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Overview of Institutional Mechanisms for combating Trade Malpractices

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BEHIND THE SCENE

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OVERVIEWOFINSTITUTIONALMECHANISMSFOR COMBATINGTRADEMALPRACTICES

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Chief (Dr.) J. O. Sanusi

It has been my earnest desire to share my vision of the economy and the damage done to it by trade malpractices. In this regard, the topic overview of Institutional Mechanisms for Combating Trade Malpractices is very apt and could not have come at a more auspicious time than now when this cankerworm has done a lot of damage to the economy. Let me begin by stating the basis for trade, which arises as a result of the unequal distribution of resource endowment within and between countries. This gives rise to the need for individuals, corporate bodies and nations to source for the shortfall of their requirements from other sources.

The importance of this process called trade to economic development cannot be over-emphasized as the volume of trade provides a measure of the vibrancy of the economy. This explains why a lot of effort is directed towards increased trade (especially exports) by most countries, as it is viewed as the engine of economic growth. Unfortunately however, the desire to increase the volume of trade has led to various abuses and malpractices. Trade malpractices come in various forms ranging from product adulteration to the falsification of documents on imported goods with the intent to defraud. In Nigeria, efforts have been made over the years, to combat the menace of trade malpractices through the setting up of several institutions and agencies. In spite of the proliferation of institutions and the enactment of laws, trade malpractices have persisted in the country. Decree No. 67 of 23rd November 1992 on Trade Malpractices (Miscellaneous Offences) outlines the various offences that constitute trade malpractices with the appropriate penalties spelt out. This paper shall highlight the implications of trade malpractices on the economy; examine the institutional mechanisms for combating trade malpractices in Nigeria. Efforts will also be made to bring to the fore some of the lingering problems that have militated against the effective control of trade malpractices. To accomplish these objectives, the rest of the paper is accordingly structured as follows: Section two following the introduction reviews trade malpractices in Nigeria and their implications for economic growth while an overview of the institutional mechanisms

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This paper was delivered at the Nigerian Institute for International Affairs (NIIA); at the National seminar on the impact of Trade Malpractices on the Nigerian Economy on 23rd - 24th October, 2002.

for combating trade malpractices is undertaken in section three. Section four discusses somelingering problems in combating trade malpractices while section five summaries the paper with some recommendations.

2. TradeMalpractices in Nigeria and Implications for Economic Growth

Malpractice simply defined refers to the improper, careless, illegal or unethical professional misconduct. Trade malpractice, therefore, can be viewed as an action, which seeks to alter the value, quality, quantity of goods and services to the advantage of one party in a trade transaction at t he expense of the other party. The other party may include government or individuals. Trade malpractices in Nigeria occur in different forms but the most common ones include the following: over-invoicing, under-invoicing, wrong labeling and false declaration of goods, under-declaration of quantity and concealment, fake and adulteration of goods. The methods adopted in the perpetration of the malpractice under the various types are highlighted below:

Over-invoicing: *This involves the connivance between importers and overseas exporters to inflate the actual price of imported goods. It is commonly used to facilitate capital flight. Evidence abounds where some airlines submitted bills to the Central Bank of Nigeria for the maintenance of their aircrafts abroad and on request for confirmation of the plausibility of the bills from the Ministry of Aviation, some were discovered to be excessively high. Similarly, the Federal Ministry of Transport when requested t o confirm the reasonableness of charter fees submitted for the repairs of some marine vessels declared such fees as excessively high.*

Under-invoicing: *The malpractice is committed with the intention of lowering the amount payable as customs duty by deliberately understating the value of imported goods.*

False declaration of goods: *Importers intentionally give false descriptions of cargo with the aim of either circumventing government restriction order and/or evading duty payment whereapplicable.*

Under declaration: *This practice, which has the same objective of lowering the duty paid on imported goods, is perpetrated through a deliberate falsification of the bill of laden.*

False documentation: *This involves the presentation of forged documents to the confirming banks after which payments are demanded against the credit. A Presidential Task Force is currently working to unravel the loss incurred by the nation through this act of trade malpractice.*

Judgement debt: *The guidelines issued by the bank have been abused in many cases through false court judgements and other false documentation to obtain foreign exchange. Some of the loopholes have been blocked with the review of some of the provisions of the guidelines. With effect from February 2002, there is an additional requirement of Approval in Principle (PIP) before any Authorised dealer can remit any fund. This is aimed at checking roundtriping and other foreign exchange abuses. Investigations involving debt judgment fraud amounting to $35.2 million by some banks are still on.*

Generally, trade malpractices lead to loss of revenue accruing to the government, arising from reduced collection of imported duties. This practice, also poses a health hazard to the consumers as sub-standard goods can be sold for consumption. Similarly, the cases of sub-standard building materials imported and used for construction have led to the collapse of some buildings. Trade malpractices by exporters which result in considerable lower prices, can cascade into dumping and lead to lower domestic industrial output, as such goods compete unfavourably with domestic products. This inadvertently leads to a drain of foreign reserves and pressure on the exchange rate as more of the nation's foreign exchange is demanded to finance cheaper and low quality imports.

3.Institutional Mechanisms for Combating Trade Malpractices

The need to ensure fair trade practices in the face of increasing incidence of sharp malpractices necessitated the setting into motion some mechanisms aimed at combating the scourge. Institutional mechanisms were evolved based on the understanding that individual efforts to deal with this problem can hardly be effective. Such institutional mechanisms, which involve creating new institutions or strengthening existing ones, involve:

i)The Federal Minsistry of Commerce: The Ministry in its continued efforts of enlightening importers and exporters issues guidelines from time to time on appropriate trade practices and procedure.

ii)Standards Organization of Nigeria (SON): The Standards Organization of Nigeria was set up by the Standards Organization Act 1971 (as amended in 1976, 1984 and 1990) as a semi-autonomous parastatal. It enforces the powers of seizure, confiscation and destruction of sub-standard goods and products and could seal up factories, which are regularly found to produce sub-standard or defective products. In its efforts to ensure compliance with government policy on standardization and quality of both locally manufactured and imported products it undertakes investigations on quality assurance system, including certification of factories, products and laboratories. It also maintains reference standards for calibration and verification of measures and measuring instruments and co-operates with other national and international organizations with a view of securing uniformity in standards specifications. Its activities over the years have improved the quality of locally manufactured products as a result of which many of them are certified internationally.

iii)National Agency for Food and Drugs Administration and Control (NAFDAC): The National Agency for Food and Drugs Administration and Control (NAFDAC) which was established by Decree No. 15 of 1993 carries out its *mandate in accordance with section 5 of the Food and Drugs Act CAP 150 of the laws of the Federation 1990, which prohibits the labeling, packaging, processing or sale of any food that is false, misleading; or is likely to create a wrong impression as to its quality, character, value, merit or safety. The Agency's activities over the years had created the necessary awareness, resulting in drastic reduction in the patronage of fake and sub-standard products. NAFDAC's initiatives, which include inc reased surveillance and enforcement activities at the ports and within the country, have aborted several attempts to smuggle sub-standard and unregistered drugs into the market, and drugs worth billions of naira have been destroyed. The determined drive and war against the production, marketing and dispensing of fake drugs, contaminated processed foods,and impure water has helped in reducing avoidable deaths and economic losses. The problem of dumping or unbridled importation of drugs into the country with attendant debilitative effects on the local industry has also been tackled by NAFDAC.*

iv)Customs and Excise Department: The Customs and Excise Department which is a major establishment for ensuring compliance with established trade policies has over the years had to contend with the issue of fraudulent imports. This resulted in the seizure of goods, blacklisting of some customs agents for their involvement in import malpractices, as well as, dealing with insider abuses by the department's staff through connivance with importers.

v)Pre-shipment Inspection Agencies: These reputable overseas companies appointed by the government verify and assess import duty payable on goods imported into the country since October 1984. This approach was aimed at checking the incidence of capital flight through over-invoicing of imports and importation of unwholesome/time expired goods. The agencies were also charged with the responsibility of ensuring that importers get value for their goods, as well as, discourage under-payment of import duty through under-invoicing.

The pre-inspection arrangement was also aimed at maintaining surveillance on legality by ensuring that the goods imported into the country conform to the prevailing laws and regulations and minimize loss of revenue on repatriable foreign exchange. Unfortunately, the programme was massively abused due to collusion between importers and inspection agents to defraud the country through various unwholesome practices. However, as a measure of sanitizing the port inspection scheme, *the 100% destination inspection of imports was reintroduced in April 2001 and this has yielded a lot of positive results through the exposure of sharp practices at theports. For instance, available data showed that underpayment recovered on Clean report of Inspection (CRI) totalled N5.07 billion in 2001 and has added up to N1.48 billion as at the end of July, 2002.*

As a further measure of ensuring the success of the 100% Destination Inspection and thereby combating trade malpractices, the Federal Ministry of Finance has requested the Organized Private Sector to undertake the compilation of all bonafide importers of goods into the country. This is with the main objective of ensuring that business and trade operators can be certified by and reached through their various Associations.

vi)The Plant Quarantine PQS which is charged with the responsibility of preventing the introduction of foreign pests into the country either by accident or deliberately, also has the responsibility of issuing import permits to prospective importers of plant materials. In 2001, it carried out 177,084 border inspections of carriers, inspected 3,932 plant material consignments at the borders and intercepted 3,244 illegally imported plant material consignments.

vii)The Central Bank of Nigeria (CBN): The CBN through its circ ulars which spell out rules and regulations on foreign trade transactions on regular basis is also involved in the efforts of combating trade malpractices. The Bank is primarily engaged in the area of financial settlement of trade transactions so as to ensure the safeguarding of the interest of all stakeholders. In addressing the issue of trad malpractices, the Bank issues circulars to Authorised Dealer banks and importers. For instance, in April 1999, the Bank issued a circular on Import Guidelines, Procedures and Documentation Requirements under the Destination Inspection Scheme. Part of the circular dealt with Import procedures specifying that each completed Form 'M' from importers shall be submitted to an authorised dealer bank, with the full details of the goods, quantities, unit cost of goods, total cost of goods and other information that will give the true value, quality and quantity of the imported goods. The Monetary Policy Circular No. 36 for 2002/2003 also spells out that to minimize price variations on imported goods, 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.

The Bank also conducts regular surveillance of Authorised Dealer Banks to ensure compliance with the various regulations and imposes sanctions and penalties on defaulters. Similarly, as a measure against other financial malpractices, the Bank initiated and collaborated with other agencies to ensure that the Money Laundering Decree and Advance Fee Fraud and Other Fraud Related Offences Decree of 1995 was promulgated.

4. Lingering Problems in Combating Trade Malpractices

The menace of trade malpractices still persists in the economy despite the various institutional mechanisms that have been put in place to combat it. This is traceable to various factors, which are both external and internal.

The external factors are associated with globalization and the free trade system, which has resulted in the flooding of the Nigerian market with diverse goods most of which are sub-standard and time-expired. This phenomenon can be attributed to the insufficient capacity to monitor the upsurge of trade by various agencies. This is accentuated by inadequate training as well as capacity-building in some of the agencies. The lack of required equipment to police the borders as well as the availability of numerous routes have all continued to aid smuggling of sub-standard and contraband goods.

