for less than 6 per cent of gross domestic expenditure for most of the period. Export which accounted for about 20 per cent of gross domestic expenditure in 1990 declined to around 10 per cent by 1999 while the proportion of imports in total gross domestic expenditure was rather unstable between 1990 and 1994 after which it increased systematically between 1995 and 1997 before declining in subsequent years to about 5 per cent in 1999.

IV.2 Growth of GDE

Turning to growth rates of the components of gross domestic expenditure, Table 6 shows that government consumption expenditure grew throughout the period except in 1995 and 1996 when it declined significantly. On the other hand, the pattern of growth of private consumption expenditure was rather erratic. The same is true of the pattern of growth of gross capital formation, exports and imports.

IV.3 Composition of Gross Domestic Capital Formation

Table 5: Composition of Gross Domestic Expenditure, 1990–99 (in percentages)

Component	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Government Consumption Expenditure	8.02	8.29	9.06	10.04	20.27	15.97	14.16	14.77	15.66	26.08
Private Consumption Expenditure	69.72	73.72	76.80	75.82	66.81	71.93	73.84	70.40	75.38	62.59
Gross Capital Formation	6.33	5.83	5.71	6.15	5.76	4.95	5.11	5.38	5.29	5.40
Exports	19.99	17.23	12.62	12.92	10.97	10.44	10.73	15.61	9.30	10.85
Imports	4.06	5.07	4.19	4.93	3.82	3.29	3.84	6.16	5.63	4.92
Total Domestic Expenditure	100	100	100	100	100	100	100	100	100	100

Source: Underlying data obtained from Federal Office of Statistics

Table 6: Percentage Growth Rates of Domestic Expenditure, 1990-99 (in percentages)

Component	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Government Consumption Expenditure	10.89	8.24	12.49	13.70	104.39	-19.48	-7.93	7.68	8.46	71.11
Private Consumption Expenditure	5.05	10.75	7.21	1.32	-10.78	10.00	6.61	-1.58	9.56	-14.73
Gross Capital Formation	31.96	-3.26	0.14	10.71	-4.22	-12.13	7.24	8.73	0.49	4.74
Exports	14.36	-9.71	-24.65	5.10	-14.03	-2.81	6.82	50.13	-39.05	19.80
Imports	19.56	30.55	14.97	20.84	-21.60	-11.87	21.16	65.60	-6.54	-10.12
Total Domestic Expenditure	8.20	4.75	2.90	2.63	1.25	2.17	3.86	3.23	2.31	2.70

Source: Underlying data obtained from Federal Office of Statistics

Table 7: Composition of Capital Formation, 1990-99 (in percentages)

Component of Capital Formation	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Building and Construction	61.01	59.90	62.11	58.89	63.31	74.00	69.84	68.27	71.71	71.01
Land Development	12.30	11.19	11.60	11.00	11.83	13.83	13.03	12.75	13.39	13.26
Transport Equipment	7.55	8.18	7.42	8.53	7.02	3.59	3.38	7.03	4.50	4.76
Machinery and Equipment	18.73	20.30	18.42	21.18	17.41	8.08	13.27	11.49	9.94	10.52
Breeding Stock	0.41	0.43	0.44	0.40	0.42	0.50	0.48	0.45	0.46	0.45
Total	100	100	100	100	100	100	100	100	100	100

Source: Underlying data obtained from Federal Office of Statistics

With respect to composition of gross capital formation, exports and imports Tables 7, 8 and 9 are quite revealing. From Table 7, it can be seen that building and construction dominated gross capital formation during this period accounting for between 60 and 70 per cent of the total throughout the period. Given the activities of the erstwhile Petroleum Trust Fund in the area of road construction in some parts of the country as well as the massive construction work in Abuja, the predominance of building and construction in total gross capital formation should be understandable. The revelation that land development accounted for between 11 and 13 per cent of gross capital formation despite the fact that agriculture accounted for over 40 per cent of gross domestic product during the period

is also understandable in view of the peasantry nature of Nigerian agriculture. Presumably, if the Nigerian agriculture were dominated by modern holdings, the situation would have been different.

Machinery and equipment are required largely by the secondary sector. Its share which peaked at around 21 per cent in 1993 before declining to a relatively small share of gross capital formation by the end of the period indicates that investment in this sector has been declining, especially since 1995 and this must have accounted for its relatively small contribution to gross domestic product. The minuscule share of transport equipment in total capital formation in an economy where tertiary sector is a large contributor to gdp suggests that, without a deliberate reinvigoration effort, the growth prospects of this sector and, indeed, the economy as a whole is not bright.

