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FISCAL POLICY THRUST OF THE 2004 BUDGET

By

Mr. F. O. Odoko*

Introduction

The budget is an important tool of economic management. Usually, it presents estimates of Government revenue and expenditure for a fiscal year. In particular, it states how the government will raise revenues and how such revenues will be channeled towards achieving macro-economic objectives such as growing the economy, reducing poverty, creating employment and improving the living standards of the people by keeping inflation at a low level. In addition, it contains the fiscal measures that influence general economic activity.

The 2004 budget is significant for a number of reasons. First, it represents the beginning of the implementation of the medium term reform agenda, the National Econ-

omic Empowerment and Development Strategy (NEEDS) which is designed to reinvigorate the economy. Secondly, it sets performance targets for major spending ministries and puts in place monitoring arrangements. In particular, it undertakes to provide quarterly reports on budget implementation for public evaluation and scrutiny. Finally, it expresses a determination to enhance cash management. The objective of this paper is to provide an overview of the fiscal policy measures in the 2004 Budget. The rest of the paper is divided into four sections. Section 1 contains the background to the budget, the policy thrust and the key parameters. Section 2 covers the highlights especially the revenue and expenditure estimates and identifies the policy priorities. Section 3 examines the prospects while Section 4 concludes the paper.

1.0 Background to the Budget

Before presenting the 2004 budget figures it is pertinent to do a summary review of the performance of the 2003 budget which served as the background to the 2004 measures. Macroeconomic developments in the Nigerian economy in the year 2003 were mixed. The economy recorded a significant growth of 10.2 per cent; inflation was estimated at 14.0 per cent, while the external reserves stood at US\$7.6 billion at the end of the year. The fiscal operations of the government resulted in a lower deficit of N202.6 billion or 2.9 per cent of GDP relative to the 5.1 per cent recorded in the preceding year. Nevertheless, several economic problems persisted during the year. Monetary expansion was excessive and that exerted pressure in the foreign exchange market resulting in the depreciation of the Naira.

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multiple bids by banks have continued to manifest. Also, speculative demand /capital flights, round tripping and expansionary fiscal operations of the government have not helped the performance of the market. Thus, the search for a satisfactory framework/approach for determining the exchange rate and managing foreign exchange is yet to be over. Considering the limitations of the market, appropriate interventions by the CBN are indispensable. Taking cognizance of the country's budget constraints, only 28.1 per cent of debt service due in 2004 will be paid. Unpaid arrears will continue to accumulate while the debt stock grows. There is the strong need for Nigeria to seek substantial relief from the heavy debt burden through initiatives that have features of debt reduction. A serious implementation of the NEEDs reform programme may be helpful in this regard.

Annex 1

Highlight of Year 2003 Fiscal Policy Measures and Tariff Amendments Effective from 27th January, 2003

A. Agricultural Sector

Tariffs reduced for 18 items ranging from fish

- Tariffs reduced for 18 items ranging from fish meal [15 to 5%] to Residues of starch [15 to 5%]
- Tariffs increased - nil

B. Mineral Products

- Tariffs reduced for 13 items ranging from sulphur of all kinds other than sublime [15 to 5%] to Base Oil [10 to 5%]
- Existing tariff retained for 3 items.

C. Products of Chemical and Allied Industries

- Tariffs reduced for 143 items ranging from Disodium Sulphates [15 to 5%] to Pickling preparations for metal surface [10 to 5%]
- Tariffs increased for 10 items, e.g., Dinonyl [10 to 5%], candles/tapers and the like [20 to 45%].
- Existing tariffs retained for 3 items.

D. Plastic/Rubber and Articles Thereof

- Tariffs reduced for 20 items ranging from New Pneumatic tyres, "herring bone" [40 to 30%] to filter paper and paper board [20 to 5%].
- Tariffs increased for 9 items ranging from Ethylene Vinyl Acetate [5 to 25%] Particle Board and Fibre Board [30 to 45%].

E. Textiles and Textile Articles

- Tariffs reduced for 6 items ranging from high tenacity yarn of Nylon [25 to 5%] to mosquito net [75 to 40%].
- Tariffs increased for 0 items.

F. Articles of Stones, Plaster, Cement, Asbestos, Mica or Similar Materials, Ceramic Products and Glass Wares

- Tariffs reduced for 4 items ranging from Millstone Ceramics [35 to 5%] to ampoules [30 to 5%].
- Tariffs increased for 2 items Ceramic tiles glazed [40 to 50%] and ceramic tiles unglazed [35 to 50%] [in other words, duty harmonized for glazed and unglazed ceramic tiles].

G. Base Metals and Articles of Base Metals

- Tariffs reduced for 25 items ranging from silicon [10 to 5%] to LPG appliances, for gas fuel and others [30 to 5%].
- Tariffs increased for 8 items, e.g., standard wire, ropes and cables [10 to 20%] and Crown corks [30 to 40%].

H. Machinery and Mechanical Appliances:

Paris Club debts, which was suspended by the Club in reaction to the Federal Government's suspension of the IMF-supervised standby arrangement in April, 2002.

As Table 3 shows the total external debt service obligation in 2004 of both federal and state governments is US\$6.104 billion [taking into consideration all outstanding arrears]. This total amount is made up of the debt service payment due in 2004 amounting to US\$2.768 billion and the arrears carried forward from 2002 and 2003 to 2004, amount to US\$3.336 billion. Of the total amount, about US\$1.597 billion or 26 per cent is due from the various States of the Federation, while about US\$4.506 billion or 74 per cent is due from the Federal Government.

Table 3 also shows the provisions for debt servicing in 2004 in relation to what is required. It shows that taking cognizance of the country's lean resources as well as its short and long term interest only 28.1 per cent of debt service due or US\$1,706.0 million will be paid in 2004. If this amount is actually paid then the balance of US\$4,371.5

million will be carried over as unpaid arrears in 2005. And unpaid arrears have the implication of increasing the debt stock even when no new loans are contracted [in this case by about US\$1,035.7 million or US\$4,371.5-3,335.8 million].

The implication of the foregoing is the strong need for Nigeria to continue to seek substantial relief from the heavy debt burden through initiatives that have features of debt reduction [see Obadan, 2004]. The opportunity provided by the current economic reform agenda NEEDS should be used to canvass for reliefs provided by debt buy-back, debt conversion and outright cancellation.

5. CONCLUSION

In the last few years, the government appears to have recognized the need to conduct trade policy, specifically, trade liberalization in a sensible and orderly manner. Hence, the growing effective protection being accorded local industries. However, in order to minimize the abuses of the privilege of protection, the country must monitor constantly the performance of the infant industries. To actualize

this, government would have negotiated certain performance targets with the protected industries, especially in relation to output, income, employment and prices and competitiveness. Besides, it is desirable to map out strategies to deal with some negative effects of the recent ban on imports on the economy, especially in the short term. Very importantly, protection alone may not enhance competitiveness. A conducive environment for production may be the critical factor. Therefore, to prepare local industries for effective and profitable participation in the globalization and liberalization process, government should provide the necessary infrastructure to enable industries produce at lower costs and enhance the competitiveness of their products at home and in the global market.

The operation of the DAS shows that its objectives of reducing the parallel market premium, conserving foreign exchange, and achieving a realistic naira exchange rate have hardly been achieved. The professional discipline expected to be instilled in the market participants by the DAS has not materialized as rent-seeking behaviour and

In addition, structural bottlenecks in the economy persisted, giving rise to high cost of production. It was against this background that the 2004 budget was formulated.

1.1 POLICY THRUST FOR 2004

The policy thrust for 2004 derived from the NEEDS and include:

- Job creation and employment generation for the youth through support for an enabling environment for the private sector.
- Diversifying the economic base of the country;
- Enhancing the quality of life of the people including food security
- Achieving a low level of inflation of not more than 10-11 per cent; and
- Limiting fiscal deficit to not more than 2.0 per cent of GDP.

1.2 KEY PARAMETERS OF THE BUDGET

The 2004 budget is based on the following key assumptions:

- Crude oil production of 2.24 million barrels per day
- Crude oil price of US\$25.0 per barrel
- Joint Venture call of \$3.2 billion
- Inflation rate of no more than 10 - 11 per cent per annum

- GDP growth rate of 5 per cent
- Exchange Rate of N136 to US\$1

2.0 HIGHLIGHTS OF THE BUDGET

2.1 Revenue and Expenditure Estimates

2.1.1 Revenue

On the basis of the above assumptions, federally collectible revenue was estimated to be N3,033.2 billion representing an increase of 57.8 per cent above the 2003 budget. A breakdown of the revenue indicates that oil revenue will be N2,344.7 billion, representing 77.3 per cent of total while non-oil revenue consisting of customs and excise, company income tax, value added tax and independent revenue of the Federal Government, amounted to N688.6 billion or 22.7 per cent of the total.