Although the functions of many of the agencies and monitoring units are well spelt out in the decrees and laws establishing them, some of them lack the enabling powers to perform the duties effectively and impose sanctions where necessary. Furthermore, some of the agencies are also not adequately funded and thus could not perform their functions adequately and this has continued to complicate the problems of trade malpractices in the country. Other internal forces consist of the lack of transparency, greed and corruption. For instance, some public servants are engaged in aiding some fraudulent importers and their clearing agents in evading duty payments through under-declaration, underpayment, concealment, smuggling, under-valuation and outright importation of prohibited and time expired goods. This has led to dumping with its adverse impact (especially second hand goods) on local production, which was more pronounced on the textiles, footwear, leather, cement, vehicle assembly, radio and television, and telecommunication equipment subgroups of the manufacturing sub-sector, which recorded persistent output contraction or outright closure of local factories in some cases. Specifically, the past few years have shown a steady decline in the capacity utilization in the textiles industries where it declined from 50.0 per cent in 1997 to 33.4; 20.2; 21.4 and 20.6 per cent in 1998; 1999; 2000 and 2001 respectively.

The 100% destination physical examination of goods, which was reintroduced in April 2001, in order to check import malpractices, has also been bedeviled by inadequate executive capacity. This has resulted in the accumulation of uncleared goods at the ports. The congestion was *exacerbated as many importers abandoned their shipments in preference to the payment of the 50 per cent penalty for falsification. Customs Department had however, generated huge revenues through the issuance of debit notes on concealed and under-declared goods since the introduction of 100 per cent inspection.*

5.Concluding Remarks

Trade malpractices have serious implications for economic growth, and the various forms of trade malpractices, such as over-invoicing, under-invoicing, wrong labeling, false declaration of goods, under-declaration of goods and concealment have been rampant in Nigeria. These have resulted in lower prices and lower domestic output as well as lower import duties. The various institutional mechanisms that have been put in place to combat these trade malpractices have made some modest achievements, albeit in various degrees. This is as a result of some lingering problems such as inadequate capacity to effectively monitor the rapidly growing trade economy. In order to solve these lingering problems and reduce the impact of trade malpractices, there is need for the enforcement of some of the existing policies while other measures should be introduced.

In this regard, the monitoring capacity of the relevant agencies should be strengthened. These agencies should also be adequately funded, well equipped and well staffed. They should also be adequately empowered to perform their functions and impose sanctions where necessary so as to ensure the quality, safety, efficacy and wholesomeness of the regulated products. For instance, the 100 per cent inspection of imports should be enforced effectively to contain the fraudulent practices of unscrupulous importers. Similarly, there is the need to further empower the National Agency for Food and Drugs Control (NAFDAC) and other agencies that control the quality of goods to fully enforce whatever directive or sanction they may impose on manufacturers or importers and further improve on their surveillance activities.

The Organized Private Sector (OPS) also has important roles to play in ensuring the effectiveness of the various mechanisms put in place to combat trade malpractices. Towards this, the OPS should act as a watchdog for the relevant sub-sectors of the economy. For instance, the Pharmaceutical Society of Nigeria should be adequately involved especially in the control of fake drugs and pharmaceuticals. They should also continue to sensitize their members on the negative effects of trade malpractices on the entire economy. Overall, there is a need to forge and sustain a strong public-private sector partnership in the quest to combat trade malpractices.

AN APPRAISAL OF FEDERAL GOVERNMENT'S NATIONAL POVERTY ERADICATION PROGRAMME (NAPEP)

BY

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1.AN OVERVIEW

In the 1960s and 1970s, Nigeria enjoyed steady economic growth and relative stability. The economy and income per capita grew steadily and few people were below the poverty line as the agricultural, industrial and public sectors absorbed most of the labour force. From the late 1970s to the early 1980s, the economy had to contend with severe economic difficulties resulting from the oil shocks, world economic recession, deteriorating terms of trade, debt overhang and macroeconomic imbalances . Poverty incidence rose to 43 per cent in 1985. Structural reforms were undertaken in mid-1986 and the economy recovered slightly, while the number of the poor declined. Poverty incidence declined to 34 per cent in 1992. With the collapse of macroeconomic discipline in the early 1990s, the economy was beset by high inflation, low productive activities and a return to economic stagnation. The proportion of people living below poverty line rose sharply to 61 per cent in 1997 and Nigeria was ranked 54th in the Human Poverty Index (HPI) and among the twenty poorest countries in the world.

The Federal Government has in line with the global convention, been responding to ameliorate the worsening condition of the poor, by shifting public expenditure towards poverty alleviation. Different poverty alleviation programmes and projects to cushion the effects of poverty initiated included: the Directorate of Food, Roads and Rural Infrastructure (DFRRI), Better Life Programme (BLP), Family Support Programme (FSP), National Directorate of Employment (NDE), Family Economic Advancement Programme (FEAP), National Agricultural Land Development Authority (NALDA), National Agency for Mass Literacy, People's Bank of Nigeria, the Federal Urban Mass Transit Programme, etc (See appendix attached).

In spite of the huge resources devoted to poverty alleviation, deterioration in fiscal discipline, corruption, political instability and inconsistent policies undermined past efforts, thus making poverty alleviation in Nigeria a paradox. The level of unemployment continued to rise, while poverty conditions exacerbated. Recognizing the need to create a conducive environment for investment, the present administration, has since assumption of office on May 29, 1999, indicated that the poverty situation in which more than 60 per cent of Nigerians live below the poverty line, required concerted efforts to prevent it from getting worse. Consequently, government initiated and launched the Poverty Alleviation Programme (PAP) within the framework of Budget 2000. The programme was designed to provide employment for 200,000 people and the

*This was presented by the Research Department of CBN on April 1, 2002.

sum of N10 billion was set aside for it. The programme was implemented in every state of the Federation and it provided jobs for 214,367 people who were paid stipends of N3, 500 per month. In January 2001, the Poverty Alleviation Programme was phased out and replaced with the National Poverty Eradication Programme (NAPEP), which has the responsibility for coordinating and monitoring the activities of the core poverty eradication Ministries and Agencies. NAPEP focuses on the coordination of act ivities of 17 Federal Ministries and about 30 Parastatals based on their activities and relevance to the eradication of poverty in Nigeria.

Against this background, an attempt is made in this paper to appraise the content and performance of the programme. To this end, the paper is organized into five sections. Thus, after this introductory overview in section 1, the programme focus is reviewed in section 2, this is followed by the modalities for programme implementation and efforts so far in sec tion 3, and Appraisal of the programme in section 4, the final section 5, contains the summary with Concluding remarks and recommendations.

2. PROGRAMME FOCUS

This section reviews the objectives, scope of activities and target groups for the Programme.

2.1 Objectives

As outlined in the operating guidelines, the overall objective of NAPEP is to eradicate absolute poverty in Nigeria by the year 2010. The philosophy of this target is based on the commonly accepted socio-economic profiles that about 70 per cent of Nigerians live below the poverty line. The eradication of poverty is mainly to ensure that all Nigerians are provided wi th:

**Steady source of income*

**High purchasing power*

**Abundant, good quality and high nutritional food*

**Basic health care facilities*

** Good quality Education*

**Good quality drinking water*

**Good standard housing units*

**Stable and affordable power supply*

**Good urban and rural Communication facilities*

**Cheap andaffordable consumer products.*

**Conducive environment for production and trade.*

2.2 Scope of Activities

The major executors of these programmes are the Federal Ministries and Agencies, whose activities are relevant to poverty eradication. The Ministries are:

a)Federal Ministry of Agriculture and Rural Development;

b)Federal Ministry of Education;

c)Federal Ministry of Works and Housing;

d)Federal Ministry of Women Affairs and Youth Development;

e) Federal Ministry of Industry;

f) Federal Ministry of Science and Technology;

g)Federal Ministry of Solid Minerals Development;

h)Federal Ministry of Water Resources;

i)Federal Ministry of Health;

j)Federal Ministry of Power and Steel;

k)Federal Ministry of Employment, Labour and Productivity;

l)Federal Ministry of Environment; and

2) Federal Ministry of Finance.

To achieve a well-coordinated implementation and monitoring of the programme of the Ministries and Agencies, their activities have been classified into four schemes.

(i)Youth Empowerment Scheme (YES) which consists of:

**Capacity Acquisition Programme (CAP)*

**Mandatory Attachment Programme (MAP)*

** Credit Delivery Programme (CDP)*

(ii)Rural Infrastructures Development Scheme (RIDS) which consists of:

** Rural Transport Programme (RTP)*

** Rural Energy Programme (REP)*

** Rural Water Programme (RWP)*

**Rural Communication Programme (RCP)*

(iii)Social Welfare Services Schemes (SOWESS) which consist of:

**Qualitative Education Programme (QEP)*

**Primary Healthcare Programme(PHP)*

** Farmer's Empowerment Programme (FEP)*

** Social Services Programme (SSP)*

(iv) Natural Resources Development and Conservation Scheme (NRDCS) which consists of:

**Agricultural Resources Programme(ARP)*

** Water Resources Programme (WRP)*

** Solid Minerals Resources Programme (SMRP)*

** Environmental Protection Programme (EPP)*

2.3 <u>Programme Objective</u>

The overall objective of NAPEP is to eradicate absolute poverty in Nigeria by the year 2010. This is to be achieved in three stages. The first stage is to restore hope to most of the affected people by lowering the poverty line and pushing the people above the line. The second stage is the restoration of economic independence and confidence whereby most Nigerians, particularly, in rural areas shall be very active in clearly defined national development activities. The third stage was designed to be that of wealth creation whereby all Nigerians would be empowered to afford all basic necessities of life and actively be part of national development.

3. <u>MODALITIES FORPROGRAMME IMPLEMENTATION AND EFFORTS SO FAR</u>

Evidently, much effort had been devoted to the planning of the modalities and institutional arrangements for implementing the programme. For the effective implementation of these schemes, the structure established is discussed in the following sub-sections.

3.1POLICY DIRECTION

(i) The National Poverty Eradication Council (NAPEC)

NAPEC is the apex body for policy formulation, coordination, monitoring and review of all poverty eradication efforts and activities within the country. The President of the Federal Republic of Nigeria, chairs the Council and the Vice President is its Vice Chairman. The Secretary to the Government of the Federation is the Secretary, while 13 Ministers of core poverty eradication Ministries, Chief Economic Adviser to the

the President and the National Coordinator are members.

Through the submissions and reports from the National Coordination Committee, the Council ensures that the President is constantly updated with the implementation efforts and their associated impacts on Nigerians. The members on the other hand ensure a regular check to minimize any execution problem or delay and its associated remedy.

(ii) The National Assessment and Evaluation Committee (NAEC)

The Committee, under the Chairmanship of the Vice President, is established to serve as a formal organ f or regular and continuous monitoring of all poverty eradication efforts in Nigeria. This is to ensure the targets and achievements are in conformity with the overall national development plans and objectives.

3.2COORDINATION

(i)The National Coordination Committee (NCC)

The Committee implements and executes the directives of the NAPEC and ensures that all relevant functions undertaken by the implementing Ministries are fully coordinated, focused and refined to achieve the set targets within the set time frame. The Committee submits regular updates and reports on all national poverty eradication efforts to the Council.