IV.4 Composition of Export and Imports

Turning to the composition of exports, Table 8 shows that oil export is decidedly dominant. The clear indication is that not much had been achieved in the area of diversifying the export base. With respect to the structure of imports, Table 9 reveals that the share of consumer goods in total imports increased systematically throughout the period from 25 per cent in 1991 to about 40 per cent in 1999. Perhaps more worrisome is the revelation that consumer non-durable goods accounted for the bulk of imported consumer goods. The share of raw materials rose systematically and peaked at 45 per cent in 1995 before declining to about 37 per cent in 1999. On the other hand, the share of capital goods declined from over 40 per cent in 1990 to 23 per cent by 1999. This pattern of import in an economy with a stunted secondary sector explains the relatively low investment expenditures in capital goods. Also, the relatively high proportion of consumer goods in total imports suggests that the secondary sector is unable to meet the domestic demands for consumer goods, especially consumer non-durables. This is another evidence in support of the earlier view that the Nigerian tertiary sector, which is dominated by distributive trade, is really servicing the economies of Nigerian trading partners, i.e. the European and Asian economies.

IV.5 Import Dependence Ratios

Table 10 shows the import dependence ratios for consumption, investment and raw materials. A quick look at the Table will reveal that Nigerian consumers, producers and investors are chronically dependent on imports. For instance, despite the fact that agriculture dominates output, import-consumption ratio still averaged over 10 per cent throughout the period implying that out of every naira of consumer expenditure, at least 10 kobo is on imported consumer goods, especially the consumer non-durable goods. Also, import-raw material ratio which peaked at 57.92 per cent in 1995 declined to 27 per cent by 1999. On the surface, this is a good development but when combined with the revelation that the secondary sector has been shrinking over the same period with the few surviving ones having to cope with low level of capacity utilisation, the situation may not be quite encouraging. Finally, the import investment ratio is even more precarious av-

Table 8: Composition of Exports 1990–99 (in percentages)

Component	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Oil Exports	97.03	96.15	97.94	97.70	97.40	97.57	98.22	97.65	95.47	98.36
Non-Oil Exports	2.97	3.85	2.06	2.30	2.60	2.43	1.78	2.36	4.53	1.64
Total Exports	100	100	100	100	100	100	100	100	100	100

Source: Underlying data obtained from Federal Office of Statistics

eraging over 80 per cent during the period. This situation suggests that the capital goods segment of the secondary sector has completely collapsed. Therefore, in order to initiate sustainable growth of the Nigerian economy in the short run, a large proportion of the foreign exchange available should be used to import capital goods and raw materials. In the medium to long term, the capital and intermediate goods producing segments of the secondary sector should be vigorously reactivated.

Table 9: Percentage Distribution of Imports by End-Use, 1990-99

End-Use of Imports	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Consumer Durable	3.20	4.20	3.20	4.20	3.49	3.10	2.80	3.00	3.10	3.60
Consumer Non-Durable	23.50	20.60	30.60	30.70	32.41	30.00	35.90	34.50	35.90	36.40
Total Consumer Goods	26.70	24.80	33.80	34.90	35.90	33.10	38.70	37.50	39.00	39.99
Capital Goods	50.50	38.00	31.70	26.40	24.76	21.50	19.20	20.40	19.90	23.00
Raw Materials	32.77	36.80	33.90	38.60	39.04	45.30	42.00	41.80	40.80	36.80
Miscellaneous	0.03	0.40	0.60	0.10	0.30	0.10	0.10	0.30	0.30	0.20
Total Import	100	100	100	100	100	100.00	100.00	100.00	100.00	100.00

Source: Underlying data obtained from Federal Office of Statistics

V. SAVINGS AND INVESTMENT PROFILE

Analysis of the structure of gross domestic product indicates that the Nigerian economy is dominated by primary and tertiary sectors while the secondary sector is essentially stunted. Analysis of the structure of gross domestic income shows that operating surplus is dominant providing a basis for expecting that savings rate should be very high. Meanwhile, analysis of the structure of gross domestic expenditure reveals that consumption expenditure is very dominant while investment expenditure is rather minuscule. Clearly, low investment does not necessarily imply low savings. In order to ascertain the true situation, it should be instrumental to examine the relationship between savings and investment. For this purpose, national savings, national investment, savings-investment gap, savings/gdp ratio and investment/gdp ratio will be analysed.

V.1 Savings-Investment Gap

Against this background, Table 11 shows the trend of real national savings and investment as well as savings-investment gap for the period between 1999 and 1999. From the Table, it can be seen that national savings exceeded national investment throughout the period with the exception of 1992. A careful perusal of the 1992 situation reveals that savings actually collapsed during the year as a result of the unprecedented capital transfers to the rest of the world which was over N8.6 billion compared to N4.2 billion in 1991. Indeed, investment/gdp ratio actually fell from 5.83 per cent in 1991 to 5.7 per cent in 1992. Notice also that the savings/gdp ratios were rather too low for an economy where operating surplus accounted for between 70 and 80 per cent of gdp. What is more, this rather low savings could not be transformed into investment as investment/gdp ratios were even lower with the exception of 1992 for reasons already mentioned.