2.1.2 Allocation of Federally Collectible Revenue

Of the federally collectible revenue, N435.2 billion was set aside as government's contribution to the cost of production of oil and N248.2 billion as 13 per cent derivation. Other non-federation account items such as value added tax (N161.0 billion), Education

tax (N18.0 billion), custom levies (N30.0 billion) were also deducted. So also was the Federal Government independent revenue which was projected to be N117.6 billion. Thereafter, the balance on federation account available for distribution was N2,023.2 billion and would be shared as follows: the federal government would receive N981.25 billion, while the state and local government would receive N540.6 billion and N416.78 billion or 26.72 and 20.6 per cent, respectively. Special funds would receive N84.6 billion or 4.18 per cent.

Federal Government Retained Revenue

Federal retained revenue was projected to be N1,121.4 billion comprising FGN's share of the Federation Account (N981.3 billion), VAT (N22.5 billion) and Independent Revenue (N117.6 billion). The revenue represents an increase of N62.2 billion or 5.9 per cent above the budgeted revenue in 2003.

2.1.3 Total Expenditure

The planned expenditure of Government for fiscal 2004 amounts to N1,302.6 billion consisting of recurrent expenditure of N539.3 million, debt service (N369.4 billion), transfers (N44.0 billion) and capital expen-

diture of N349.9 billion.

A breakdown of the recurrent expenditure shows that payroll accounts for the bulk (68.3%) while overhead and pension account for 18.7 and 13 per cent, respectively. As indicated above, the planned expenditure on debt service amounts to N349.0 billion which is further subdivided into domestic and external debt service. It is important to note that the provision for the domestic debt service appears more realistic in the 2004 budget than previously. In the past there was a deliberate under-provision. Furthermore, there are indications that, unlike in the past, payments in respect of external debt service will be applied to reducing the stock rather than for interest and penalty payments only.

2.2 BUDGET PRIORITIES

The 2004 budget shows that 66 per cent of total capital expenditure has been targeted at the priority sectors including roads, water resources, power, agriculture, education, health and security. For example, budgetary allocation to education at all levels rose to N55.4 billion from N48.2 billion in the preceding year. Similarly, the allocation to healthcare

rose from N52.0 billion to N60.0 billion representing an increase of 15.3 per cent. The emphasis of the health programme is on upgrading the healthcare delivery system focusing on control of HIV/AIDS as well as malaria and other communicable diseases.

Furthermore, it is expected that special attention will be given to national immunization program. Under-scoring the commitment of the government to the enhanced performance of the power sector there was a 16 per cent increase in the allocation to the sector. The strategy is to improve the performance of NEPA. Another priority area is agriculture. The objective in the sector is to consolidate the performance of the preceding year when a tremendous growth of 7 per cent was recorded. Some of the programs include greater support for research and extension services, implementation of the presidential initiative on rice, cassava, livestock, and vegetable oil as well as provision of inputs to farmers at reasonable prices and on time. Closely related to agriculture is water supply. The government intends to improve access to clean potable water as well as make water available for agricultural purposes.

Finally, government is convinced about the need for protecting lives and property and is committed to making visible, significant and sustained progress in the area. Overall, the intention is that as more resources are focused on the identified priority areas, opportunities will open for business to create jobs in agriculture, small and medium enterprises, manufacturing, services, and the solid minerals sector.

2.3 Overall Balance

With the projected expenditure of the federal government put at N1,302.5 billion and retained revenue of N1,121.4 billion the fiscal operation of the Federal Government is thus projected to result in a deficit of N181.1 billion or 2.1 per cent of GDP. The deficit represents a substantial reduction from the past deficits. This shows the determination of the government to bring its spending more in line with the available revenue and thereby introducing greater fiscal discipline.

2.4 Financing

The deficit is expected to be financed by recourse to the capital market in addition to the utilization of recovered looted money. The plan

ests is that the search for a satisfactory framework/ approach for determining and managing the exchange rate is yet to be over. The experimentation thus goes on. One thing that is noteworthy though is that a reform of the fiscal operations of government along the path of fiscal balance will moderate the growth of monetary aggregates and lessen the demand pressure in the foreign exchange market. Furthermore, if the limitations of the market are appreciated, then appropriate interventions of the Central Bank in the market can be better appreciated.

4. EXTERNAL DEBT MANAGEMENT

Budget 2004 acknowledges the external debt stock at about US\$31.0 billion as serious and unsustainable. It constitutes an overhang and deterrent to private investment and generally to growth and development.

External debt management will continue to pose a daunting challenge in 2004. This challenge relates to how to service the debt in a manner that is satisfactory to creditors without compromising the requirements for domestic growth and development. The budget rightly acknowledges that the payment of huge debt service would jeopardize growth as little resources would be available to finance capital expenditures for health, education and infrastructure.

Yet, there are a group of creditors [the must-pay group of creditors] whose debt must be serviced as and when due, otherwise serious consequences may result to the country. For example, multilateral loans [e.g World Bank loans] must be serviced as and when due to avoid suspension of disbursements as well as the granting of new loans. Also, default on the Par

Bonds and Promissory Notes carry serious penalties including the seizure of the assets of the Central Bank of Nigeria and the Nigerian National Petroleum Corporation abroad. In the case of Non-Paris Club bilateral debts, default results in penalty charges of between one and three per cent per annum above the normal rate charged. Such defaults would also affect the credit rating of the country. According to the Debt Management Office [2003], failure to honour the country's debt obligations will undermine Nigeria's efforts to secure:

- substantial debt relief in the medium-term;
- secure restoration of the much-needed Western countries' export credit guarantee covers for imports of goods and direct investment into Nigeria; and
- the restoration of debt conversion for eligible

Table 3: External Debt Service Requirements and Provisions in 2004 [US\$ Million]

Type of Debt	Debt Service Due in 2004			Provision in 2004 Budget	Proportion of Provision in Debt Service Due [%]
	State Government	Federal Government	Total		
Arrears as at 31/2/03	940.9	2,394.9	3,335.8	-	0
Multilateral	182.0	260.1	442.1	433.00	97.9
Paris Club	403.1	1,617.1	2,020.2	1,000.00	49.5
London Club [Par Bonds]	72.0	18.1	90.1	90.12	100.0
Promissory Notes	-	177.9	177.9	171.18	96.2
Non-Paris Club	-	11.5	11.5	11.64	101.2
Total	1,597.9	4,479.5	6,077.5	1,706.00	28.1

Source: Debt Management Office, "Debt Service Requirements in Fiscal Year 2004" [December 18, 2003].

for fiscal 2004/2005", in a continued effort to stabilize the exchange rate for the naira, as well as enhance the efficiency of the foreign exchange allocation through a market-based exchange rate determination, the Dutch Auction System [DAS], reintroduced in July, 2002 has been retained in 2004/2005. The DAS replaced IFEM which was designed as a two-way quote system, and intended to diversify the supply of foreign exchange in the economy by encouraging the funding of the interbank operations from privately-earned foreign exchange. The achievement of a realistic exchange was an additional objective of IFEM. But problems relating to supply rigidities, and the persistent fiscal excesses of the government and the associated excess liquidity in the system adversely affected the operations of IFEM.

The DAS was expected to serve three purposes, viz:

- reduction of the parallel market premium;
- conservation of the dwindling foreign exchange reserves; and
- achievement of a realistic naira exchange rate.