(ii) NAPEC Secretariat

The NAPEC Secretariat provides secretariat services to facilitate the operations of the Council and the National Coordination Committee. It ensures the effective coordinat ion, monitoring, evaluation and impact assessment of all poverty eradication programmes and projects as implemented by the Federal Ministries, Parastatals and other Agencies of Government. It also coordinates the efforts of all the NGOs and the donor Agencies relating to poverty eradication in Nigeria.

(Iii) State Coordination Committees (SCC)

The State Coordination Committee are established in every state of the Federation and the FCT. Their functions are to coordinate and supervise the execution of all poverty eradication programmes of the Federal Government in their respective states. The Committees also collect all updates and reports from the Local Government Monitoring Committees and submit to the Federal Coordination Committee.

3.3MONITORING

(i) Local Government Monitoring Committees (LGMC)

The Committee is established in all Local Government Areas of the Federation. They are empowered to commission highly effective local resource teams to conduct regular field monitoring exercise. This is with a view to establishing the location and achievements of all pover ty eradication projects in the Local Government Areas and also assess the impact of these interventions based on accepted guidelines and indices. The LGMC is expected to submit regular reports to the State Coordinating Committee.

3.4FUNDING

Direct NAPEP activities fund shall be drawn from the Poverty Eradication Fund (PEF) to be administered by the NAPEC, but all the programmes and projects originally budgeted for implementation by the core Ministries shall remain funded from the budgetary allocations, though completely coordinated and monitored by NAPEC. Between 1999 and 2002, the PEF was allocated a total of N1,021.87 billion, representing 61 per cent of the total capital expenditure for that period.

3.5 IMPLEMENTATION

The implementation of programmes and projects shall be through the Implementation Agencies of Government. However, where the capabilities and the capacities of such Agencies are inadequate, other options open to NAPEP are:

a) Use of Non Governmental Organizations (NGO), through the utilization of their facilities and capabilities;

b)Award of specific contracts to capable organized private sectors following Government regulations;

c) Use of States and Local Government facilities and capabilities through direct allocation and assignment;

d) Use of community facilities and capabilities by direct allocation and assignment;

e) Use of the facilities and capabilities of Donor Agencies in collaboration with other relevant and acceptable stakeholders.

In achieving its objective of eradicating absolute poverty in Nigeria by the year 2010, the various Ministries and Agencies had executed projects aimed at reducing the poverty level. A total number of 126,128 youths were trained all over the country under the Capacity Acquisition Programme (CAP), while 76,332 graduates were trained under the Mandatory Attachment Programme (MAP). Also, a total of 4 Youth Information Centres were built in each State and 2 in the FCT. A total of 2,497 three-wheeler paggio vehicles (KEKE NAPEP) were also sold to beneficiaries at a discount all over the country.

4. APPRAISAL OF THE NATIONAL POVERTY ERADICATION PROGRAMME

The 2000 Poverty Alleviation Programme (PAP) was a short-term (one-year) strategy initiated to reflate and jump-start the poverty alleviation programme of the Federal Government, pending the time a more suitable programme would be introduced. It was designed to provide meaningful hands-on employment to 200,000 people all over the country within the year. The Programme was implemented in every State of the Federation and provided jobs to 214,367 people who were paid N3,500 per month. Some of the jobs done by the beneficiaries included the unblocking and cleaning of drainages, culverts and bridges; sweeping of roads, filling and sealing of cracks and potholes; installation and restoration of road signs; and rehabilitation and maintenance of public buildings such as markets and hospitals. The ad-hoc Poverty Alleviation Programme was phased out in January 2001 and its gains fused into strategies adopted for the National Poverty Eradication Programme (NAPEP). This was largely to meet the Federal Government's overall target of eradicating absolute poverty among Nigerians. Given that the programme is new, the appraisal will lean heavily on the appropriateness or otherwise of its modalities and institutional arrangements, compared with previous *poverty alleviation programmes and the extent of its achievements so far.*

4.1 Appropriatenes of the Objectives

The Programme's objectives of generating direct jobs and to keeping the crime prone youths off the streets, as well as provide income to enable the participants enjoy basic necessities of life are laudable. They are capable of reducing unemployment and alleviating poverty. The creation of 200,000 semi-skilled and unskilled persons as well as retired/retrenched workers from the unemployed group was expected to reduce a lot of the existing socio-econ omic and political problems such as fraud, prostitution, armed robberies, etc. If well implemented, the programme would, to a modest extent, ensure the security of lives and property and restore prospective investors' confidence in the economy. However, it appears that the planning period has been too long; hence by the middle of 2002, there were no visible signs of the fruits of the programme.

4.2 Comparisons with the Previous Poverty Alleviation Projects

a) Unlike the previous Poverty Alleviation Programmes such as the Better Life Programme for Rural People (BLP), Family Support Programme (FSP), and the National Directorate of Employment (NDE), the current poverty eradication programme focuses on a wide range of projects and schemes which complement each other, centrally planned and coordinated. Some of the numerous pitfalls observed in the earlier programmes, which tended to reduce their impact on the poor, and made them less enduring and sust ainable include:

(i) The initial efforts at poverty alleviation were aimed at geographical location, with emphasis on regional disparities and focus on the rural areas as useful instruments for projects targeting, while the current programme covers the entire country.

(ii) There were no mechanisms for targeting the poor or identifying the beneficiaries in the previous poverty alleviation programmes.

(iii) Except the NDE and DFRRI, other poverty alleviation programmes, which were pet projects of former First Ladies, had no good foundation laid for programmes' monitoring, implementation, evaluation and comparative analysis. NAPEP on the other hand, adopted a bottom-up approach in programme implementation and monitoring.

(iv) The principle of join t planning and joint requirement, which are exemplified in the new poverty alleviation programme, were not included in the previous poverty alleviation programmes.

(v) Previous poverty alleviation programmes did not focus attention on sustainability. There were no financial, institutional, political

and environmental sustain ability built into the projects.

(vi)Also the previous attempts at poverty alleviation did not address the various dimensions of poverty in the country.

4.3 Modalities for Implementation

The arrangements for implementing the programme from the Federal to Local Government levels are commendable. The monitoring and coordination of the programme at the state and local government levels will enable the President, as the Chairman, and other members of the National Council on Poverty Alleviation Council (NAPEC) to be apprised with developments for policy directive, and ensure that the overall impact is achieved.

4.4 Sustainability

With NAPEP as the centrepiece of Government's efforts at poverty reduction, emphasis should be placed on its sustainability so as to increase the international development goal of halving the incidence of poverty by 2015. Similarly, as the current programme is centred on youth empowerment, rural infrastructural development, provision of social welfare services, natural resources development and conservation, its sustainability will not only hasten poverty reduction but also enhance overall macroeconomic stability.

5. SUMMARY, CONCLUDING REMARKS AND RECOMMENDATIONS

The paper has focused on appraising the objectives, scope, target, modalities and institutional arrangements for the National Poverty Eradication Programme. The paper has adjudged NAPEP's objectives, target and modalities for implementation as satisfactory. The Programme's contents are considered sufficient to enhance Nigeria's economic and social performance.

From the foregoing observations and reviews, the following suggestions are made to facilitate the expansion, sustenance and success of future programmes.

(i)There is need to introduce Entrepreneurship Development Programme (EDP) To imbue the participants in the various schemes and programmes with entrepreneurial instincts, drive and counseling for eventual self-employment.

(ii)For NAPEP to make a meaningful impact on poverty there is need for the various poverty reduction programmes to be implemented within the framework of rapid economic growth and with equity, controlled population growth, sound economic management and good governance among others.

(iii)Providing jobs alone may not solve the problem of uncertainty engendered through high crime rates. Government should reinforce the security apparatus through massive recruitment, training and provision of equipment for police officers. This would not only provide security but also jobs.

(iv)In line with the objective of the Poverty Reduction Strategy Process (PRSP), the fundamental

Principle of open-ended participation by all stakeholders should be encouraged.

(v)The use of the local governments, community development associations and Non-Governmental Organisations (NGOs) in the monitoring and implementation of the various schemes and programmes require the strengthening of administrative capabilities at the local government level.

(vi)Finally, youths should be encouraged to plant commercial trees on the available space in the local government areas nationwide instead of only flowers. Seedlings of highly demanded tropical hardwoods such as teak, iroko, mahogany, opepe, abora, mansonia which are in high demand in the global markets, should be made available, and distributed to the youths for planting especially in the rain forest areas.

APPENDIX

REPRESENTATION OF PAST POVERTY ALLEVIATION EFFORTS

Programme	Period of activity	Projects executed and funds disbursed
1. Directorate of Food. Roads and Rural Infrastructure (DFRRI)	1986 - 1993	a) 90.857.40km feeder roads were constructed with the sum of N72m b) 1000 communities were electrified at an estimated cost of N193m c) 22,267 communities were provided with potable water d) 2000 individuals were trained and equipped with skills to build the improved rural housing type e) 15,000 extension workers were trained
2. Better Life Programme BLP	BLP (1987 - 1993)	1. BLP a) Agricultural Programme i) 9,998.9 tonnes varieties of seeds supplied at N6.6 million ii) 1,062 livestock farms established at N5.1 million b) 929 Development Support Services provided at N4.5 million c) 959 Market Support Services provided at N6.1 million d) 8,258 Cottage Industries established at N41.7 million e) 114 VVF clinics established at N3.4 million 2. FSP a) Agricultural programme i) 10.717.6 tonnes varities of seeds supplied at N16.3m ii) 1,208 livestock larns established at N30.3 million b) 975 development Support Services rendered at N13.9m c) 2,579 Market Support Services rendered at N20.3 million d) 17,437 Cottage Industries established at N154.0 million c) Health Programme

			i) 795 Vesico-Vaginal Istula (VVI) clinics established ii) 52 mobile clinics established d) Exportation of local art and crafts via participation in international trade fairs and organisation of training programmes for rural women entrepreneurs in export development.
3.	NDE	1987 to date	a) 6,340 peasant farmers were employed under Mass Agricultural Projects (MAP) i) 7,421 school leavers and 8,217 graduates recruited and trained for the projects ii) 3,091 retired people turned farmers and graduates benefitted from loans totalling N31m for rural based agricultural projects: iii) 19 irrigation pumps were provided as relief loans to 240 farmers displaced by flood in Bauchi and Borno States at N1.5m b) i) 400,500 people benefitted from the small scale enterprises scheme ii) 100,000 Youth Corpers went through the Entrepreneurship Development Programme (EDP) iiii) 600 unemployed university graduates were assisted to establish micro-entreprises under the graduate job creation guarantee scheme. iv) Market stalls and toilets were constructed under the Special Public Works (SPW).
4.	Family Economic Advancement Programme (FEAP)	1997 - 1999	FEAP disbursed N1.73b to 11,747 cooperative societies nationwide in 1998 for locally based production of goods and services to potential entrepreneurs.