Table 10: Import Dependence Ratios, 1990-99

Import Dependence Ratio	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Import - Consumption Ratio	7.32	9.45	11.40	10.23	7.40	15.00	8.64	12.17	11.03	10.88
Import - Investment Ratio	59.48	95.46	76.99	53.72	46.81	141.40	66.04	83.75	86.12	86.64
Import - Intermediate Input ratio	19.83	35.76	35.17	33.06	18.81	57.92	27.99	36.66	34.00	27.05

Source: Underlying data obtained from Federal Office of Statistics

Clearly, Nigeria is a low savings and even lower investment economy. In order to get out of this low-savings-lower-investment trap, it is necessary to vigorously pursue policies and programmes that will encourage investment thereby transforming Nigeria from an economy where national savings are low and yet it exceeds investment into one where investment is large and it exceeds high national savings. It is equally important to ensure that a large proportion of the investment goes to the secondary sector, especially the manufacturing activities that produce intermediate and capital goods. This way, the prevailing situation whereby investment is heavily dependent on imports will be reversed. Also, this way, the prevailing situation whereby the multiplier effects of economic activities are leaked out of the country through excessive dependence on imports for consumption, production and investment activities will be reversed and the benefits of the employment and income generated by these activities will be internalised. Consequently, the disappointing economic development experience will be replaced by a satisfactory one where the economic base will be effectively diversified away from oil and from imports and the economy will be returned to a sustainable, self-reliant and non-inflationary growth path, i.e. growth with structural and technological change.

The challenge to all stakeholders in Nigerian development, therefore, is how to rekindle investment in the Nigerian economy in ways compatible with increased contribution of the secondary sector to output and employment, increased growth rate of output and income, diversified productive base of the economy, reduced dependence on oil and on imports thereby increasing national savings which will further lead to increased investment. In doing so, it should be instrumental to examine the profiles of certain key economic variables that influence investment in Nigeria. Towards this end, the profiles of interest rates, inflation rates, growth of credit to the economy, growth of credit to private and public sectors, sectoral distribution of credit to the economy as well as the maturity structure of bank loans and advances are examined. Also, the exchange rates profile and the pattern of foreign exchange allocation by end-users are examined.

V.2 Profile of Interest and Exchange Rates

Beginning with interest rates structure and the profile of inflation rates, Table 12 shows that interest rates on savings declined from 17.8 per cent in 1990 to 5.3 per cent in 1999. Looking at the inflation rate profile during this period, it can be seen that real interest rates on savings deposits were negative throughout the period excepting 1990 and 1991. The indication, therefore, is that the interest rate on savings during this period discouraged savings deposits. Indeed, several banks exhibited hostile attitudes to small savers.

On the other hand, interest rates on loans were generally very

high throughout the period under review. Meanwhile, the minimum re-discount rate (MRR) which peaked at 26 per cent in 1993 was reduced to 13.5 per cent in 1994 and it remained constant untill 1999 when it was raised again to 18 per cent. Notice the very high and widening spread between savings and lending rates which peaked at 22.4 per cent in 1993 before declining to 7.9 per cent in 1994. Thereafter, it rose systematically to reach about 22 per cent by 1999.

Clearly, the interest rates on loans that prevailed in Nigeria during this period tended to discourage investment in the primary and secondary sectors of the economy while encouraging tertiary sector activities. Foremost, an attribute of the distributive trade operators who deal mainly in imported finished goods is that they have short turnaround time, which does not exceed 3 months. For the secondary sector operator, the minimum turnaround time is six months while the average could be much higher if the other constraints to secondary sector operations are taken into account. The implication is that the effective bank lending rate is more affordable by the traders compared to the manufacturers who dominate the secondary sector. Secondly and probably more importantly, low effective bank lending rate to the traders compared to the secondary sector operator make the locally produced goods less competitive compared to the imported alternatives. Meanwhile, it has been mentioned that the Nigerian primary sector is dominated by agriculture which is basically peasantry. Given the low literacy rates in the rural areas, these peasants face structural problems in patronising the formal financial institutions for loans. They are, therefore, consigned to seeking loans from the informal financial institutions where interest rates on loans are much higher than those of the formal financial institutions and they also have to contend with longer turnaround time as well as high risks of crop failures. The implication is that the cost of production of the peasant farmers tend to be higher than necessary if they were able to patronise the formal financial institutions.