However, the operation of the DAS for close to two years has shown that the

Table 2: Naira Exchange Rate Movements January, 2002 -December, 2003

Period	Exchange Rate [N/US\$]	Rate of Depreciation /Appreciation [%]	Cumulative Depreciation [%]
2002			
January	113.96	0.45	0
February	114.75	0.69	1.14
March	116.04	1.12	2.27
April	116.10	0.05	2.32
May	116.54	0.38	2.70
June	118.49	1.67	4.37
July	121.24	2.32	6.69
August	125.65	3.64	10.38
September	126.46	0.64	10.97
October	126.48	0.02	10.99
November	126.82	0.27	11.26
December	126.88	0.05	11.31
2003			
January	127.11	0.18	11.49
February	127.32	0.17	11.66
March	127.16	-0.13	11.53
April	127.37	0.17	11.70
May	127.67	0.24	11.94
June	127.83	0.13	12.07
July	127.77	-0.05	12.02
August	127.90	0.10	12.12
September	128.58	0.53	12.65
October	129.76	0.92	13.57
November	136.61	5.28	18.85
December	137.21	0.43	19.29

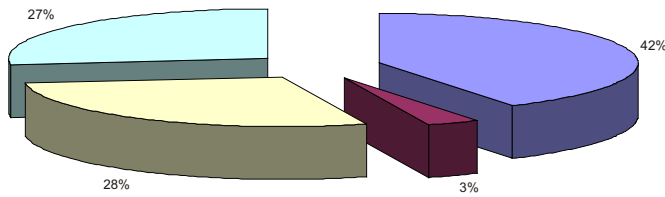
Source: Central Bank of Nigeria

above objectives have hardly been achieved. The parallel market premium is still significant while foreign exchange reserves have tended to decline rapidly. Furthermore, the goal of having a stable and realistic exchange rate has yet to be achieved. Most of the time, the naira exchange rate has exhibited the features of uni-directional depreciation and instability. Table 2 shows exchange rate movement over the two-year period, 2002-2003. Out of the 24 months, the exchange rate appreciated marginally only two times in March and July, 2003. The cumulative depreciation of

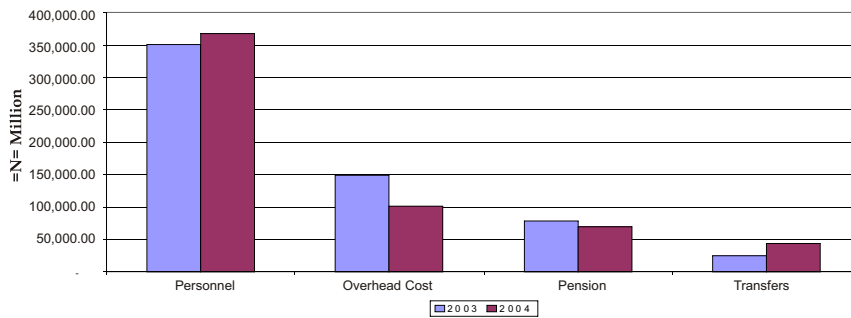
the exchange rate was 19.3 per cent, 11.3 and 7.96 per cent in 2002 and 2003, respectively. Thus, the operation of the DAS has been less than satisfactory. The professional discipline expected to be instilled in the participants by the nature of the market has not materialized as rent-seeking behaviour and multiple bids by banks have continued to manifest. Also, speculative demand/capital flights, round tripping and expansionary fiscal operations of government have not helped the performance of the market.

What the foregoing sugg-

Components of FG Total Expenditure



Components of Non-debt Recurrent Expenditure (2003 & 2004 Budget)



involves working out an issuance program by the Debt Management Office such that the total financing required could be raised over a period of seven months. With better cash management, government will go to the market early and raise funds in small tranches such that the capital market can provide the money without unnecessary disruption. This is a remarkable move because in the past the financing of deficits was largely through the banking system. Such a mode of financing was detrimental to the effectiveness of monetary policy. However, there are reasons for apprehension. Even though Government has indicated that it will use part of the

recovered looted funds to finance the deficit, raising about N100.0 billion from the market in the period indicated will require raising interest rates which will not be popular. It may also crowd out the private sector as high interest rate may discourage private investment as it will divert the flow of credit to the public sector.

3.0 PROSPECTS

There are good prospects that oil sector performance will continue with enhanced revenue flow. In other words, if the current high price of oil in the international market is sustained and expenditure does not rise in tandem, then finance is not likely to constrain most of the objectives of the

budget. The current ban on a number of imported products may adversely affect the realization of the non-oil revenue projections especially import duties. Besides there is need to strengthen the administrative capacity for budget monitoring. The due process mechanism already in place which is designed to ensure transparency, accountability and value for money especially in the procurement of goods and services should be sustained. It is also pertinent to note the likely impact of the monetization of the fringe benefits of civil servants that may increase recurrent expenditure in the short term but is likely to reduce in the long run. An important innovation in the 2004 budget is the desire to ensure that funds allocated are promptly released. An important institutional measure in this regard is the setting up of a cash management committee headed by the Honourable Minister of Finance. In the past the execution of capital projects was hampered by the non-release of funds. The new measure is likely to remedy the situation. Overall, it is expected that performance of the 2004 budget will show a marked improvement.

TABLE 1
FEDERATION ACCOUNT OPERATIONS (BUDGET ESTIMATES) 2001-2004
=N= million

	2001 (1)	2002 (2)	2003 (3)	2004 (4)
Federally collectable Revenue (Gross)	2,126,500.0	1,454,080.9	1,922,547.4	3,033,213.4
Oil Revenue (Gross)	1,673,200.0	938,180.9	1,317,463.4	2,344,613.4
Government Crude	862,730.0	241,839.2	330,239.4	1,036,460.8
PPT	353,430.0	203,176.9	394,918.9	470,841.8
Rent & Royalty	163,180.0	133,845.1	180,925.2	236,360.8
Gas Sales (Upstream & NLNG)	30,000.0	19,070.9	35,000.0	40,800.0
Domestic Crude	241,560.0	327,448.8	368,379.9	553,758.0
Open Acreage Allocation fee	10,000.0	0.0	0.0	
Other Oil Revenue	12,300.0	11,000.0	8,000.0	6,392.0
Less:				
First Charges on Oil Revenue:	776,274.3	627,022.1	889,765.9	683,423.7
JVC Cash Calls	350,000.0	350,000.0	441,000.0	435,200.0
External Debt	150,000.0	168,000.0	252,000.0	
Subsidy on Domestic Crude	137,250.0	0.0	0.0	
Transfer to PTDF	10,000.0	6,000.0	0.0	
13% Natural Resources Derivation Fund	80,024.3	73,022.1	171,270.3	248,223.7
NNPC Priority Projects Fund	34,000.0	2,000.0	0.0	
National Judicial Council	15,000.0	28,000.0	25,495.6	
Oil Revenue (Net)	896,925.7	309,158.8	427,697.5	1,661,189.7
Non-Oil Revenue	453,300.0	517,900.0	605,084.0	688,600.0
Custom & Excise	113,800.0	180,000.0	195,387.0	219,000.0
Companies Income Tax	70,000.0	90,000.0	90,000.0	143,000.0
Value-Added Tax (VAT)	70,000.0	90,000.0	113,000.0	161,000.0
Federal Government Independent Revenue	60,000.0	50,000.0	165,000.0	117,600.0
Privatisation Proceeds	70,000.0	75,000.0	0.0	
Proceeds from sale of grains/Loans recovered	2,500.0	2,500.0	0.0	
Levies	20,000.0	20,000.0	31,503.2	30,000.0
Education tax	7,000.0	10,000.0	10,000.0	18,000.0
Tax on Petroleum Products	40,000.0	0.0	0.0	0.0
Others	0.0	400.0	193.8	
Federally Collected Revenue (Net)	1,350,225.7	827,058.8	1,032,781.5	2,349,789.7
Allocation:	1,351,866.2	521,550.1	1,801,188.7	2,349,789.7
Transfer to Other Accounts 1/	229,500.0	247,500.0	319,503.2	326,600.1
Federal Government's share	565,295.4	138,523.5	782,788.1	1,139,648.0
State Government's share	279,733.8	68,735.3	353,886.6	627,863.8
Local Government's share	238,111.5	57,341.3	294,905.5	484,056.7
Special Funds (3.5%) 2/	39,225.5	9,450.0	50,105.3	98,221.2
FCT	11,207.3	2,700.0	14,315.8	
Ecological Fund	22,414.6	5,400.0	28,631.6	
Stabilization	5,603.6	1,350.0	7,157.9	
Others	3,362.2	26,538.7	81,747.1	
Balance of Revenue and Allocation:	-1,640.5	305,508.7	-768,407.2	
Financing:				
Reserve Accounts 3/	-1,640.5	0.0	705,407.2	161,000.0
VAT Distribution:	70,000.0	90,000.0	113,000.0	24,150.0
Federal Government	10,500.0	13,500.0	16,950.0	80,500.0
State Governments & FCT	35,000.0	45,000.0	58,500.0	56,350.0
Local Governments	24,500.0	31,500.0	39,550.0	

1/ Includes transfers of VAT, Independent revenue of the Federal Government, privatisation proceeds accounts, etc.

2/ Excludes 13% Derivation Funds

3/ includes transfers to/from Federation Reserve Account.

Sources: Federal Government Budget Estimates (2001-2003)

4.0 CONCLUDING REMARKS

The review of the 2004 budgetary provisions shows that the budget is capable of fostering an environment that is supportive of long-term sustainable development. It is therefore critical that Government implements the budget with a

sense of commitment and determination for the benefit of the Nigerian people.