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THE ROLE OF CENTRAL BANK OF NIGERIA IN ENTERPRISES FINANCING

BY
O.J.Nnanna*

INTRODUCTION

The role of capital in enterprise growth and development has been recognized over the years and well documented in literature. Capital is needed for the establishment of new businesses as well as the expansion, modernization and diversification of existing ones. Although, there is evidence that there are many bottlenecks in the growth and development of enterprises in Nigeria, such as difficulties in local sourcing of raw materials, capital inadequacy, poor managerial and technical know how, as well as infrastructure deficiencies, the problem of long-term funds and working capital has pre-eminence. In recognition of this and in order to address the problem, various efforts and policies have been put in place.

One of the developmental role of the Central Bank of Nigeria as the apex financial institution in the country is

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to facilitate the flow of finance to the needy areas of the economy. The objective of this paper, therefore, is to provide an overview of the role of the Central Bank of Nigeria in enterprises financing, in particular, for the Small and Medium Enterprises (SME). For this purpose, the remaining part of this paper is divided into four sections. Section two, following this introduction, discusses the objectives of the Central Bank of Nigeria, highlighting the need for the developmental roles of the Bank. Past institutional arrangements for the financing of SMEs with the support of the CBN is considered in section three, while section four is an overview of the current financing initiatives and proposals on the way forward. Section five summarizes and concludes the paper.

II. CBN OBJECTIVES AND THE NEED FOR DEVELOPMENTAL ROLES

The Central Bank of Nigeria (CBN) was established by an Act of Parliament of March 1958, and it became fully operational on 1st July, 1959. The activities of the Bank as contained in the CBN Act, otherwise referred to as its traditional functions, are the issuance of legal tender currency in Nigeria; maintenance of external reserves to safeguard the international value of the currency; promotion of monetary and a sound financial structure in Nigeria and acting as a banker and financial adviser to the government.

In addition to the above, the CBN also performs with

*O. J. Nnanna, Ph.D, is the Director of Research Department, CBN *some developmental functions. These include the promotion of money and capital markets development and the establishment of development finance institutions. Consequently, the CBN has been very active in the establishment and development of the Nigerian capital market. The Nigerian capital market is a source for raising long-term finance for project development in both public and private sectors. The capital market deals in both government securities (which are issued and managed by CBN) and private ones. The volume of pri vate securities was boosted in 1978, following the implementation of the Nigerian Enterprises Promotion scheme, which the CBN through its monetary and credit policy effectively facilitated.*

Also, in order to ensure steady availability of long-term finance to enterprises, the CBN contributed to the establishment of development finance institutions (DFIs) in which the CBN holds substantial equity shares. The CBN also facilitated the setting up of the =N= 100 million Agricultural Credit Guarantee Scheme Fund (ACGSF) in 1977 to guarantee up to a maximum of 75 percent of commercial and merchant banks' agricultural credit. The fund was aimed at increasing the flow of credit to the agricultural sector. The fund is currently managed by the CBN. Other institutions, which the CBN facilitated their establishment, include the Nigeria Export-Import Bank (NEXIM), which was established in 1991. NEXIM provides export financing and export related services such as rediscounting and refinancing facilities and stocking facility to export firms.

These developmental roles of the Bank have been justified on the following grounds :

**Acute shortage of capital and low rate of domestic savings at Independence:*

The Nigerian economy as at 1960, was characterized by acute shortage of capital and low rate of savings. There was therefore the need to generate savings within a short time to enhance economic development.

**Need for requisite institutional framework:*

The traditional functions of the central bank would be hampered if the bank did not undertake some developmental functions. For instance, issuance of legal tender currency as well as the execution of monetary policies would fail in the absence of concomitant development of money and capital markets. Even now, the lingering problems in these markets still constrain the smooth transmission of monetary policies.

**Need for a sustainable rate of economic growth:*

The need to have a government agency capable of carving out a growth path for the economy. This is common to emerging economies and constitutes the divergence in the roles assigned to the central banks of the developed and those of the developing economies. The CBN therefore, is to ensure the development of the economy through the establishment and nurturing of requisite institutions that would facilitate the allocation of resources. For instance, both the agricultural and industrial sectors of the economy need supportive policies and measures to grow on a sustainable basis so as to provide the much needed employment and transformation of the economy. This is in appreciation that the achievement of macro economic stability, *which the bank pursues, would be better facilitated if the performance in the real sector is enhanced and focused, such that demand-pull inflation can be controlled through improved productivity.*

In a nutshell, an appreciation that the success of the traditional functions of the CBN requires an enabling and conducive productive environment, which is a prerequisite for the growth and development of the economy, provides a strong basis for the developmental roles of the CBN.

III. CENTRAL BANK OF NIGERIA'S SUPPORT AND SCHEMES FOR SME FINANCING

The SMEs have been generally acknowledged as the bedrock of the industrial development of any country. Apart from the numerous goods produced by SMEs, they provide ver itable means of large-scale employment, as they are usually labour intensive. They also provide training grounds, for entrepreneurs even as they generally rely more on the use of local materials. Moreover, if well managed, the SMEs can gradually transform into the giant corporations of tomorrow. These contributions thus explain why Governments and International Agencies mobilize efforts towards the realization of sustainable industrial growth and the creation of mass employment through the rapid growth and development of the small-scale enterprises.

However, the SME have had limited access to institutionalized credit facilities, owing to various factors. Some of the major factors include:

**Consideration that the SMEs are very risky in view of their vulnerability in the market as well as their high mortality rate.*

**Banks and other financial institutions are operationally biased in favour of lending to large corporate borrowers, where there is assurance of security, high profitability and faster rates of returns.*

**Owing to their nature, SMEs seeking loans are usually unable or unwilling to provide accounting records and other documentation required by banks, while most are unable to provide acceptable collateral for their loans.*

In recognition of these constraints and in order to ensure the realization of the potential benefits of virile SME in the economy, the Central Bank of Nigeria has remained committed to the growth and development of the small and medium scale enterprises in Nigeria. This stance has been successively reflected in the Bank's policies over the years. In particular, the CBN has through its credit guidelines over the years, and until very recently, required the erstwhile commercial and merchant banks to allocate stipulated minimum of credit to the preferred sectors including the SME. In 1979/1980 fiscal year for instance, the minimum stipulated percentage was 10 of total credit to indigenous borrowers, which constituted the SME. It was raised to 16 and 20 of total l oans and advances in 1980 and 1989, respectively. In cases of default by banks, such shortfalls were deducted at source from 1987, from the defaulting banks' deposits with the CBN and passed on to the appropriate sector through the relevant development banks, such as the NBCI, NACB, etc. This led to greater compliance by the banks, thus credit to the SME sector expanded. For instance, aggregate credit to SME rose from N 23.9 billion in 1992 to N41.5 and N177.1 billion in 1995 and

1997, respectively. This represented 45.1, 24.2 and 16.0 percent of total loans and advances for 1992,1995 and 1997, respectively (See table). The financial sector was, however finally liberalized

* The National Economic Reconstruction Fund (NERFUND)

With the introduction of the Structural Adjustment Programme (SAP) in 1986 and the resultant devaluation of the Naira, many small and medium scale enterprises found it

Bank of Industry in 2001.

* World Bank –Assisted SME II Loan Project

In order to further expand credit delivery to SMEs, the Federal Government negotiated some financial objective of meeting the credit needs of the very small (micro) enterprises. By 1993, the activities of the bank had extended to all the states of the federation in the bid to achieve a target of 170 branches. The bank's loans were administered to groups of entrepreneurs rather than individuals on a deliberate policy based on the "peer pressure" concept.

*Community Banks

The CBN facilitated the establishment and the development of the community banks scheme, which took off in 1991. The objectives of the community banks include: the promotion of rural development by providing financial and banking services to communities inadequately supplied with such services. Although the National Board for Community Banks was inaugurated in 1991 with the responsibility of setting up community banks in the country, the Community Banks have since come under the surveillance activity of the Central Bank of Nigeria and their activities are therefore receiving adequate guidance from the Apex Bank.

* The Nigerian Industrial Developmental Bank (NIDB)

The Nigerian Industrial Developmental Bank was established in 1962 with the primary mandate of providing medium to long-term loans for investments in industrial activities. Although its loan portfolio covers mainly large-scale industries, the bank had special units focusing on SMEs financial requirements. An attractive feature of NIDBs financing is its policy of equity participation in the paid up share capital of some of the projects it financed. It disbursed a total of N174.6 million to the SME between 1980 and 1988 and was also responsible for the bulk of credit delivery to the SME under SME II loans scheme, accounting for more than 80 percent of the total number of disbursements under the scheme. Arising from financial and other constraints, NIDB has been merged with similar institutions under the newly established Bank of Industry.

*The Nigerian Bank for Commerce and Industry (NBCI)

The Nigerian Bank for Commerce and Industry (NBCI) was set up in 1973 to provide among other things, financial services to the indigenous business community, particularly SME. The NBCI operated as an apex financial body for the SME and also administered the SME I World Bank loan scheme. It approved a total of 797 projects with a credit value amounting to N965.5 million between 1973 and 1989 and disbursed N141.82 million between 1987 and 1988. The bank also financed a total of 126 projects under the World Bank loan scheme, some of which were however cancelled due to the failure of project sponsors to contribute their counterpart funding. The NBCI suffered from operational problems, culminating in a state of insolvency from 1989. It is now part of the newly established Bank of Industry.

*Agricultural Credit Guarantee Scheme Fund

The Agricultural Credit Guarantee Scheme was introduced in 1978 to facilitate the accessibility of credit to the agricultural sector. The decree that established the scheme provided for a fund of N100 million subscribed to by the Federal Government (60 percent) and the Central Bank of Nigeria (40 percent). In 2001, the capital base of the fund was increased to N3.0 billion in order to enhance its coverage and performance.

The purpose of the fund was to provide guarantee in respect of loans granted by the commercial and merchant banks for agricultural purposes with the aim of increasing the level of the bank credit to the agricultural sector. In order to guard against the misuse of the funds, the decree provided that in the event that such loans are used to purchase livestock, machinery or farming equipment, the loan should not be paid to the borrower but to the supplier who should furnish the Bank with the document in evidence of the delivery of the items.

The Agricultural Credit Guarantee Fund has made some impact on the extension of credit to the agricultural sector as the introduction of the scheme in 1978 increased the percentage of commercial banks' loans to the agricultural sector. The scheme has granted over =N= 3.3 billion to beneficiaries since inception.

* Nigeria Export Import Bank

The Nigeria Export-Import Bank (NEXIM) was established in 1991 to provide finance, risk mitigating facilities and trade information as well as advisory services to Nigerian exporters. NEXIM's Rediscounting and Refinancing Facility was introduced to assist banks to provide pre and post shipment finance in support of non-oil exports.

In summary, though the schemes and programmes which were put in place to find solutions to the problems of credit delivery to the SME have achieved considerable successes, there still exists a huge gap which should be filled. The need to reduce the credit risks on loans to SMEs by the financial institutions has become more pronounced given the extremely slow rate of draw down on facilities like the World Bank- assisted SME 11 loan and NERFUND. In its analysis, the technical committee for the establishment of a National Credit Guarantee Scheme for Small and Medium Enterprises (SMEs) in Nigeria, established that not more than 50 percent of aggregate effective demand for investment loans in the manufacturing sector are currently being met. This therefore, necessitates further action aimed at enhancing the flow of financial resources to the SME sub -sector.