V.3 Trend of Major Monetary Aggregates

Turning to the profile of key monetary aggregates, Table 13 shows that credit to the economy grew systematically between 1990 and 1993 before decelerating between 1994 and 1997. Credit to the economy actually declined in 1996 and 1997 reflecting the decline in credit to government. Similarly, credit to the economy grew in 1998 and 1999 arising from the growth of credit to the government. The indication is that credit to government tended to dominate total credit to the economy. Meanwhile, growth rate of credit to the private sector peaked at about 52 per cent in 1993 after which it tended to decelerate. Notice that actual credit to the private sector did not decline absolutely throughout the period. Notice also that during 1998 and

Table 11: National Savings and Investment Rates, 1990–99

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
National Savings (N billion)	14.68	12.39	4.15	11.73	12.79	12.55	14.18	16.28	14.53	16.87
National Investment (N billion)	5.73	5.53	5.57	6.16	5.85	5.13	5.56	5.98	6.01	6.30
Savings – Investment Gap (N billion)	8.95	6.86	-1.43	5.57	6.94	7.42	8.62	10.30	8.52	10.57
Savings/gdp Ratio (%)	6.33	5.83	5.71	6.15	5.77	12.11	13.18	14.65	12.78	14.46
Investment/ gdp Ratio (%)	16.22	13.07	4.25	11.71	12.61	4.95	5.17	5.38	5.29	5.40

Source: Underlying data obtained from Federal Office of Statistics

1999 when credit to government grew rather phenomenally, credit to private sector also grew faster than it did in the two preceding years. The indication is that during the period under review, there is no strong evidence to suggest that the private sector was crowded out of the credit market. Rather, the demand for credit by the private sector is essentially determined by its absorptive capacity which, in turn is determined by the affordability of interest rates. This revelation is supported by the findings of the NISER Survey of Business Conditions, Experience and Expectations during second half of the 1990s, namely, that majority of the operators in the Nigerian manufacturing sector confirmed that credit was readily accessible but they found the bank lending rates unaffordable.

Table 12: Interest and Inflation Rates Profiles, 1990-99

Interest Rate	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Savings	17.8	14.0	16.1	16.7	12.3	12.6	10.1	6.1	5.2	5.3
Inflation Rate (%)	7.5	13.0	44.5	54.2	57.0	72.8	29.3	8.5	10.0	6.6
Maximum Lending	26.5	21.0	31.2	39.1	20.2	20.8	20.8	20.9	21.8	27.2
Savings-lending Rate Spread	8.7	7.0	15.1	22.4	7.9	8.2	10.7	14.8	15.6	21.9
Minimum Rediscount Rate	18.5	15.5	17.5	26.0	13.5	13.5	13.5	13.5	13.5	18.0

Source: Central Bank of Nigeria

A look at Table 14 showing the maturity structure of bank loans and advances will reveal the preponderance of short-term loans which are more suitable for the traders than producers. The indication is that the bulk of private sector credit is delivered to the tertiary sector operators, especially the traders who distribute imported finished goods. This situation also suggests that the Nigerian financial sector services the government and importers of finished goods. Therefore, policies and programmes that will encourage the banking sector to provide credit to the secondary sector operators at affordable interest rates should be carefully articulated and vigorously implemented.

With regard to exchange rate profile, Table 15 shows the trend of exchange rates in the official market as well as in the Bureaux de Change and the parallel market. A quick look at the Table will reveal that the parallel market exchange rate premium was lowest in 1995 when Government, in a bid to close the gap between the parallel market and the official exchange rate decided to raise the exchange rate from around N21:$1 to N85:$1 in March 1995. Thereafter, the premium continued to increase reaching N7 or about 8% by 1999. In a collaborative study by CBN and NISER on the Nigerian Informal Foreign Exchange Market, it had been pointed out that the success in closing the gap between the official and parallel market exchange rates can only be transitory unless the primary and secondary causes of the gap, which are scarcity and differential transaction costs, are addressed. Probably more important is the fact that the naira exchange rate depreciated throughout the period. Given the high import dependence of producers and investors as proxied by import-raw material an import-investment ratios, shown in Table 11, a depreciating exchange rate should have contributed to the low growth of output and low level of investment in the Nigerian economy during the period. Specifically, under this condition heavy import dependence, a depreciating exchange rate profile will raise the naira cost of production which, like high bank lending rate, will tend to make locally produced goods less competitive compared to imports. Similarly, the almost total dependence on

Table 13: Growth of Credit to the Economy, 1990-99

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Credit to Government	14.9	82.9	109.7	121.6	27.7	7.7	-61.6	-32.5	199.3	57.9
Credit to Private Sector	18.4	23.7	34.6	51.6	32.2	49.4	23.3	39.3	23.7	27.3
Credit to the Economy	17.1	45.3	69.1	91.4	29.2	22.0	-25.8	-16.9	55.7	35.5