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Federal Republic of Nigeria (2004): Press

Briefing on the 2004 Budget by the Honourable Minister of Finance, May 6, 2004

Chairmanship of the Ministry of Transport, had been set up to help work out the technology, risk management issues and all other issues connected with destination inspection. The government further pointed out that since January 1, 2004 is no longer realistic, a new start date would be announced later. But meanwhile, according to the CBN's Monetary, Credit, Foreign Trade and Exchange Policy Guidelines for Fiscal 2004/2005, all goods, except personal effects, used motor vehicles and perishables, i.e. day-old chicks, human eyes, human remains, vaccines, yeast, periodicals/magazines, imported into the country shall be subject to pre-shipment inspection in the country of supply and issuance of an appropriate Clean Report of Inspection [CRI].

The destination inspection of imports is to replace the pre-shipment inspection schemes for imports and exports. This policy had been approved for implementation for a long time now, indeed, since the late 1990s. Government had acknowledged that, over the years, both the import and export inspection schemes have not achieved their objectives, i.e. to enhance the growth of imp-

ort and export trade, stop the drain on foreign exchange reserves, and ensure that goods imported are government approved, meet quality and quantity standards and are well priced. While the pre-shipment of imports has caused delays in the importation process, the export inspection scheme added to costs of exports and made them less competitive in the international market.

As I had observed in 1999 [Obadan, 1999: 1140], "While the destination inspection policy is a desirable and laudable one, as it replaces the rather anachronistic pre-shipment inspection in an era of deregulation, its successful implementation is doubtful, especially in the short to medium term when vital equipment and facilities are absent. Experts have pointed out the need for prerequisite facilities such as sophisticated X-ray equipment, a well equipped clinical/forensic laboratory, as well as "research" or "study" centres belonging to the state, but operating commercially. These facilities will speed up the assessment of all goods arriving the ports. The only snag for now is that the facilities and equipment are non-existent.

Therefore, in light of the likely implementation problems, the destination inspection policy may have to be reviewed for implementation in phases".

This advice has obviously not been heeded and so many years after, the destination inspection scheme has not been able to take off.

3. EXCHANGE RATE POLICY AND MANAGEMENT

Two notable new foreign exchange market policy measures for 2004/2005 relate to the following:

- freedom given to authorized dealers to deal in autonomous funds in their own right, subject to compliance with advised Open Position Limits. However, no bank would be allowed to purchase autonomous funds, including inter-bank funds, in the market on behalf of a customer without a valid, duly documented underlying transaction from the customer; and
- the pegging of the amount which bureaux de change can sell at a maximum of US\$2,500.00.

However, according to the Central Bank's "Monetary, Credit, Foreign Trade and Exchange Policy Guidelines

sectors. The implications of this are many, one of which is that tariff concessions and protective measures are not borne out of negotiations which commit the benefiting sectors/industries to deliver some targets on output, income, prices, and employment as well as competitiveness to reciprocate the concessions. Very importantly, protective measures may make little or no impact on competitiveness, output and prices as long as the environmental constraints poor electricity and water supply and other infrastructure remain binding. Under the circumstances, industries remain infant and unable to outgrow concessions. And tariff concessions may turn out to be less important in competitiveness compared to adequate provision of the necessary infrastructure which would enable the industries to produce at lower costs, and enhance the competitiveness of their products at home and in the global market. Therefore, besides the above, it is important to have a clear vision of the industrial sectors of priority to promote in phases and in a holistic way-not just focusing on protective measures-such that whatever concessions that are given will make an impact. More-

over, it is necessary to have protective measures to be the outcome of a process of negotiation between the government and the manufacturers. Through this process, concessions given would have to be matched by agreed targets in output, income and employment, and reductions in prices, which enhance competitiveness. and finally, as I had pointed in 2001 [Obadan, 2001: 4], for maximum effectiveness of the policies, it is important for government to continue to intensify efforts on:

- adequate supply of infrastructure. The absence of good infrastructure - electricity, fuel, telecommunications, water supply results in producers' additional investment in alternative sources of supply, all of which increase costs of production unnecessarily and, hence, neutralize the effects of tariff protection. The economy cannot be transformed industrially nor can it be competitive if the infrastructural base continues to be weak;
- complementing the tariff incentives to agriculture with adequate provision of rural feeder roads, electricity, pipe-borne

water, among other things;

- strengthening the naira in the foreign exchange market. Continuous depreciation of the naira neutralizes the desired effects of tariff reductions;
- tackling the menace of dumping and smuggling in the economy. Manufacturers have not relented at pointing out that these two menaces have virtually killed many domestic industries, especially those in tobacco, textiles, pharmaceutical and tyres; and
- improvement of the macro-policy regime, especially the dismantling of multiple tax regimes. There have been reports that the Lagos State Government has introduced a sales tax that is different from the existing value added tax. This appears to be "one tax too many".

2.2 Pre-Shipment Inspection Versus Destination Inspection

According to the budget statement, the government proposes to move ahead with destination inspection in 2004. To this end, a cabinet level implementation committee, under the



O. J. Nnanna, Ph.D

MONETARY AND OTHER FINANCIAL SECTOR POLICY MEASURES IN 2004

By

O. J. Nnanna* Ph.D

Introduction

It is well settled that macroeconomic stability is a pre-requisite for sustainable growth and poverty reduction. The primary aim of monetary policy in 2004/2005 therefore, is to achieve price and exchange rate stability through the pursuit of non-accommodating monetary policy. Accordingly, the current monetary policy seeks to achieve a single digit inflation and balance of payment viability.

Nigeria's overall macroeconomic environment has over the years, been characterized by the twin nemeses of liquidity surfeit and excessive demand pressure in the foreign exchange market as a result of the instantaneous monetization of crude oil receipts and the deficit budgetary operations of the three tiers of

government. In view of the continued danger posed by fiscal dominance on monetary management, efforts aimed at addressing the persistent problem of excess liquidity in the banking sector and its adverse effects on domestic price and exchange rate stability, shall continue to be the central focus of monetary policy in the short-to-medium term.

The objective of this paper, therefore, is to review the monetary and other financial sector policy measures in 2004, with a view to identifying how they assist in achieving the macroeconomic objectives of the government in fiscal 2004. The rest of the paper is divided into three parts. Following this introduction, Part I evaluates the financial sector and the macroeconomic developments during fiscal 2003. Part II examines the monetary and other financial sector policies in 2004, while part III concludes the paper.

1.0 Evaluation of Financial Sector and Macroeconomic Developments during 2003

1.1 The Focus of Policy in 2003

Macroeconomic policy measures in 2003 were designed to achieve sustainable growth and development of the Nigerian economy. In particular, macroeconomic policy was expected to encourage private sector participation, reduce poverty, as well as establish the road-map for the achievement of the millennium development goals. The objective of monetary policy was: to promote a stable macroeconomic environment for the achievement of a non-inflationary output growth rate of 5.0 per cent; achieve a single digit inflation; sustain stability in the naira exchange rate; promote financial sector soundness; and achieve external sector viability defi-

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ned as an external reserve stock that could support at least 6 months of imports. Consistent with these objectives, the medium term monetary policy framework for 2002/2003 addressed effective control of growth in money stock (M2), especially, in anticipation of the liquidity injection which was likely to arise from government spending during the election year of 2003.

Consequently, a tight monetary policy stance was designed to mitigate the effects of excess liquidity and macro-economic instability.

The new measures introduced in 2003 included the granting of some Bureaux de Change (BDC) operators the authority to deal in the sale of Travellers Cheques (TCs) to end-users. The objective was to deepen the foreign exchange market. Furthermore, the Nigerian payments system received a boost following the introduction of the Nigerian Automated Clearing System (NACS), which reduced the clearing cycle to three days, thus building more consumer confidence in the cheque clearing system. In addition, two clearing sessions (morning and afternoon) became operational in Lagos, while the enhanced Transfer Module

for large value transfers from the 22 branches of the CBN to the Head Office of the DMBs in Lagos went live in year 2003. An assessment of the effectiveness of the measures adopted in 2003 are undertaken below:

1.2 Financial Sector Performance

Notwithstanding the relative stability in the financial sector in 2003, the banking system was characterised by persistent liquidity surfeit, induced by the expansionary fiscal operations of the federal and state governments. Consequently, the growth in monetary aggregates exceeded targets by substantial margins. Specifically, broad money supply (M2) grew by 24.1 per cent compared with the programmed target of 15.0 per cent, while narrow money supply (M1) increased by 29.5 per cent as against the prescribed target of 13.8 per cent for fiscal 2003.

The main expansionary factors of M2 were the increase in aggregate credit to the domestic economy, especially net credit to government, and foreign assets (net) of the banking system.