IV. CURRENT FINANCING INITIATIVES AND THE WAY FORWARD

In order to make the SME sector more vibrant, the Central Bank of Nigeria has evolved new initiatives, which are geared towards improving accessibility and availability of credit to the SME through the following:

* The Small and Medium Industries Equity Investment Scheme (SMIEIS)

Bothered by the persistent decline in the performance of the industrial sector and with the realization of the fact that the small and medium scale industries hold the key to the revival of the manufacturing sector and the economy, the Central Bank of Nigeria successfully persuaded the Bankers' Committee in 2000 to agree that each bank should set aside 10 percent of its annual pre tax profit for equity investment in small and medium scale enterprises. To ensure the effectiveness of the programme, banks are expected to identify, guide and nurture enterprises to be financed under the scheme. The activities targeted under the scheme include agro-allied, information technology, telecommunications, manufacturing, educational establishments, services, tourism and leisure, solid minerals and construction. The scheme was formally launched in August 2001. With the introduction of the scheme, it is expected that improved funding of the SMEs will facilitate the achievement of higher economic growth. As at August 2002, the sum of N11.572 billion had been set aside by 77 banks. Out of this amount, N1.692 billion had been invested in the small and medium scale enterprises.

* Nigerian Agricultural, Cooperative and Rural Development Bank (NACRDB)

The Nigerian Agricultural Cooperative and Rural Development Bank Limited is an amalgam of the former Peoples Bank of Nigeria, Nigerian Agricultural and Cooperative Bank and the Family Economic Advancement Programme (FEAP). It was set up in October 2000, primarily to finance agriculture as well as small and medium enterprises. The NACRDB is structured to accept deposits and offer loans/advances in which the interest rates are graduated according to the purpose for the loan to Nigerians and their business. The bank also offers a number of financial products including target savings, start–up as well as smallholder loan schemes.

* The Bank of Industry

This is an amalgam of the former Nigerian Industrial Development Bank, the Nigerian Bank for Commerce and Industry and the National Economic Reconstruction Fund (NERFUND). It was set up in 2000 with the principal objective of providing credit to the industrial sector, including the small and medium scale enterprises.

*Refinancing and Rediscounting Facility

With effect from January 2002, the CBN introduced the Refinancing Facility at concessionary interest rate to support medium to long term bank lending to the productive sectors of the economy. This facility instituted to provide liquidity to banks in support of their financing of real sector activities. This was in recognition of the fact that aggregate credit by deposit money banks was mainly short term, and as such loans were channeled mainly to general commerce and trade. Furthermore, there is need to encourage medium to long term lending to the productive sectors of the economy, if the production base of the economy is to be expanded and diversified. 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 to the specified productive sectors. The sectors include agricultural production, semi manufacturing and manufacturing, solid minerals and information technology. Under the facility, banks shall have access up to 60 percent of qualifying loans. Qualifying loans must have been held for not less than one year.

The Way Forward

The various measures taken to ensure the growth and development of the small and medium scale enterprises have witnessed limited success as a result of myriad of reasons. These include inadequate infrastructural facilities, continued restricted access to credit as well as abuse of the various programmes by both the beneficiaries and the operators arising from insincerity of purpose, among others.

The small and medium scale industries however remain very prominent in the industrial growth path of any economy. Consequently, efforts towards a sustainable growth of the sub sector should be intensified. In this regard, the various current initiatives (SMIEIS, BOI, NACRDB, ACGS etc) should be strengthened and refocused in order to obviate the problems associated with past initiatives.

Towards this, the following should be seriously considered:

* Efforts should be intensified towards the adequate provision of infrastructures. This would not only reduce the cost of production and enhance competitiveness, but would also encourage further investment and growth of the sector.

*Observed constraints such as demand for cumbersome collateral security in accessing available credits should be removed. Operators of the different initiatives should therefore endeavour to ensure that funds get to the targeted group of investors. This may require a review of the existing framework to ensure greater flexibility without sacrificing the principle of sound financial practice.

*Government should on its part endeavour to fund the Banks of Industry and the Nigerian Agricultural Cooperative and Rural Development adequately.

* The apparent lull in the activities of the Small and Medium Industries Equity Investment Scheme (SMIEIS) shows that the problem with the growth of the SMEs is not just capital. There is the problem of inertia, unwillingness to dilute ownership and control, fear of the unknown, etc. These can be solved through enlightenment. Therefore, the active involvement of the Nigerian Association of Small Scale Industrialists (NASSI) and all other groups of the organized private sector should be encouraged in order to have wider coverage and patronage. Experience has also shown that information on SMIEIS is yet to be adequately disseminated.

* Efforts should be made by the Government to attract international financial institutions towards the growth and development of SMEs in Nigeria. Such organizations as the World Bank, the International Finance Corporation, among others have made laudable contributions towards this in the past.

V.SUMMARY AND CONCLUSION

The Central Bank of Nigeria in pursuance of its traditional role has also been involved in development issues. These developmental roles of the Bank became necessary in order for the economy to grow in a sustainable way. The CBN has aided the financing of enterprises through several approaches including the establishment of developmental finance institutions, use of monetary and policy guidelines to channel credit as well as operation of loan guarantee scheme among others. These efforts have attained varying levels of success and have actually moved the SME sub sector forward. However, much still needs to be done by all the stakeholders in the sub sector. This has necessitated the new initiatives which hopefully would minimize the constraints to accessing institutional credit by the SMEs, while ensuring that identified bottlenecks to the efforts are corrected.

Table

Commercial and Merchant Banks' Loan and Advances to Small and Medium Enterprises 1993 - 2000

	Total Credit (1) ₦'m	SME Credit (2) ₦'m	(2) Percentage of (1) %
1992	529998.8	23893.9	45.08
1993	73245.8	20363.9	27.80
1994	126809.1	26041.8	20.54
1995	171768.2	41534.1	24.18
1996	210381.2	47897.9	22.77
1997	1,100,883.1	176126.8	16.00
1998	1264251.8	201160.6	15.91
1999	402,338.1	53213.1	13.23
2000	565871.3	51001.1	9.01

Source: CBN Statistical Bulletin, December 1998 Commercial and Merchant Banks' Returns

ECOWAS MONETARY INTEGRATION AND DATA REQUIREMENT IN PERSPECTIVE

BY
A. BAMIDELE*

INTRODUCTION

Timely availability of credible data is crucial in any surveillance activity whether at national, sub-regional, regional or global level. For this reason, economic monitoring at the supra national level requires that each member of the group makes available reliable statistics to the central body for effective measurement of economic activity against agreed benchmarks. It is in the light of this that the West African Monetary Agency (WAMA) requires reliable data on timely basis from all members of the Economic Community of West African States (ECOWAS) in its bid to execute its mandate of establishing a single monetary zone with a common currency to be managed by a central bank in the near future. Preparatory to the realization of this objective is the fulfillment of some minimum conditions otherwise known as macro-economic convergence criteria by all member states. This calls for rigorous monitoring by WAMA that has been mandated to midwife the process by the Authority of Heads of State and Government.

WAMA's surveillance experience in the achievement of both primary and secondary criteria, which have been set as minimum conditions for the operation of the single monetary zone, has been fraught with low quality data. Apart from the long lags associated with data sets supplied by member countries, the variability of such statistics on most economic aggregates from the same country raises credibility problems. Such problems could arise in the areas of gauging the level of economic activity; inter-temporal/cross country analysis or reaching spurious conclusions in applied research studies. The avoidable consequences of this include misrepresentation of facts and prescription of sub-optimal and/or spurious policy measures for fundamental economic problems.

The focus of this paper is to evaluate the status of ECOWAS member countries data vis-a-vis the objective of monetary cooperation with a view to bringing out the problems involved and proposing some policy options. This paper is divided into six parts. Following this introduction is Part II, which presents an evolution of the ECOWAS monetary integration process with a brief literature. To actualize this laudable programme requires a plethora of data in ascertaining compliance with minimum preconditions aimed at orderly transition to the ultimate objective of a single monetary zone. This is the subject of Part III. Part IV analyses ECOWAS member states data position, while Part V proffers some policy recommendations. The paper is concluded in Part VI with a summary.

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II. EVOLUTION OF THE ECOWAS MONETARY INTEGRATION PROCESS

Conceptual Issues

Conceptually, monetary integration is a process whereby a group of countries form a monetary union. According to Ojo (2001), monetary integrating in a broad sense involves exchange rate unification and currency convertibility. While exchange rate unification entails a permanently fixed relationship among the currencies of integration members, currency convertibility means the absence of all exchange controls for both current and capital transactions within an area (Max Corden, 1972). Monetary un ion, on the other hand, is characterized by a single money, or several currencies fully convertible at fixed exchange rate, monetary policy determination at the union level and a single exchange rate policy with a common pool of external reserves of members (Allen 1976). Monetary integration or union could take many forms ranging from the limited currency convertibility type, as practiced under the current ECOWAS clearing mechanism, to a monetary union having a unified economic policy exemplified by the European Monetary Union (EMU). Other intervening phases of monetary union and single currency union Chipeta and Mkandawire 1994, Crockett 1991, and Soyibo, 1998b).

The attraction of monetary integration can be found in the reduction of transaction cost within an area as the working balances in a convertible currency is reduced since only net balances are settled at the end of each transaction period, thus economizing the use of foreign reserves. Additi onally, activity level is enhanced as intra-regional trade is promoted (Tella and Adesoye, 2001).

ECOWAS Monetary Integration Experience

Financial integration initiatives covering the whole of the West African sub-region dates back to 1975 when the treaty establishing the ECOWAS, states that inter alia "monetary cooperation will entail that member States shall, within a time-table to be determined by the Assembly, harmonize their monetary, financial and payment policies, in order to boost intra-community trade in goods and services to further the attainment of the objectives of the community and to enhance monetary and financial cooperation among member States". Consequently, the West African Clearing House (WACH), the first clearing house in Africa, was established on June 25, 1975 to settle payments for goods and services on a multilateral basis. The WACH, which began operations in July 1976 at its headquarters in Freetown, Sierra Leone, was aimed at facilitating the use of domestic currencies for current account transac tions and trade liberalization among member States. The long-run objective was anchored on promotion of monetary cooperation and consultation among members.

By 1987, ECOWAS members at the Abuja meeting agreed to the establishment of ECOWAS Monetary Cooperation Programme (EMCP) for the purpose of strengthening the broad objective of regional currency convertibility in the short-run and a single monetary zone in the long-run (ECOWAS 1991). Given several changes that had taken place in the sub-regio n since 1975, including increased trade liberalization, improved corresponding banking relationship, etc., the WACH was transformed into the West African Monetary Agency (WAMA), a specialized autonomous agency of the ECOWAS on August 8, 1996 to meet the challenges of changing economic landscape. The long-term objective of WAMA is creating a single monetary zone with a single currency. This is to be preceded by the use of national currencies in intra-regional trade and thus economize on the use of foreign exchange; harmonization of monetary and fiscal policies and programmes; trade liberalization; monetary cooperation and consultation; and promotion of market oriented macro-economic policies; among others.