Source: Central Bank of Nigeria

Table 14: Maturity Structure of Commercial Bank Credit

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
On call	49.58	50.28	54.13	50.35	47.71	52	52	51.9		
Within 6 months	19.13	10.28	18.26	20.66	18.35	20	20	20.0		
Between 6-12 months	12.27	11.43	9.46	9.85	9.17	10	10	10.0		
Within 12 months	1.04	1.29	0.80	2.23	9.17	7.2	1	0.90		
Between 1-3 years	7.38	7.58	6.76	6.12	6.42	7.2	7	6.90		
Between 3-5 years	5.30	5.27	4.74	5.45	4.59	1.8	5	5.00		
After 5 years	5.30	4.87	5.84	5.33	4.59	1.8	5	5.00		
Total	100	100	100	100	100	100	100	100		

Source: Central Bank of Nigeria

import for capital goods implies that a depreciating exchange rate will crowd out marginal investment proposals on account of high investment costs in a high bank lending rate regime. These revelations is corroborated by the findings of the NISER Annual Survey of Business Conditions, Experience and Expectations in the manufacturing sector during the second half of the 1990s as majority of the respondents indicated that foreign exchange was affordable but they considered the exchange rates unaffordable.

Against this background, the pattern of foreign exchange allocation among the various end-users shown in Table 16 should not be surprising. For example, the high exchange rate profile making locally produced goods uncompetitive must have contributed to the declining proportion of the allocations to raw material imports between 1995 and 1999. For the same reason, the allocations to ma-

Table 15: Exchange Rate Profile 1995–99

Exchange Rates	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Official Market Rate	7.94	9.91	17.30	22.07	21.89	82.33	81.48	81.98	84.38	92.65
Bureaux de Change Rate	9.55	13.41	20.39	35.98	23.43	83.69	83.15	85.08	88.07	99.26
Parallel Market Rate	9.61	13.43	20.34	36.15	60.76	83.54	83.09	84.97	87.87	99.16
Parallel Market Premium	1.67	3.52	3.04	14.08	38.87	1.4	1.9	3.5	4.0	7.0

Source: Underlying data obtained from Central Bank of Nigeria

chinery and equipment remained relatively low and declining throughout the period. A high exchange rate profile in an economy where production and investment depend heavily on imports tend to encourage trading. This situation combined with a high bank lending rate profile tend to create enabling environment for importation and distribution of finished goods while creating a disabling environment for existing producers and discouraging new investors. Under this situation, it is rational for the bankers to allocate a large proportion of their foreign exchange acquisitions to importers of finished goods. This explains the relatively high and rising allocations to finished goods. The indication, therefore, is that allowing banks to allocate foreign exchange among end-users unconditionally is unlikely to alter the prevailing pattern of allocation which is inimical to national economic development. If the banks must continue to allocate foreign exchange in addition to intermediation, then necessary conditions must be attached to this role in order to encourage the banks to voluntarily alter the pattern allocation in favour of Nigerian producers and investors in the Nigerian economy.

VI. SUMMARY OF FINDINGS AND POLICY RECOMMENDATIONS

VI.1 Summary of Findings

In reviewing Nigeria's economic development between 1990 and 1999, attention was focused on key attributes of the economy necessary to assess achievement of the subsisting economic development aspirations, namely, to alter the structure of production and consumption activities so as to diversify the economic base, reduce dependence on oil and on imports, all in a bid to put the economy back on the path of self-sustaining inclusive and non-inflationary growth thereby reducing poverty. The key indicators examined are the structure and growth of output, income and expenditure. Also, the composition of investment expenditure, exports and imports, import intensities and the relationship between national savings and investment were examined.

It was found that as at 1999, the Nigerian GDP remained dominated by agriculture and distributive trade while manufacturing remained an insignificant contributor to output. This lopsided structure along with the high diversification index imply that there were no indications that the economy was being diversified suggesting that the economy was not developing contrary to expectations. Also, it was found that income remained dominated by operating surplus and that the slight improvements in compensation of employees at different times were reflections of increases in wage rates and not increases in number of people employed. Therefore, growth of the economy continue to be non-inclusive and, hence, poverty could not be reduced. Domestic expenditure remained dominated by consumption expenditure leaving little room for savings

Table 16: Foreign Exchange Allocation by End-Use, 1995–99 (in percentages)

End-Use Category	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Raw Materials	37.2	36.1	36.6	35.6	42.6	50.3	46.3	31.5	30.5	30.4
Machinery and Equipment	26.6	28.1	25.7	22.2	21.2	17.1	15.6	30.3	18.4	18.3
Agricultural Sector Imports	0.6	0.3	0.8	0.0	2.3	3.2	2.1	1.0	2.0	1.6
Finished Goods	25.2	28.7	29.4	33.7	24.2	21.1	28.2	28.4	38.2	37.3
Invisibles	10.2	6.7	7.6	8.3	9.7	8.3	7.8	8.8	10.9	12.5
Total	100	100	100	100	100	100	100	100	100	100