Aggregate bank credit to the domestic economy incre-

ased by 32.7 per cent, compared with the programmed target of 25.7 per cent for fiscal 2003. Banking system credit to the private sector grew sluggishly, particularly in the first half of the year. However, following the monetary authority's incentive of a lower CRR of 9.5 per cent for banks that exceeded the set lending target of 20.0 per cent or more, to the real sector of the economy, with end-June, 2003 as base period, credit to the private sector improved markedly from the third quarter of the 2003, culminating in an overall growth of 27.1 per cent during the year compared with 32.3 per cent targeted for fiscal 2003 (See Table1).

The financial system was relatively sound in 2003. An empirical analysis based on prudential criteria revealed that while the performance of some banks improved, others showed serious signs of weakness. Further analysis, using the CAMEL yardstick, showed that eleven (11) banks were "sound", fifty-three (53) were "satisfactory" while fourteen (14) and nine (9) banks were rated "marginal" and "unsound", respectively.

Reported bank deposit rates rose marginally, while lend-

continue to agitate for a continuation of protective policies. It has further been argued that apart from the difficulty of identifying and measuring internal and external economies for the purpose of determining which industries to protect, protection breeds an atmosphere where inefficiency, lethargy and lack of innovation thrive.

Notwithstanding, the real basis for protecting infant industries remains valid. This is that if as a result of an infant industry growing the society gains it is not unreasonable for the society to pay a price in terms of protection "in order to see the infant to maturity" [Wells, 1973].

Thus measures aimed at achieving the country's industrialization goal through increased investment in manufacturing will not only increase income and enhance backward and forward linkages in the development and utilization of the nation's resources but will also create employment opportunities. Indeed, the medium and long-term multiple employment effects of the ban are very likely to be quite substantial especially when investors would have fully taken advantages of the manufacturing opportunities thus thrown open to

them. However, in order to minimize abuses of the privilege of protection it is necessary for the country to monitor constantly the performance of the infant industries. This can further assist in the determination of the duration of protection. Besides, government may have to map out strategies to deal with some negative effects of the ban on the economy, especially in the short-term. These include the following:

- apart from the immediate effect of the possible retrenchment of some workers in the affected import areas, there is the issue of reduced government revenue in the form of loss of import duties on previously tariffed goods that are now banned;
- the possible intensification of smuggling. This inevitably flourishes only when control in one form or the other is introduced on the free flow of goods between national borders. It is, perhaps in the light of the above two effects that it has been argued that import prohibitions tend to be ineffective and encourage smuggling as well as deny government of import duty revenue. On the

other hand, tariffs are generally more efficient and can be relied upon to achieve the objectives of protecting local industry, reducing consumption and boosting government revenue; and

- as a result of lags created in the short-term the ban is likely to attract scarcity values to some commodities that may at present not be produced in sufficient quantities, thus resulting in rather exploitative prices. Indeed, it is not unlikely that some business enterprises would capitalize on the short period scarcity to earn economic rent. This actually leads to repercussions on the market structure in terms of development of monopolistic tendencies and practices among local manufacturers.

A major observation with respect to the growing protection of domestic industry is that the tariff concessions, import bans and protection appear to derive from individual or group pressures on the government with respect to the protection of individual commodities rather than from an agreed strategy on the development of priority

the Honourable Minister of State for Finance announced the prohibition of importation of many items including textile fabrics of all types and articles thereof, excepting those listed for exclusion; men's footwear and bags of leather and plastic [excepting ladies']; soap and detergents; furniture; assembled bicycles; flowers [plastics and fresh]; fresh fruits; cutlasses, pick axes, spades, shovels, wheel barrows, pork and pork products, beef and beef products, mutton, lamb and goat meat; tooth pastes; pencils; ball point pens; plastic plates, knives, spoons, forks, cups, buckets, bowls, bins containers and hangers; barytes and bentonites; vegetable oils; corrugated boards and cartons; and live or dead birds. A grace period of 90 days, effective from 7th January, 2004, was allowed to enable importers who must have entered into irrevocable trade agreement before the release of the ban order to allow them to process and clear the goods at the prevailing duty rates.

Thus, in the last few years, there has been a consistent effort by government to increase effective protection for local industries and also conserve foreign exchange.

Also, the ban on certain imports is an avenue for operationalizing the objective of self-reliance and reduced economic dependence as well as serve a medium for promoting discipline in our consumption habits [Obadan, 1980: 53], with the increased protection, government appears to have recognized the fact that some developing countries, Nigeria included, are not well equipped at the present time to participate profitably in the international competition in the global economy. The high level of international competitiveness demanded is hampered by numerous capacity constraints at the policy, institutional and enterprise levels. In Nigeria's case, a conducive and enabling environment is lacking and the infrastructural support constraint is very strong. In many cases, enterprises have had to provide their own electricity and telecommunications facilities, sink their boreholes, and even construct/maintain their roads all at prohibitive costs and all these have adverse implications for competitiveness [Obadan, 2000: 71].

A very significant aspect of the import ban is the expected encouragement of investment in local prod-

uction of manufactured goods through import substitution and the offering of protection to existing infant industries against well established foreign competitors. Like other developing countries Nigeria regards industrialisation as the key to her economic development. Protective policies are therefore inevitable to support industrialization programmes. While free trade is perhaps a better policy for highly industrialised countries, the infant industry argument is of particular appeal to developing countries. This argument recognizes the fact that in developing countries there are certain industries with potentials for expansion and for such industries to survive they need to be protected against foreign competition. Besides generating external economies these industries are likely to benefit from internal economies of scale. Protection will thus enable them to expand, reduce costs and be in a position to face foreign competition. This is the argument of the protectionist.

Free traders, on the other hand, argue that experiences in developing countries show that such industries never admit of their maturity. Consequently they

Table 1: Selected Macro Variable: Targets and Achievements in 2003

Performance measures	Targets	Actual	Remarks
Broad Money (M2)	15.0	24.1	Missed
Narrow Money (M1)	13.8	29.5	Missed
Aggregate Domestic Credit	25.7	32.7	Missed
Credit to Government	(150.3)	47.9	Missed
Credit to Private sector	32.3	27.1	Achieved
Inflation(12month moving average)	9.0 (Single digit)	14.0	Missed
Real GDP Growth Rate	5.0	10.2	Achieved
External Reserves	US\$8.0-8.5 billion	US\$7.5 billion	Missed

ing rates generally declined during the year. This followed the down-ward adjustment of the minimum rediscount rate (MRR), as well as the use of moral suasion by the CBN. Consequently, the spread between banks' weighted average deposit and maximum lending rates narrowed from 12.9 percentage points at end-December 2002 to 10.8 percentage points in December 2003, while the margin between savings deposit and maximum lending rates also narrowed from 22.0 to 18.4 percentage points during the period. With inflation at 14.0 per cent at the end-December, 2003, lending rates were positive in real terms, while all deposits rates, except that on 3-month maturity were negative.

To further enhance the

effectiveness of monetary policy, the CBN increased the frequency of the open market operations (OMO) from bi-weekly to daily basis in November, 2003.

Approval for the issuance of the National Saving Certificate (NSC), aimed at enhancing the savings culture of Nigerians was granted by the Federal Government in 2003. Arrangements have reached advance stage to issue the NSC in 2004.

1.3 Other Sectoral Developments in 2003

The performance and problems of other sectors of the economy, which were germane to the effectiveness of monetary and financial policy measures in 2003, are examined below:

(a) Fiscal Sector

The fiscal operations of the

Federal Government in 2003 resulted in an overall deficit of N202.7 billion or 2.8 per cent of GDP, compared with the programmed fiscal deficit of not more than 2.5 per cent of GDP and the overall deficit of N301.4 billion or 5.5 per cent of GDP recorded in 2002. The overall deficit was traceable to the impact of debt service burden and unsustainable overhead expenditure. The deficit was financed entirely from domestic sources, with N105.6 billion coming from the banking system and N97.1 billion from the non-bank public.

Provisional data on the fiscal operations of the State Governments resulted in an overall deficit of N60.4 billion in 2003, compared with the N54.7 billion deficit recorded in 2002. The operations of 659 (out of 774) reporting local governments, however, resulted in an overall surplus of N8.4 billion during the year.