In giving effect to the broad objective of financial integration, the ECOWAS Traveler's Cheque (ECOWAS-TC) was introduced in 1998 not only as a clearing and settlement instrument but also as an integral part of the EMCP. Specifically, the EMCP was put in place for the purpose of adopting collective policy measures in order to achieve a harmonized monetary system and common management institutions. For the purpose of orderly achievement of set targets,

ment institutions. For the purpose of orderly achievement of set targets, the broad objectives of the EMCP were divided into short, medium and long-term goals.

The tasks to be accomplished in the short-term include settlement of outstanding payment arrears in the clearing mechanism; extension of the range of eligible products covered by the mechanisms; introduction of new payments instruments; and removal of all non-tariff barriers of a monetary nature that restrict the use of sub-regional currencies for certain current transactions. The intermediate objective is the institution of a system of limited regional currency convertibility through the removal of restrictions on the use and acceptability of national currencies in intra-regional trade and payments transactions. In this connection, member countries are expected to enter into sub-regional convertibility agreement during this period. As stated earlier, the ultimate objective of the EMCP is a single monetary zone. This is to be characterized by the use of a common convertible currency in existing nine currencies; creation of a common central bank; pooling of foreign reserves; and negotiation of an external convertibility guarantee with an appropriate international body.

The achievement of these objectives, however, requires a number of policy reform measures to be implemented by member states in order to achieve macro-economic convergence, which is a minimum condition for the establishment of a single monetary zone. Among the policy reforms are the liberalization of exchange control and exchange regimes; realignment of exchange rates and the maintenance of market-determine exchange rates; adoption of a market-oriented approach to monetary policy; and reduction of fiscal deficits through the rationalization of government expenditure as well as reform of the tax system. The EMCP which was originally meant for the 1991 – 1994 period was extended to cover the 1991 – 2000 period and was pushed further to 2004 at the Lome Summit of December, 1999 due to lack of achievement of preconditions.

The determination of the degree of country performance in the implementation of the agreed policy measures under the EMCP necessitated setting some macro-economic convergence criteria to be complied with by the year 2000. Currently the convergence indicators have been expanded and divided into primary and secondary operational macro-economic convergence criteria after the review of 1999. The primary criteria which are the macro-economic variables considered crucial to the achievement of a single monetary zone include budget deficit (excluding grants)/GDP ratio of 4.0 per cent maximum by year 2002; inflation rate of 5.0 per cent maximum by 2003; central bank financing of budget deficit of 10.0 per cent maximum of previous year's revenue by the year 2003 and a maximum gross reserves cover of 6 months of imports. Six other conditions considered as related to and supportive of and in some cases capable of being used as policy instruments to reinforce the primary ones are grouped as secondary criteria. These are zero domestic arrears i.e. prohibition of new internal arrears and liquidation of all existing ones by end-2003; tax revenue/GDP ratio of 20.0 per cent minimum; salary mass/total fiscal receipts ratio of 35.0 per cent maximum; public investments financed from internal resources/tax receipts ratio of 20.0 per cent minimum; real exchange rate stability; and positive real interest rate.

The establishment of benchmarks requires putting a good monitoring system in place to ensure compliance on a consistent basis. The WAMA has been statutorily mandated to carry out surveillance activity under a multilateral surveillance mechanism. Other bodies involved in the mechanism are the Convergence Council (comprising Ministers of Finance and Central Bank Governors); the Technical Monitoring Committee (made up of Director of Research of member Central Banks and high ranking Ministry of Finance Official); the ECOWAS and the National Coordinating Committees. At the WAMA level, country performance under the EMCP is expected to be produced annually and of recent bi-annually to enable the Technical Monitoring Committee and the Convergence Council make informed decisions. The effective tracking of member countries' activity level and performance under the EMCP requires up to date and credible data from member states on the level of economic activity as well as other macro-economic variables including domestic prices, exchange rate, fiscal operations, etc. The specific data need of WAMA in this area is the subject of the next section.

III. THE RELEVANCE OF WAMA'S DATA REQUIREMENTS IN SURVEILLANCE ACTIVITY

The statistical needs of WAMA in general economic surveillance and monitoring are usually required from countries through administration of questionnaire on macro-economic aggregates covering all sectors of the economy. Under the EMCP, the data sets are utilized in appraising the level of each member country's compliance with the macro-economic convergence criteria. The main data sets include real sector data such as output represented by the Gross Domestic Product (GDP) and domestic price level; money and banking statistics in the financial sector; government fiscal operations; and developments in the external sector viz.; balance of payments, exchange rate movements, external debt and external reserves position.

1.Real Sector Statistics

a)Gross Domestic Product (GDP)

Aggregate national output measured by the GDP is required not only for gauging the level of economic activity, but also for understanding the workings of the economic system as most other variables are related to it. For instance, it is used for ascertaining sustainable deficit level under the primary convergence criteria, while it helps in understanding internal resources generation efforts in the secondary criteria. What is required in this regard is quality data on real and nominal national production, income and expenditure in accordance with the United Nations system of national accounts 1993 (SNA 93) preferably at quarterly, half yearly and annual frequencies. The shorter frequencies are preferred as they enable intra-year analysis.

b)Price Statistics

The level of domestic prices is essential for monitoring policy out turns in both the primary and secondary convergence criteria as well as cost of living, among others. For the EMCP purposes, WAMA utilizes CPI to determine the rate of inflation in the primary convergence criteria, and for computing the real interest and exchange rates in the secondary criteria. Alternative measures of inflation include consumer price index (CPI), producer (wholesale) price index and GDP deflator. The availabili ty of the first two indices simplifies the tracing of the price movements from the producer to the final consumer, while the GDP deflator shows economy-wide price inter-temporal relativity.

2.Financial Sector

The data required in the financial sector comprise the monetary survey i.e. the balance sheet of the banking system, the components of which are the central bank balance sheet and the balance sheet of the deposit money banks. These are required to measure the level of liquidity consistent with the economic ac tivity on temporal basis through such monetary aggregates as money supply, credit to the domestic economy and levels of foreign and domestic assets and liabilities. In addition, information is required on the structure of interest rates, all of which are expected to be credible and timely.

3.Fiscal Statistics

Government fiscal operations data are required to measure the level of fiscal discipline, internal revenue generation efforts as well as public sector investment aimed at ushering in sustainable growth and development. Consequent ly the data set usually requested include government expenditure, revenue, fiscal balance and its financing. Expenditure level and sources of revenue are very important in evaluating existence or otherwise of crowding out of the private sector as well as trace sources of liquidity surfeit and consequent inflation.

4.External Sector Statistics

The balance of payments is the analytical framework required to keep abreast of developments in the external sector. The analytical balance of payments framework consists of trade, current, capital and financial accounts statistics. Also included is the over all balance position, financing items and level of official reserves. The exchange rate is also required to gauge the competitiveness of a country's tradables in the international market. Apart from monitoring external viability of an economy, this data set has implications for domestic stability, which is why external sector statistics should be comprehensive and timely.

IV. ECOWAS MEMBER STATES' DATA POSITION

Having discussed the relevance of data requirements for monitoring compliance with macro-economic convergence criteria, it is essential to evaluate the data situation in the sub-region in order to appreciate how quickly the EMCP objective could be realized. The general outlook of individual country's macro-economic statistics within the ECOWAS sub-region has been characterized by long lags, data gaps, inconsistencies, historical bases, etc. in most economic variables as reflected in responses to WAMA's questionnaire. The more fundamental problems include conceptual, measurement, coverage and methodological issues in the derivation of most of the indicators especially in domestic prices, fiscal and balance of payments statistics except in the financial sector data compiled by member central banks. This has compounded the problem of surveillance in general and convergence criteria monitoring in particular. Part of the general concern being raised on country data includes lack of reliability and comparability of figures as well as mis-representation of facts.

WAMA's general experience is summarized under the following major macro-economic indicators.

Gross Domestic Product

The member countries' national accounts data is currently compiled on annual basis as opposed to quarterly and half-yearly series. The general problem faced here has to do with long lags. Spanning more than two years in some countries, in the production of national account statistics, while projections are made for a number of years. This has made computation of most of the criteria, which are usually based on GDP problematic. The trend worldwide is quarterly production of national accounts data in view of its crucial role in intra-year tracking of activity level. Another major concern is in the area of structural/sectoral coverage of the economy, as the SNA68 are still in use in most countries in the sub-region. Only Sierra Leone has adopted the SNA93, which ensures reasonable coverage of activity and standard data preparation methods, while others still use the SNA68 manual. The SNA93 is recommended to all other countries in the community. The UEMOA countries' effort of embracing the PARSTAT project and other harmonization measures carried out by AFRISTAT is a welcome development as it allows greater comparability of data among those countries.

Domestic Prices

Inflation measurement within the community is faced with lack of alternative measures of the domestic price level, as only the price at the short end of the market i.e. the CPI is available for this purpose. Domestic price measurement is further compounded by wide divergence in the composition and geographical coverage of the CPI in the sub-region. For instance, apart from Ghana and Nigeria, the CPI covers mostly urban centres, usually the capital cities in all the other countries; while the component items covered vary.

The CPI is required on monthly basis for effective monitoring and fine-tuning of monetary and fiscal policies, however, price statistics in the Community suffer lon g lags of about two to six months. Other peculiarities include the use of historical base period ranging from fifteen to thirty years that has little or no relationship with current economic circumstances. The correction of all the anomalies associated with the CPI and the computation of alternative measures of inflation such as producer price index and GDP deflator are advocated in view of the relevance of this indicator to both primary and secondary macro-economic convergence criteria.

Financial Statistics

The fina ncial data, especially money and banking statistics compiled by member central banks including monetary aggregates, interest rate structure, etc. conform with international standards. In most cases, the monetary data conforms to the IMF's General Data Dissemination System (GDDS), with lag of only one or two months maximum. For continuous upgrading and compliance with international best practices, countries are enjoined to embrace the Special Data Dissemination System (SDDS) of the IMF.

Fiscal Statistics

Government revenue and expenditur e figures are produced by each country's Ministry of Finance and supplemented by Central Bank data in some cases. The general problem with fiscal data has to do with lack of comprehensiveness in terms of covering all tiers of government and all expenditures including that of state owned enterprises. Similarly, there is paucity of data on domestic arrears while reporting format differs from one country to another. One of the problems fiscal data is veiling of some aspects of government expenditur e through many devices includes bye-passing the budgetary process in some cases. Another problem is excessive budget deficit and its financing through the central bank, which negates two conditions of the primary criteria.

External Sector Statistics

The balance of payments statistics compiled by member central banks is in line with the IMF standard in most cases. However, some countries, notably the Gambia, Nigeria and Sierra Leone still use the Fourth Manual of the Balance of Payments published in 1986 as opposed to the Fifth Manual of BOP (WAMI 2002). The BOP is compiled annually with one-year lag/projections in some countries. It should also be mentioned that the treatment of capital and financial accounts varied among the countries. For example, capital and financial accounts were lumped together in Ghana. External debt and gross reserves data are readily available in most of the countries, while exchange rate is available on daily basis. However, Guinean exchange rate is still available once a month as foreign exchange mar ket is conducted monthly.