Source: Underlying data obtained from Central Bank of Nigeria

despite the fact that operating surplus dominated income. Building and construction dominated capital formation reflecting the roles of the erstwhile Petroleum Trust Fund and the influence of the massive construction work going on in Abuja. Exports remained dominated by oil exports indicating that the export base is yet to be diversified and imports of consumer goods became more prominent during the period reflecting the consequences of uncompetitive domestically produced goods when compared to the imported alternatives. Finally, it was found that Nigeria was confronted by low savings and lower investment trap as savings exceeded investment throughout the period even though there were excess capacity in every sector of the economy and large number of the unemployed. Put simply, the 1990s was a lost decade in terms of Nigerian economic development.

VI.2 Policy Recommendations

In order to restart the process of achieving the economic development aspirations, efforts should be directed at extricating Nigeria from the low savings-lower investment trap. Towards this end, the on-going efforts to rehabilitate and expand the infrastructural facilities, especially energy, should be sustained. The on-going reform of the budgetary process as well as the measures aimed at restoring transparency and accountability in government procurement processes should be vigorously pursued in order to assure high value for money. Government should seriously consider insisting on maximisation of local resource input into its public works being undertaken by multinational corporations in the country. In particular, appropriate norms should be established for different categories of construction works specifying the minimum local contents so as to maximise the domestic multiplier effects of these works without compromising on quality of work.

In order to enable the operators in the secondary activities to take maximum advantage of the improved infrastructural facilities, the prevailing high bank lending rate regime should be seriously addressed because it encourages trading and discourages production activities. In this connection, the new Bank for Industry should be properly funded and encouraged to provide long-term capital to the real sector operators at concessionary interest rate while the commercial banks should also be encouraged to provide complementary short-term working capital. For this purpose, banks should be encouraged to engage in loan syndication whereby the Bank for Industry will provide the long-term loans while the other banks will provide the short-term working capital facilities. This strategy should be

used to promote the intermediate and capital goods producing segment of the manufacturing sector which had decayed during the last 15 years. With respect to funding of Bank for Industry, the proceeds of the on-going privatisation exercises could be injected into it. Also, the National Social Insurance Trust Fund should be encouraged to place its resources at the disposal of the bank. Indeed, the NSTIF should be a major share holder in the Bank for Industry.

The monetary authorities should take necessary steps to reduce the spread between bank lending rate and the savings deposit rates to not more than 7 per cent by encouraging banks to reduce lending rate. In that case, since the savings deposit rate was 4.8 per cent in June, 2001, the maximum bank lending rate should not have exceeded 12 per cent as against 28.4 per cent which it was.

It should be recognised that at the present stage of Nigerian economic development, the bulk of financial resources is used to lubricate the production of goods and services and not to lubricate consumption activities. See Ajakaiye, (1992) for an elaboration of this view and the implication for the conduct of monetary policy. For instance, personal loans accounted for less than 40 per cent of total credit to the economy in 1999 while the rest is delivered to entities engaged in the production of goods and services. In such a situation, reliance on interest rates manipulation as a strategy for demand management is likely to affect only 20 per cent of total credit. The impact on the remaining 80 per cent will be to raise cost of production of goods and services. Therefore, the monetary authorities should be more cautious in raising the minimum rediscount rate as a strategy for controlling inflation and exchange rate movements. In essence, the monetary authorities should avoid high interest rates policy because of the adverse structural effects on the economy.

With regard to foreign exchange management, it should be realised that since naira is not a convertible currency as yet, foreign exchange is really a commodity and not money. Therefore, leaving its allocation to the banks is unlikely to alter the undesirable pattern observable so far. The monetary and fiscal authorities should, therefore, coordinate their activities and introduce policies that will encourage banks to allocate foreign exchange in favour of the manufacturers and not in favour of importers of consumer goods. A possibility is to tie government patronage to acceptable behaviour of the banks in terms of foreign exchange allocation, bank lending rate and interest rates spread.

Finally, it should be reiterated that rehabilitating and expanding the infrastructure facilities are necessary but insufficient conditions for initiating desirable economic development in Nigeria. Policies that will reduce bank lending rate, arrest continuous depreciation of the currency as well as deliver credit and foreign exchange to the producers are among the sufficient conditions. These should be the focus of policy for the foreseeable future if Nigeria is to escape from the low savings-lower investment trap, initiate inclusive growth and reduce unemployment, all of which are necessary for dealing effectively with threats to life, property and, indeed, the nascent democracy.