(b) Real Sector

Data from the Federal Office of Statistics (FOS) revealed that the real gross domestic product (GDP), measured at 1990 constant basic prices, rose by 10.2 per cent in 2003, compared with the target of 5.0 per cent and the 3.5 per cent growth recorded in 2002. The improved performance reflected the growth

in all the major sectors of the economy. Agricultural production was enhanced largely by the temporary import prohibition on some selected agricultural produce, favourable weather conditions and government price support programme. Also, there was a substantial increase in crude oil production, owing largely to the increase in the country's OPEC quota and production of condensate and gas. Inflationary pressure however, persisted, especially during the last quarter of the year. Specifically, inflation rate, which was 12.9 per cent in December 2002, accelerated to 14.0 per cent at end-December, 2003. The observed upward trend in inflationary pressure reflected largely the increase in the prices of petroleum products in the course of the year with the attendant consequences on the cost of transportation and domestic production. Other factors that combined to drive-up inflation rate included the persistent excess liquidity in the banking system, as well as exchange rate depreciation and structural rigidities in the economy.

(c) External Sector

The pressure on the external sector of the economy moderated in 2003, as the

overall balance of payments deficit narrowed from N565.35 billion or 10.0 per cent of GDP in 2002 to N162.84 billion or 2.4 per cent of GDP. The development was attributable largely to the robust goods account, occasioned by the favourable developments in the international oil market, as the average price of crude oil rose from US\$25.04 per barrel in 2002 to US\$29.61 per barrel in 2003. Consequently, the current account recorded a surplus of N507.12 billion, equivalent to 7.3 per cent of the GDP, as against 0.7 per cent in 2002. The stock of external reserves declined by 2.8 per cent to US\$7.47 billion as at end-December, 2003, from US\$7.68 billion in December 2002. The level of external reserves could finance 6.5 months of imports, compared with 7.8 months recorded in the preceding year. The import cover of 6.5 months was above the West African Monetary Zone (WAMZ) minimum requirement of 3.0 months.

The naira exchange rate was relatively stable during the first half of 2003. However, the stability was disrupted during the fourth quarter of the year as a result of market exuberance and speculative activities. Consequently, the average exchange rate at the

Dutch Auction System (DAS), depreciated by 6.5 per cent from an average of N120.97 in 2002 to N129.36 in 2003. In the bureaux-de-change (BDC), the exchange rate depreciated from N137.79 to N141.99 per US dollar. The premium between the DAS and bureaux-de-change rates narrowed from 14.8 per cent in 2002 to 9.8 per cent in 2003.

1.4 Overall Economic Performance and Outstanding Problems

The overall macroeconomic developments in 2003 were mixed. While growth in output was remarkable, inflationary pressure persisted as inflation rose to 14.0 per cent in 2003 from 12.9 per cent in the preceding year. The external sector experienced moderate pressure, resulting in a draw down of the external reserves and a balance of payments deficit of 2.2 per cent of GDP. Consequently, the naira exchange rate depreciated in all the segments of the foreign exchange market. The persistence of excess liquidity in the banking system, arising from fiscal dominance, posed serious challenges to the conduct of monetary policy during the year. The expansionary

haps in view of the significant tariff changes in 2003. Those amendments have probably been retained in 2004. The customs tariff changes in 2003 largely addressed the concerns of manufacturers through tariff reductions on major manufacturing inputs and tariff increases on mainly finished products or inputs which can be sourced locally. Custom duty rates on major raw materials/inputs for the manufacturing of various products were reduced in order to revitalize ailing

industries, increase sectoral capacity utilization and enhance their competitiveness as well as increase employment generation. Table 1 shows that the number of tariff reductions in all the sectors/products ranged from 4 for Articles of Stones, Plaster, Cement, Asbestos, Mica or similar materials, Ceramic Products and Glass wares to the highest of 143 in the Products of Chemical and Allied Industries. Tariffs were increased in five of the eight sectors/products ranging from 2 for the

Machinery and Mechanical Appliances, et al, products to 10 in the Products of Chemical and Allied Industries. The latter included items such as dinonyl [10 to 25%] and candles/tapers and the like [20 to 45%]. Annex 1 shows examples of products whose tariffs were reduced, increased or retained.

The major trade policy pronouncement in 2004 relates to the ban placed on the importation of a number of items. In a circular dated February 25, 2004, and titled "Import Prohibition Order",

Table 1: Year 2003 Tariff Amendments

Sector/Product	Tariff Reduction [No. of Items]	Tariff Increase [No. of Items]	Tariff Unchanged [No. of Items]
A.Agricultural Sector	18	-	-
B.Mineral Products	13	-	3
C.Products of Chemical & Allied Industries	143	10	3
D.Plastic/Rubber and Articles Thereof	20	9	-
E.Textiles and Textile Articles	6	-	-
F.Articles of Stones, Plaster, Cement, Asbestos, Mica or Similar Materials, Ceramic Products and Glass Ware	4	2	-
G.Base Metals and Articles of Base Metals	25	8	-
Machinery and Mechanical Appliances: Electrical Equipment, Parts Thereof, Sound Recorder, Reproducers, Television Image and Sound Recorder and Reproducers, Parts and Accessories of such Articles	14	2	1

Source: Federal Ministry of Finance [Budget Office] Circular on "Implementation of the Year 2003 Budget Fiscal Policy Measures and Tariff Amendments".



Prof. Mike Obadan

Introduction

External sector problems have continued to pose serious challenges to economic management in Nigeria. There is the challenge of conducting trade policy within the framework of the World Trade Organisation's [WTO] rules and regulations without compromising the country's short and long-term interests. Even with the re-introduction of the Dutch Auction system of exchange rate management, it appears that a generally satisfactory approach has not been found to exchange rate management, as the foreign exchange market is still characterized by exchange rate instability, significant parallel market premium and declining foreign exchange reserves. External debt servicing has

EXTERNAL SECTOR POLICIES IN THE 2004 BUDGET

By

Prof. Mike Obadan*

continued to pose a serious burden on the country. As the country is not able to service the debts fully as and when due, the debt stock continues to rise even when no new borrowing takes place.

Accordingly, this paper discusses the policy thrusts with respect to three issues in 2004, viz:

- Trade policy;
- Exchange rate policy; and
- External debt management.

The budget statement does not contain much information on the issues. The information used in the discussion was obtained from complementary circulars and inputs into the budget.

2. TRADE POLICY

Trade policy in 2004 is to be conducted within the framework of the Trade Liberalization Scheme of the ECOWAS, and pro-

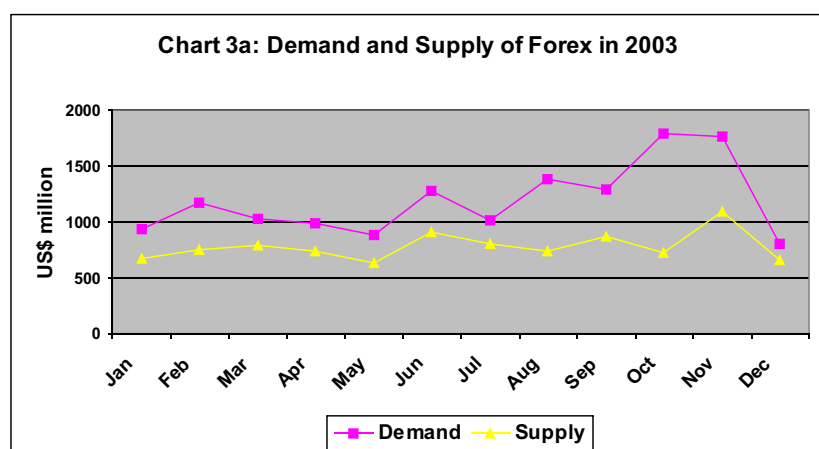
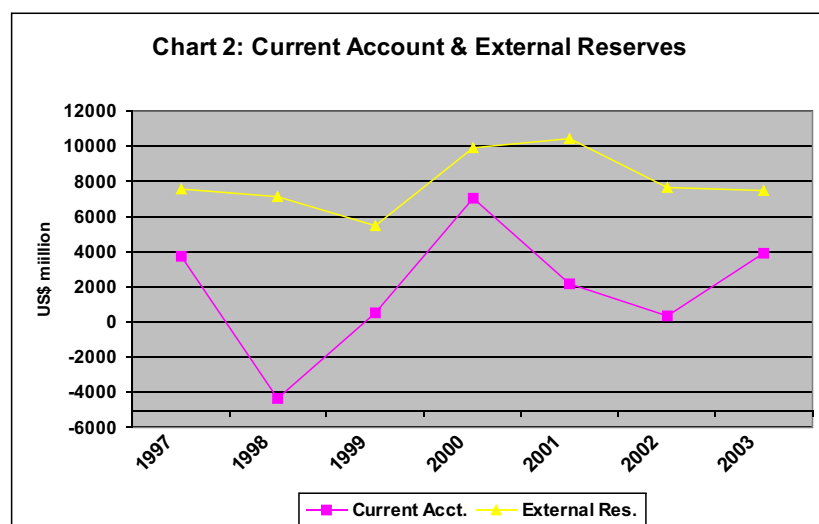
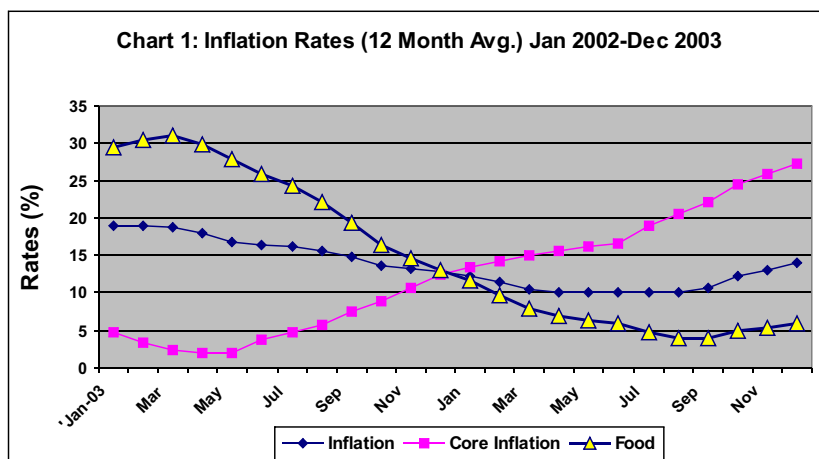
tection in the context of the remedies allowed by the World Trade Organisation [WTO]. According to President Obasanjo, in his budget speech:

“On the issue of tariffs, waivers, duties and concessions, we intend to bring coherence and structure to our policy. As you are aware, Nigeria is committed to common external tariff regime with other ECOWAS countries. Accordingly, government is working towards tariff harmonization in ECOWAS in the nearest possible future. However, we are mindful of the need to protect some of our local industries from dumping and unfair competition and we propose to do this within the remedies allowed us in the context of the WTO and regional frameworks.”

2.1 Tariff Policy and Import Prohibition

It appears that no tariff changes have been effected or proposed in 2004, per-

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fiscal operations of the Federal and State Governments induced excessive growth in banks' liquidity and influenced the rapid acceleration in monetary growth. Though, lending rates declined, the oligopolistic structure of the banking sector continued to encourage the unacceptable wide spread between deposits and lending rates. The foregoing problems posed serious challenges in the achievement of the performance targets stipulated in the 2002/2003 monetary policy circular.

2.0 Monetary And Other Financial Sector Policies In 2004 Objectives, Strategies And Targets

The second phase of the medium-term perspective framework commenced in the year 2004 and would run through 2005. It would be recalled that the medium term framework was introduced in January 2002 to eliminate the problem of time inconsistency and in recognition of the fact that monetary policy measures affect the ultimate target with a substantial lag.

2.1 Objectives

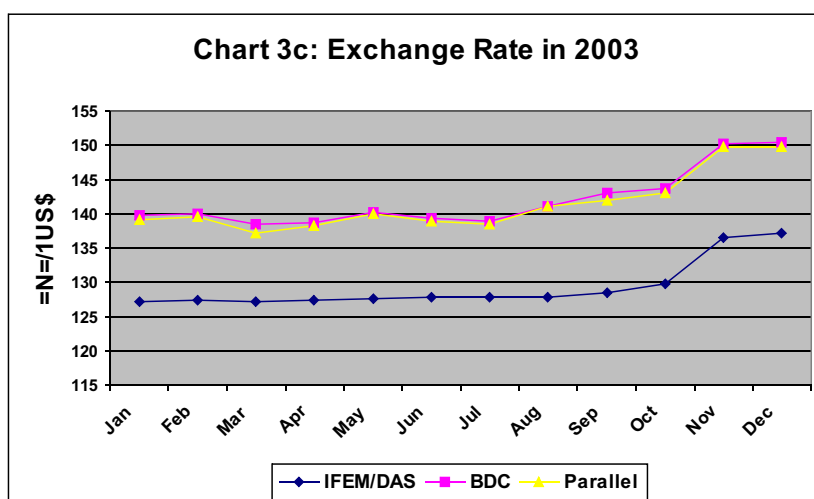
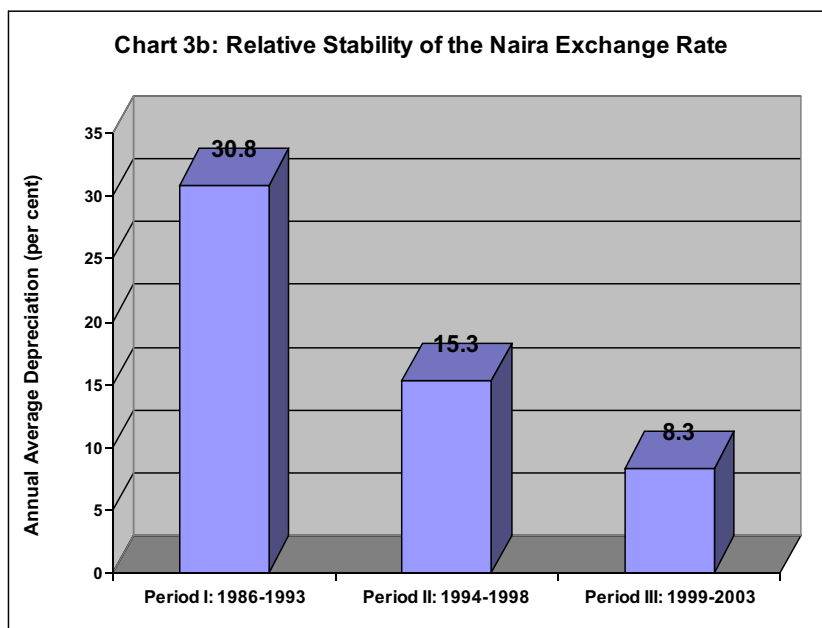
The primary objective of monetary policy in 2004/2005 is the achievement of price and exchange rate stability.

Specifically, monetary policy will seek to subdue inflation to a single digit during the period, through effective control of the growth of monetary aggregates.

2.2 The 2004 Monetary Policy Measures

Consistent with the medium-term framework, the monetary programme will cover the period 2004/2005. The focus of monetary policy in 2004 include: effective control of the liquidity surfeit in the banking system and its adverse effects on inflation and exchange rate; strengthening and sustaining financial sector stability; and further improving the payments and settlement systems.

As in the preceding year, the conduct of monetary policy shall continue to be market-based. With open market operations (OMO) as the primary instrument, supported by reserve requirements and discount window operations for enhanced effectiveness. The CBN's own intervention security would be issued, as the need arises, to ensure uninterrupted conduct of OMO and its effectiveness in liquidity control. Interest rate will also continue to be market-driven, while its direction shall be influenced



by the invisible hand. The minimum rediscount rate shall be used proactively and its movement shall be driven by the domestic price level.

Other highlights of monetary, credit, foreign trade and exchange policy measures in 2004 include:

- The implementation of the National Savings Certificates (NSC), which was approved by

the Federal Government in 2003 to complement CBN's efforts in promoting growth in domestic savings and addressing the problem of excess liquidity on a sustainable basis.

- Further improvements in the payments and settlement systems through the promotion of the use of cheques and e-money in line with global trend;

Appendix 2: Relative Stability of the Naira Exchange Rate

Year	Annual Average Exchange Rate N/US\$	Dep.(-)/Appr.(+) In Percentage	Average for the Period
1985	0.89375	-	
1986	2.020575	-55.8	} Period I: (1986-1993) 30.8%
1987	4.017942	-49.7	
1988	4.536733	-11.4	
1989	7.391558	-38.6	
1990	8.037808	-8.0	
1991	9.909492	-18.9	
1992	17.29843	-42.7	
1993	22.05106	-21.6	
1994	21.8861	+0.75	} Period II: (1994-1998) 15.3%
1995	81.02284	-73.0	
1996	81.25275	-0.3	
1997	81.64943	-0.5	
1998	83.80717	-3.6	
1999	92.3428	-9.2	} Period III: (1999-2003) 8.3%
2000	102.1053	-9.7	
2001	111.9456	-8.8	
2002	120.9706	-7.5	
2003	129.3565	-6.5	

Appendix 3: Exchange Rates in 2003

	IFEM/DAS	BDC	Parallel
January	127.0695	139.7045	139.1045
February	127.315	140	139.5
March	127.164	138.4545	137.1
April	127.37	138.75	138.25
May	127.6676	140.3143	139.9048
June	127.8317	139.4167	138.9167
July	127.772	139	138.5
August	127.895	141	141
September	128.575	143	142
October	129.7886	143.6705	142.9659
November	136.6067	150.2083	149.6944
December	137.2233	150.4167	149.8571

their loans as and when due a refund of 40.0 per cent of what they paid as interest on such loans. In fiscal 2004, eligible beneficiaries under the programme will be entitled to a refund of 40.0 per cent of the interest paid on eligible bank loans after liquidating the underlining credits so as to encourage timely loan repayment by farmers and induce more banks to lend under the Agricultural Credit Guarantee Scheme (ACGS).