V.POLICY RECOMMENDATIONS

It is evident from the foregoing analysis that the community's macro-economic data leaves much to be desired which must be corrected as a matter of urgency, if the single currency objective is to be realized at the revised target date of 2004. As the deadline approaches it is important and necessary to increase the pace of monitoring from half-yearly to quarterly interval. To do this requires timely rendition of data by all ECOWAS member countries. Policy measures necessary for the fundamental issues include but are not limited to accelerated capacity building at the national level, data cooperation and harmonization at the community and international levels and above all demonstration of political will at all levels including data bank building which is germane to growth and development at national and regional levels. Each of these options is discussed in what follows.

Timely Data Rendition

The immediate solution to the data problem facing the EMCP multilateral surveillance mechanism is the timely rendition of data to all the agencies involved in general and WAMA in particular. This is necessary for close monitoring and policy fine-tuning to ensure the achievement of the desired result of monetary integration within the agreed time frame. In this regard, member countries are enjoined to make available macro-economic indicators every quarter. This is very important as we move closer to the take-off date of 2004.

Accelerated National Statistical Capacity Building

The need for capacity building in the area of macro-economic data production cannot be over-emphasized if the community's monetary cooperation programme is to succeed. Capacity building requires enormous capital outlay in terms of financial, human and materials resources. However, it is a worth while venture owing to the immense economic and social benefits derivable from availability of credible and timely data for policy formulation and execution.

As noted in the last section, while efforts should be directed at all sectors, the real and public sectors' statistics call for special mention. In the area of real sector data, capacity should be improved towards generating CPI with national coverage and bases of not more than five years as well as production of other forms of price indicators such as producer price index and GDP deflator. Concerning the national accounts data, except for Sierra Leon, all the other member countries are enjoined to adopt the United Nations SNA93 version to solve the structural composition problem, among others.

The challenges of fiscal data are both technical and transparency in nature. The technical aspect relates to ability to cover all government accounts including all tiers of government and parastatals as opposed to only central government coverage. On the side of transparency, what is required is the political will of full disclosure in order to capture the full impact of government expenditures. ECOWAS member state are also implored to adopt the IMF Fifth Manual of BOP in order to streamline their external sector statistics, while efforts should be geared towards compliance with the IMF's SDDS for monetary data.

Community-wide Data Harmonization

Effective monetary integration requires the application of identical set of rules and borrometer with which to ascertain compliance. It is in the light of this that the harmonization of data across all ECOWAS countries remains sine qua non -for economic convergence criteria monitoring and the timely take-off of the West African single currency.

An affirmative action in this regard is the AFRISTAT initiative aimed at harmonizing output and price data in the ECOWAS. Given the feat already recorded in streamlining the GDP and price statistics of the UEMOA countries through AFRISTAT efforts, the same should be extended and improved upon community-wide. In addition, the harmonization process should be extended to cover all sectors to enable data comparability within the sub-region. It is gratifying to note that most member states are adopting multilateral institution's reporting formats such as IMF, UN, etc., albeit at a slow pace. The advice here is for all the countries in the sub-region to keep pace with international best practices.

Data Exchange among ECOWAS Institutions

The data problem of the sub-region could also be solved through cooperation among all the institutions in ECOWAS. This requires data sharing among the ECOWAS Secretariat, WAMA, WAMI, UEMOA and other affiliated bodies through a network programme. The data network programme could be extended to member countries central banks and national statistics offices for ease of data sourcing.

Demonstrable Political Will

The most important factor in any union is demonstrable commitment and political will on the part of all constituent units not only to sign protocols of agreement but also to implement decisions mutually reached. While it is recognized that the single monetary zone entails surrendering part of national sovereignty in monetary and fiscal policies, it is our belief that the benefits of economics of scales far outweigh narrow national considerations.

The political will demonstrated in the case of the Second West African Monetary Zone that led to the creation of the West African Monetary Institute is worth emulating. When this is combined with the long-standing association in the UEMOA countries, with the same viguor, the ECOWAS-wide single monetary objective will no doubt materialize, additional incentives can be found in the increasing gale of globalization in which regional and sub-regional economic groupings such as the European Union (EU), North-American Free Trade Area (NAFTA), Southern African Development Commission (SADC) puts nations at advantage in terms global economic outreach and political influence. In this wise ECOWAS member countries are enjoined to devote all their energies both human and materials to the realization of the Community objective of single currency managed by a common central bank.

VI.SUMMARY AND CONCLUSION

Attempt is made in this paper to evaluate the status of ECOWAS member countries' macro-economic data required in a multilateral surveillance mechanism under the ECOWAS Economic Cooperation Programme designed to give birth to a single currency to be managed by a common central bank come 2004. It is observed that given the comprehensive nature of the envisioned monetary cooperation programme in the ECOWAS, macro-economic data is required, on current basis, in all the sectors of the economy viz: fiscal, financial, real and external.

An evaluation of t he data position the sub-region revealed that there is much to be desired especially in the areas of data currency which could not keep pace with rendition of returns to the monitoring body at agreed intervals. Another obstacle is the lack of data uniformity among all the community members, which present the problem of data comparability. It is gratifying to note that the latter problem is being resolved through the AFRISTAT initiatives in the areas of national accounts and domestic prices. The paper advocates the intensification of such nitiatives and extension to other sectors of the economy. Other policy measures proffered for resolving the community data problems included accelerated capacity building at the national level, exchange of data among sub-regional institutions and above all, unalloyed political will to execute the plans and programmes mutually agreed under the EMCP protocol of agreement. It is by doing this that the welfare of the ECOWAS citizens could be enhanced in an increasingly globalized world.

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INTERNATIONAL RESERVE MANAGEMENT: A SYNOPSIS

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INTRODUCTION

ound international reserve management practices are important because they can increase a country's overall resilience to shocks. Through their interaction with financial markets, reserve managers gain access to valuable information that keeps policy makers informed of market developments and views on potential threats. The importance of sound practices has also been highlighted by experiences where weak or risky reserve management practices have restricted the ability of Central Banks to respond effectively to financial crises. Moreover, weak or risky reserve management practices can also have significant financial and reputation costs.

It is therefore desirable that appropriate portfolio management policies concerning currency mix, choice of investment instruments and acceptable duration of the reserves portfolio reflect a country's specific policy settings and circumstances. Sound reserve management policies and practices can support but not substitute for sound macroeconomic management. Similarly, inappropriate economic policies (fiscal, monetary and exchange rate etcetera) can pose serious risks to the ability to manage reserves.

1)WHAT IS INTERNATIONAL RESERVE?

International reserve management has been variously defined in the context of objectives for reserves management, reasons for holding reserves and the components and structure of reserves. However, it is widely accepted that "reserves management is a process that ensures that official foreign exchange reserves are readily available to meet a range of objectives for a country"

According to Rasheed (1997), reserves may be defined as the "external assets of a country that are readily available to and managed by the Central Banks for direct financing of Government's expenditure, intervention in foreign exchange markets and meeting other external financial commitments". The precise classification of reserves is in fact rather arbitrary, although conventionally would incorporate gold, convertible currencies, Reserve Positions in the IMF and Special Drawing Rights (SDR).

Management of reserves in a country is influenced by external sector developments such as international trade transactions, domestic and related international exchange rates, external debt and other external obligations (i.e. mandatory contribution to international organizations).

Oputa (1994) opined that reserves should only include those assets on which the Central Bank of a country exercises direct and effective control. A clear distinction is required at this juncture in view of the fact that a country's external assets are often erroneously confused as its external reserves. In this connection, a country's external assets comprise the foreign holdings of the Government, semi-official institutions, commercial and merchant banks and that of the Central Bank of that country. On the other hand, only the Central Bank's component of the external assets may be interpreted as its external reserves.

International reserves can also be explained in terms of net or gross reserve position. The gross reserve comprises gold, convertible foreign currencies and SDRs. The net reserve is a residual component derived from subtracting the current foreign liabilities of the Central Bank from the gross reserves. However, the gross concept is the most acceptable measure, since it indicates in totality the level of a country's external assets that is available to the Central Bank, part of which can be used for the financing of balance of payments without recourse to adjustment measures.

This paper reviews the meaning, reasons and objectives for holding reserves, the composition, optimum size of reserves and strategy for reserves management. Finally, the importance of training and enabling environment in reserves management was underscored.

2)REASONS FOR HOLDING EXTERNAL RESERVES

Although almost all countries hold foreign e xchange reserves, their reasons for doing so differ widely. Before setting a strategic policy for the reserves, the authorities need to establish precisely why they are holding the reserves that they have. Only then can a sensible debate be held on such issues as optimum size of reserves, their funding and their investment. The following are some of the main reasons for holding reserves:

a)Transaction needs

b)Intervention purposes

c)Wealth diversification and/or accumulation.

d)To enhance a country's international credit worthiness

e)Buffer against external shocks

f)To provide a defence against emergencies or disaster.

g)Demonstrate the backing of domestic currency by external assets.

Each central Bank adopts a combination of these and none appears to have been dominant over recent years, as justification for holding a desired level of reserves.

TRANSACTION NEEDS

Reserves may be held to provide the liquidity needed for se ttlement of obligations to and transactions with the rest of the world. It provides the financing for readily foreseeable foreign exchange demands of either the public or private sector. This factor is generally considered to be fairly insignificant in terms of importance for the industrialized economies that have developed an excellent access to international capital markets.

The transactions' objective

may be particularly important in developing countries where extensive use of exchange control measures leads to the channelling of a high proportion of a country's foreign currency transactions through its Central Bank.

INTERVENTION NEEDS

Reserves are also held for the purpose of foreign exchange intervention in pursuit of either balance-of-payment or exchange rate stability. In the opinion of Neil (1993), for majority of countries, the intervention motive is considered to be the most important reason for holding r eserves. This is so especially for those countries with very relaxed tariff policies and capital markets.

Monetary authorities occasionally intervene in the foreign exchange market to counter disorderly market conditions. Since the breakdown of the Bretton Woods system, Central Banks have used foreign exchange intervention both to slow rapid exchange rate moves and to signal that the exchange rate did not reflect fundamental economic conditions.

WEALTH DIVERSIFICATION NEEDS

Although wealth or portfolio return considerations may be important in motivating Central Banks' holdings of foreign currency assets, the factor rather than influencing the level of reserves, is more relevant to decisions regarding its composition. Wealth considerations may, however, have significance for reserves' levels in certain circumstances. The most notable example is where a central bank has some responsibility for managing the net reserves to earn more income.

TO ENHANCE A COUNTRY'S INTERNATIONAL CREDIT WORTHINESS

External reserves represen t the ultimate line of defence if credit worthiness of a country is in doubt and it cannot have access to new borrowing. More importantly, a respectable level of reserves serves notice to the watching international community that the country's economic prospects are good. This enhances international investor confidence and attracts foreign investment into the country.

BUFFER AGAINST EXTERNAL SHOCKS

Available stock of reserves can be used as a buffer against external shocks. A high level of external reserves provides a cushion for the country against external shocks, such as a sudden fall in the price of oil, giving the country time to adjust its expenditure patterns to this external shock without causing any destabilization in the economy.

DEFENCE AGAINST EMERGENCIES OR DISASTER.

Reserves can provide a defence against emergencies or disaster, by acting as a fund to finance recovery and rebuilding. Thi s is most likely to be appropriated for small countries that are not large enough to provide self-insurance; larger countries are more likely to fund recovery from crisis in one part of their domestic economy from elsewhere in the economy. But a small country may possibly be completely overwhelmed by a disaster; for example a natural disaster that wipes out the only export or a collapse in their terms of trade, or even military disaster. For such events reserves can provide a diversification of assets, a pool of readily usable funds and security and comfort for potential lenders.