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REALISING THE POTENTIALS OF AGRICULTURE IN NIGERIA

BY
PROF. ANGO ABDULLAHI*

INTRODUCTION:

For a farmer to grow a good crop of maize there are pre-conditions which have to be met. These include good seeds, and an array of good crop husbandry practices, like application of fertilizers, pesticides, weed control in addition to well-prepared seedbed. Failure to satisfy one or more of these conditions can result into progressive yield reductions up to the possibility of total crop failure. A bumper harvest of maize is good only if it brings adequate and rewarding returns to the farmer; and eventually satisfy the requirements of consumers and processors in the food chain.

Similarly, for any economy to grow certain pre-conditions have to be met. The dynamic and complex interplay of these conditions determines whether the economy is growing, stagnating or, in fact, declining. I am not in any way competent to pass a professional or expert judgement about the true position of the Nigerian economy today. However, as part of the larger Nigerian society, I am acutely aware of the glaring lack of consensus as to the real situation of our economy. Opinions defer widely from those who believe the economy is declining to those who think there is moderate economic buoyancy. One thing which is certain in this endless debate is that the various discussants use different variables and different sets of data to reach their various defensible conclusions. To be on the safe side, my own assessment is that the Nigerian economy is still not SATISFACTORY for the AVERAGE Nigerian Citizen. There are of course several quantifiable indices to support this assertion. However, it may suffice to simply adopt an aggregate common index called POVERTY. Going by the latest domestic and international surveys, it is now believed that up to 70% of Nigerians live below the Poverty Line, defined as less than US$1.00 per capita per day.

As indeed the economy is not growing satisfactorily, there must also be reasons why this must be. The adage which says "You Reap What You Sow" seems appropriate for the Nigerian economic situation. Going back to my earlier analogy, the Nigeria economy is like a potentially fertile land where the farmer, even though desirous of a bumper harvest, refuses or fails to adopt good crop husbandry techniques in his farming operations. The result inevitably, is poor harvest or even crop failure. It's my considered opinion that the Nigerian economy has failed to achieve our expectation of growth, because we have failed to manage and husband it in such a way as to fully achieve its POTENTIALS. Rather sadly, we talk copiously about enormous Nigerian potentials rather than take concrete measures to exploit and harness these potentials for the benefit and well-being of Nigerian people.

AGRICULTURE WITHIN THE NIGERIAN ECONOMY

Perhaps before looking into its potentials, we should briefly understand the position of the Agricultural Sector within the overall Nigeria economy. Nigeria's socio-economic history and development has been very closely tied to its agricultural sector. Before the advent of oil, the country depended almost entirely on its agriculture for its food, for its agro-industrial raw materials; and for its foreign exchange earnings through commodity trade. Needless to add that the agricultural sector also provided gainful employment to over 75% of the country's labour force, and satisfactory livelihood to over 90% of the entire population at the point of our political independence four decades ago. Agriculture contributed up to 70% of the GDP even in the mid-1960s. Over the past three to four decades, the dominant role of agriculture in the economy, especially in terms of the country's foreign exchange earnings, gave way to petroleum. Agricultural growth generally

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slowed down to the extent that the country was becoming a net-importer of agricultural goods it used to sell to other parts of the world; unfortunately, including food items which the country was in a position to produce in self-sufficient quantities. As of to-day, the agricultural sector is said to be barely coping with its crucial role of adequately supplying the food needs of the country. If our agricultural import bills, now estimated at a staggering figure of over N200 billion, is taken into serious consideration; we cannot avoid the painful conclusion that the agricultural sector has failed. Of course, this conclusion could not be correct in view of the fact that the huge agricultural imports is caused by several other factors, apart from the productive capacity of the agricultural sector per se. I am confident that this Forum will clearly identify these factors and proffer the appropriate remedies.

POTENTIALS OF NIGERIA'S AGRICULTURE

One area of general agreement on Nigeria's agriculture is its undisputed POTENTIALS. Brief mention of some of the indicators of these potentials is made hereunder:

Major Geo-physical Indicators of Potentials

* *Total land mass - 923,771 sq. Km (92.4 million hectares)*
* *Estimated Arable land - 68 million hectares*
* *Natural forests and range lands -37 million hectares*
* *Large diversity of livestock & wild-life*
* *Large Rivers and Lakes - 120,000 sq. Km*
* *Coastal and Marine Resources - 960 km shore line*
* *Variable suitable climate*

Socio-Economy-Related Agricultural Potentials

* *Large Population - Estimated at 120 million (2001).*
* *Large Consumers Market*
* *Relatively High-level Manpower*
* *Large Regional and Continental African markets*
* *World Market*

Taking all these indicators into account, Nigerians cannot understand why agriculture is still relatively not developed in the country to fully play its expected roles in the economy.