BACKING FOR DOMESTIC CURRENCY

Reserves are sometimes held as formal backing for the domestic currency. This use of reserves was at its height under the gold standard, and survived after the Second World War under the Bretton Woods system. After the breakdown of the Bretton Woods system it became less common, though the use of gold especially to back a currency has never completely disappeared, and the idea of using foreign exchange reserves (rather than gold specifically) to back and provide confidence in domestic currency has recently been revived. Nevertheless, for most countries this is not, these days, the prime use of reserves.

3)RESERVES MANAGEMENT OBJECTIVES

The principal objectives of central banks' reserve management world over are safety of principal amount, liquidity and returns maximization.

Undoubtedly, Central Banks are primarily concerned with the security or safety of their external reserves. The Reserve portfolio should be able to preserve its nominal principal value and ideally also maintain its real value overtime. Safety considerations apply not only to the credit rating to the counterparty but also the country in which the investment is domiciled as well as the attendant currency risks.

The second major concern of Central Banks is that of liquidity. Central Banks endeavour to place their reserves in assets that are sufficiently liquid to ensure prompt and timely availability of adequate funds to settle all foreseeable and unexpected external obligations.

Return maximization, while not as important as the two primary objectives of safety and liquidity is steadily becoming a very important goal in the reserve management of Central Banks. Central Banks investment portfolios are now structured to include long-dated instruments in order to boost earnings.

4)THE OPTIMUM SIZE OF RESERVES

Any debate over the optimum size of the reserves has two main elements. The first is the correct identification of the uses of the reserves and therefore of the minimum required to meet the identified needs. No sensible discussion of the optimum size of reserves can take place before this has been done. The second element is a correct analysis of the cost of funding the reserves. The debate over limiting the growth of the reserves will be easier to conduct if the true cost of reserves accumulation is known.

The optimal level of reserves may also depend on the nature of the exchange rate regime, the external exposure of the economy as well as trade and capital market restrictions. A country's actual reserves at any given time are quite likely to differ from the desirable level. The latter should be regarded as a medium to long-term target level around which reserve levels may vary considerably.

The calculation of the optimal size of reserves is clearly a rather complex matter that has been the subject of a number of theoretical and empirical studies. One of the most widely used measures is the value of external trade. A common rule of thumb is that foreign exchange reserves should cover three months' imports. On the other hand, some school argues that four months import is a better measure. Roger's (1993) examination of reserves for sixty countries found that on average, reserves fell short of these levels and were sufficient for only about two months' imports. Import coverage for developing countries was found to be substantially higher than for industrialised countries.

5)COMPOSITION OF EXTERNAL RESERVES

For most countries, international reserves consist of demand deposits and call money at foreign financial institutions, investments in treasury bills and securities of foreign governments, and other relatively liquid investments in foreign currency assets. These foreign reserves are held in basket of convertible currencies.

Gold held in the vault of Central Banks to increase the international liquidity of a country also qualify as part of the external reserves. With the advent of paper money or convertible currencies as reserves, the composition of gold to total Central Banks' reserves has been on the decline. However, gold reserves have continued to be part of external reserves of most countries due to its intrinsic value and its acceptability in the settlement of international foreign exchange obligations.

International reserves also include the gold tranche and special drawing rights of a country with the International Monetary Fund (IMF). Gold tranche is an unconditional international reserve asset arising from a country's subscriptions to the IMF. Gold tranche represent a net creditor claim on the IMF and is defined by Ana logbei (1999) simply as the member's quota minus the fund's holdings of member's own currency. The intrinsic value of gold as international reserve might have informed the IMF in establishing a rule that member countries' quota be paid in a proportion of 25 per cent gold and 75 per cent of member own currencies.

Analogbei also defined Special Drawing Rights as reserve assets created by the IMF and allocated to its member countries in accordance with their respective quotas. SDR was initially conceived as "paper-gold" fixed to the official US dollar price of gold but currently it is denominated in terms of a basket of four currencies.

6)STRATEGY FOR RESERVES MANAGEMENT INSTITUTIONAL FRAMEWORK

In discharging their statutory responsibility for reserve management, most Central Banks are continuously seeking to improve the art and strategy of managing reserves prudently and professionally. They begin by ensuring that an institutional structure that seeks to reflect the best practice is in place.

Sound institutional and governance arrangements are established through a legislative framework that clearly establishes a central bank's responsibilities and authority. This will include an internal governance structure for reserves management that is guided by the principles of clear allocation and separation of responsibilities.

In most cases, there is the Board of Directors that sets the overall strategy; they determine the asset allocation framework, investment guidelines (which include exposure limits for markets, currencies and modified duration); they also determine performance benchmarks. There exist also an investment committee in central banks, which is responsible for strategic decisions against established benchmarks and periodic portfolio rebalancing.

At the operational level, decision making and responsibility for day–to–day reserve management operations are usually separated between those who initiate reserve management transactions (front office), those who control and ensure that risk limits are observed, assess performance and provide reports for management (middle office), those who arrange settlement of transactions (back office) and those who maintain the financial accounting records that form the basis of public disclosures (accounting office/department as the case may be).

INVESTMENT POLICY

The investment policy of central banks is guided by the three objectives alluded to earlier in this paper, which are treated as interactive elements; these are the maintenance of value (safety), liquidity and return. The hallmark of the investment policies of a number of central banks is that of conservative asset management. The general framework employed involves a number of steps that are taken to ensure proper risk identification and measurement. A good investment policy should define what is an acceptable risk level and establish a framework for monitoring and managing identified risks.

TRANCHING OF RESERVES

In line with the defined investment policies and pursuant to the reserves management objectives, central banks partition their reserves into segments of portfolios:

LIQUIDITY PORTFOLIO

The liquidity portfolio is treated as a buffer against short-term trade and capital account fluctuations, and as a cushion to finance unforeseen developments in the external payments situation. Should holdings in the liquidity portfolio fall below an agreed level, the first line of defence to improve the balance of payments will be macroeconomic policy adjustments affecting interest rates, the exchange rate and government revenues and expenditures.

For operational convenience, the liquidity portfolio is divided into two parts: the Transactions Balance Tranche and Liquidity Investment Tranche. Investment instruments for the transactions balance tranche are money market instruments (call and overnight deposits) with maturity of up to 5 days, and this typifies the transitory nature of inflows and outflows. The liquidity investment tranche is invested in money market instruments with a modified duration of up to 1 year, and it is subject to performance review.

MEDIUM-TERM PORTFOLIO

This range of portfolio is used to enhance returns in a manner consistent with the principles of capital preservation and risk diversification. It is usually matched against medium-term obligations. Securities under this holding have maturities ranging from 13 months to 3 years.

LONG-TERM PORTFOLIO

The primary objective of this portfolio class is to ensure that a county's national savings are deployed to optimise their contribution to sustained national economic development. To the extent that such resources cannot be absorbed in the economy for productive purposes without distorting the domestic prices, long-term offshore investments had to be considered.

A secondary objective is to depoliticise the investment of financial resources so as to mitigate or deflect demands for their immediate utilization for what could be frivolous, unproductive or unsustainable public purposes.

Another objective of investing in longer term assets, such as longer term bonds and equities is the expectation of earning a higher return than could be achieved overtime on conventionally managed foreign exchange reserves. Such earnings would allow sustained long term development even if export revenues were to be adversely affect ed by factors over which a country has no control. Based on historical data and over a long period, long term bonds and equities are normally expected to outperform short-term investments. Returns on long term investments are however more volatile than returns on short term investments; hence it is necessary to have a longer investment horizon in order to forecast expected higher return with some degree of confidence.

THE USE OF EXTERNAL FUND MANAGERS

Another feature of Central banks' operational strategy for managing reserves is the use of external fund managers. External management of reserves provides an alternative or fall back position in the absence of relevant skills in the Bank and in the case of possible brain drain on a central bank's scarce manpower resources, particularly given that central banks are not always in a position to offer competitive remuneration packages.

Furthermore, the incremental benefits that accrue to the central banks in terms of training provided by fund managers t o banks' staff over the years has a positive impact.

External fund managers also provide central banks with means of performance comparison for their staff given that both the fund managers, and banks' performance are measured against common benchmarks. The return derived through the manager's investment activity also adds value to the portfolio.

Finally the use of external managers offers central banks the opportunity to invest indirectly in certain markets where it would be difficult to be activ e, either for time zone reasons or due to lack of the required expertise.

USE GLOBAL CUSTODY SERVICES

Central Banks also make use of the services of global custodians. Global custody offers advantages through centralized reporting on portfolio valuation and performance measurement. The custodian provides an audit trail on transactions generated by all the fund managers, monitors the fund manger's adherence to their respective mandates and guidelines and provides the necessary third-party "checks and balances".

The custodian also obtai ns adequate insurance cover against failure to account for any money as a result of error or omission, wrongful or negligent act, dishonest or fraudulent act of any employee, loss of valuable property on the premises, electronic or computer crime and related omissions or commissions.

TRAINING AND CREATION OF ENABLING ENVIRONMENT

No Central Bank can make any meaningful progress in its reserve management operations without the twin factors of adequately trained personnel and up to date infrastructure. It is widely believed that the difference between successful and unsuccessful central banks lies in the extent of training and exposure of their staff alongside the operating environment and available information technology.

Successful central banks provide customized training for their reserve management staff in the areas of fixed income instruments, bond mathematics, portf olio management, benchmarking, strategic asset allocation, foreign exchange trading, fixed income accounting, performance measurement, risk management, interest rates, bond yields and yield curve, and structure of the US, Euro, Yen and Sterling fixed income markets.

An information technology module that supports the maintenance of investments, does the accounting and procedures risk and compliance statistics, handles deposits, foreign exchange contracts, repurchase agreements and international bo nds is a prerequisite for effective and efficient reserve management. The provision of Reuter's news and dealing systems, the Bloomberg, a PCs network, telephone and fax with IDD facility is indispensable. To say the least, the above training and IT requirements are the minimum standard expected of any central bank that wants to be part of the fast evolving global financial market.

CONCLUSION

Reserves management requires diligence in among others, establishing investment policies, selecting investment currencies and designing appropriate guidelines and per formance benchmarks, and all this requires an appropriate operational infrastructure. The purchasing power that reserves command should ideally be maintained in real terms, while the reserves have to continue to yield the best possible return, commensurate with acceptable risk levels. Given that risk is unavoidable and frequently unquantifiable, it is necessary to formulate a risk policy so that the investment policy can derive value for the risks taken.

It is important to add that

there is no unique set of reserve management practices or institutional arrangements that is best for all countries or situations, as circumstances differ. In the final analysis the best approach is to keep the operations in a simple and systematic sequence and bear in mind that effective operational procedures And manuals are indispensable.

There is considerable scope for reserves managers to learn from each other and to be exposed to best practice in pursuing their objectives through exchange programs and attachments. International/regional workshops and seminars can also be exploited by reserve managers to enable them interact and profit from experiences of people with diverse background.

Finally, it is important to note that reserves management is a complex and time- consuming business.

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