FACTORS MILITATING AGAINST REALISATION OF AGRICULTURE POTENTIALS

Some of the major constraints against the realisation of the potentials of Nigeria's Agriculture include the following:

* Unfavourable government policy environment
* Unclear policy initiatives
* Marketing and Pricing constraints
* Low availability and high cost of inputs (Fertilizers, seeds, Agro-chemicals, etc.)
* Inadequate purchasing power of small-scale producers
* Poor access to Capital and Markets
* Low labour productivity
* Lack of improved implements
* Land tenure systems
* Low technology development
* Inadequate agricultural extension services
* Environmental constraints

BRIDGING THE GAPS

For Nigeria's agriculture to play its full role in the socio-economic development of the country, the existing wide gap between what has so far being achieved and its enormous potential must be bridged. The major areas which require particular attention in our efforts to bridge the gaps within the complex web of constraints include the following:

Policy Related Constraints

Nigeria's design of macro-economic policies, over the years, have focused on ensuring stability in the macro-aggregates, which to

a large measure discriminated against agriculture. Therefore, the fiscal, monetary, trade, exchange rate and income policies designed for economic stability invariably had adverse effects on agriculture, leading to the weakening of the much desired linkages between agriculture and industry. Again, the so-called liberalisation polices since the late 1980s, designed to restore macro-economic stability and growth resulted in the high cost of major agricultural inputs, particularly the imported inputs, which led to reduced profitability of agricultural enterprises.

Primary Production

At the primary level, Nigeria's productivity per unit area of land or per unit animal, or per man-day etc, compared to productivity elsewhere in the developed or even in some developing countries is pathetically low. While a maize farmer in Nigeria gets about 3 tons/hectare, his counterparts in America or South Africa get up to 10 tons and 6 tons respectively. And where a Fulani herdsman gets one litre of milk per cow per day, his counterpart e.g. in Europe, gets up to 40 litres. We are very much aware of the numerous technical, technological and institutional constraints against high agricultural productivity at the primary level. Once these constraints, which are easily surmountable, are removed, primary level productivity will increase significantly.

Post Harvest Technology

In addition to the low productivity at primary level, the existing high level of post-harvest losses, which average up to 25% for all agricultural commodities, have significantly further reduced our already low achievable agricultural output. These annual losses amount to about 25 million metric tonnes of agricultural commodities with estimated value put at N500 billion. This is an intolerable level of wastage, which the country can least afford. Measures which must be put in place here, includes, improved storages, preservation, efficient handling, transportation and processing. All these measures, especially together, would go a long way in enhancing our productivity and greater realisation of our agricultural potentials.

Post-Harvest – Pricing and Marketing

Agriculture, like any other private enterprise, is propelled by entrepreneurs who are motivated by benefits from their investments and entrepreneurship. Agricultural, like any other commercial goods, must therefore attract prices, which make farmers executions worthwhile. Poor and unpredictable prices for agricultural goods at the domestic and international markets have far reaching consequences on the ability of Nigeria to fully exploit its agricultural potentials.

Public Support to Agriculture

While it is generally accepted that agriculture is a private sector enterprise, it still requires well designed public support to flourish as we can see around the world. This is in addition to the conducive macro-economic environment, which must be created to encourage greater investments in the sector. At present the situation in Nigeria is a bit confused especially in view of the persistent pressures of international institutions like the IMF, the World Bank and WTO. Taking advantage of the inadequate resource base of the country against its numerous contending needs, these pressures only lead to further discriminatory treatment of the agricultural sector.

Weak Private Sector

The Agricultural Sector like the industrial sector can only grow through investments. At the moment new private sector investments in agriculture are near zero. In fact there are indications that the agricultural sector is going through a period of decapitalisation whereby large private sector investments by corporate bodies have been halted and in many instances wound up. This can easily be explained by very high costs of inputs like tractors and low returns on investments due to confused marketing and low pricing of commodities both at the domestic and international markets. In addition the agricultural sector, like its industrial counterpart, is assaulted by large scale dumping of cheap, low quality and in some cases highly subsidized goods, made possible by the so-called liberalisation of trade at both Regional and Global levels. Mention has already been made of high cost of capital through the de-regulated banking system in which lending rates could be as high as 30%.

Integrated Approach

Over the years, the agricultural sector has suffered as a result of lack of coordination of activities by all the stakeholders. At the public sector level, the three tiers of government continued to work in disparate isolation despite the weak linkages provided in National Agricultural Policy documents. The public and private sectors also worked in isolation without sufficient coordination which would promote and strengthened agriculture concomitantly with industrial development.

Political-Will and National Interest

With political will and commitment to national interest, the realisation of the enormous development potential generally and especially its agricultural potential is not far-fetched. This has been amply demonstrated by numerous examples of poor countries (with lesser development potentials than Nigeria) which, with political will and patriotism, succeeded in turning their economies around within a very short time. This is the real underpinning for Nigeria's economic recovery without which we cannot achieve peaceful political development to sustain our nascent democracy.

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