3.0 Concluding Remarks

A good monetary policy is expected to achieve macro economic stability and a sound financial sector if effectively implemented and barring fiscal shocks. Overall, socio-political stability and fiscal discipline are critical factors for the effectiveness of monetary policy. The efficacy of monetary policy in Nigeria has continued to be constrained by fiscal shocks.

Inconsistent policy pronouncements from the political leadership can also undermine monetary policy because of

APPENDICES

Appendix 1: Demand and Supply of Foreign Exchange in 2003

	Demand	Supply
January	937.73	665.33
February	1172.20	747.74
March	1027.03	786.61
April	985.31	731.21
May	878.99	636.55
June	1278.64	908.29
July	1018.25	805.05
August	1386.74	740.44
September	1285.44	873.07
October	1790.76	728.60
November	1764.27	1090.90
December	805.63	662.18

the wrong signals which it sends to economic agents. The structure of the financial system is also crucial for the successful implementation of monetary policy measures. The enduring oligopolistic structure of the banking system has continued to sustain the problem of wide spread between banks deposit and lending rates. This has discouraged savings and undermined investment. But while the mix of 2004 monetary policy instruments are conceptually very sound, it must be acknowledged that in developing economies like Nigeria, monetary policy plays a second

fiddle to fiscal policy. Consequently, effective collaboration between the monetary and fiscal authorities remains a critical success factor.

- The continuation of the Dutch Auction System (DAS), of exchange rate management, in order to enhance efficient and transparent allocation of foreign exchange.

In pursuit of the medium-term perspective monetary policy framework, the performance targets for fiscal 2004 are set as follows:

- Growth in broad money supply (M2) of 15.5 -17.5 per cent. This level of liquidity is consistent with the output growth target of not less than 5 per cent and a single digit inflation rate in 2004.
- Growth of 22.44 per cent in banking system credit to the domestic economy.
- Growth in credit to the private sector of 30.0 per cent for fiscal 2004.

The targets are consistent with the broad economic reform programme under the NEEDS medium-term framework.

2.3 Major Monetary Policy Instruments

The major instruments of monetary policy will continue to be the Open Market Operations (OMO), supported by the reserve requirements and discount window operations, including Repurchase Agreements

(REPOs). These are further discussed below:

(a) Open Market Operations (OMO)

OMO will be conducted on daily basis, via the Dutch Auction system in the secondary market, for short term government securities, appropriately tenured to provide for various preferences in the market.

(b) Reserve Requirements

Reserve requirements shall serve as a prudential and liquidity management instrument. The cash reserve requirement (CRR) will complement OMO towards the achievement of monetary stability. The dual CRR introduced in July 2002 created distortions in its implementation and monitoring because of the tendency of some banks to window-dress their returns to the CBN in order to qualify for the concessionary rate. In this regard, effective 2nd January 2004, the subsisting ratio of 12.5 per cent was reduced to a uniform 9.5 per cent for all banks. The existing minimum Liquidity Ratio (LR) pegged at 40 per cent for all banks is retained, but would be reviewed in line with developments in monetary conditions during the year. It should be noted that liquidity provision is a pru-

dential requirement and does not constitute a cost to banks.

(c) Discount Window Operations

The use of discount window is also retained in 2004. Its use is consistent with the role of CBN as a lender-of-last-resort. Transactions at the Window will be conducted on short-term basis, largely over-night loans, collateralized by the borrowing institution's holding of government debt instruments and other eligible instruments approved by the CBN.

(d) Interest Rate Policy

As in the previous years, interest rates shall be market-driven in 2004. In this regard, the CBN will influence the level and direction of interest rate movements through changes in its minimum re-discount rate (MRR) and moral suasion, to reflect the prevailing market condition.

The persisting widespread between the banks' deposit and maximum lending rates reflects the un-competitiveness and inefficiency of the interest rate structure, which has serious implications for savings, investment and growth. To address this problem, a more competitive financial

environment will be pursued. In particular, the CBN shall intensify its enlightenment campaign to sensitize the investing public on alternative investment opportunities in the financial market. Deposit money banks are also urged to exercise restraint in their quest to maximize profit, bearing in mind that a high interest rate structure is harmful to the economy.

New Policy Measures Introduced in 2004/2005 Monetary Framework

(i) Settlement and Clearing Banks

In order to foster a safe, stable and smooth functioning banking system, devoid of collateral shocks and disruptions, as well as ensure settlement finality at the CBN, Settlement Accounts for banks that meet the prescribed criteria for clearing and settlement operations shall be maintained by the Bank.

Banks that meet the specified requirements shall be designated as "Settlement Banks", while other banks that fail to qualify shall do their clearing through the Settlement Banks under agency arrangement and shall be known as "Clearing Banks". Currently, the CBN has appointed and

designated 7 banks as "Settlement banks" to perform clearing and settlement functions for other banks with effect from 1st April, 2004. Settlement banks enjoy no special privileges, nor are they superior to non-settlement banks.

(ii) National Credit Guarantee Scheme for SMEs

A major constraining factor to bank financing of the small and medium enterprises (SMEs) has been the inability of promoters of such enterprises to provide required collaterals to reduce the risk of default in repayment. In this regard, a National Credit Guarantee Scheme would be established in 2004 to mitigate the risks associated with lending to the real sector. The scheme is expected to encourage financial institutions, particularly, deposit money banks to lend to small businesses, which have viable projects and good prospects of success, but are unable to satisfy the lender's collateral requirements. Eligible beneficiaries of the scheme would be micro, small and medium scale enterprises in manufacturing activities or related service industries, as officially defined by the

National Council on Industry. Furthermore, the scheme is intended to complement the SMIEIS in channelling funds to the real sector of the economy, particularly SMEs. In this regard, a bank would be compensated under the scheme on the condition that it lends to the SMEs. The details on the modalities of the scheme would soon be provided. The CBN's scheme shall be subsumed by the FGN/Private sector scheme when it eventually takes off.

(iii) Public Sector Deposits

Movement of public sector deposits in and out of the banking system will constitute an important instrument of monetary management during the year. Accordingly, the CBN would signal its intention to move the deposits of key government parastatals and the overhead accounts of core ministries out/in of Deposit Money Banks depending on the liquidity conditions of the banking system. It is expected that this measure will assist in liquidity management. Deposit money banks are therefore cautioned not to inordinately depend on public sector funds for their operations.

(iv) Consultant's Verification of NOTAP Certificates

There has been significant rise in foreign exchange transfers under the invisible category in recent times. In particular, requests for technical fees have risen sharply, without the commensurate level of transfer/acquisition of technology in the country.

Consistent with the policy of transparency, a consultant's certification of National Office for Technology Acquisition and Promotion (NOTAP) approval would be required for foreign exchange disbursements for technical fees and royalties, with effect from January, 2004.

Other Subsisting Measures To Be Retained/Modified in The 2004 Monetary Policy Framework Include:

(i) Minimum Paid-up Capital Requirement

In order to sustain a strong financial base for banks and to enhance public confidence in the banking industry, all existing banks are encouraged to raise their minimum paid-up capital to

N2.0 billion by end-2005.

(ii) Revitalizing the Community Banks (CBs)

To further widen the scope of the operations of the CBs as well enhance their efficiency, the CBN has approved the participation of the CBs in the Agricultural Credit Guarantee Scheme with effect from 2004 fiscal year. Also, the minimum paid-up capital of a CB has been raised to N5.0 million. In addition, following the removal of the restrictive shareholding structure of 5.0 per cent for individuals and 30.0 percent for Community Development Associations (CDAs), each shareholder, individual or corporate bodies can hold any percentage share of the equity of a community bank.

(iii) CBN Rediscounting and Refinancing Facility (RRF)

The Rediscounting and Refinancing Facility (RRF) introduced in fiscal 2002 to encourage banks to lend on long-term basis to the productive sectors of the economy elicited only a modest patronage

from banks. Consequently, a review of the Guidelines on RRF will be undertaken in the fiscal year in collaboration with all stakeholders, in order to regenerate interest in the use of the facility and make it more attractive to banks.

(iv) Capital Fund Adequacy

In keeping with international standards, the minimum ratio of capital to total risk-weighted assets has been increased from 8.0 per cent in the preceding year to 10.0 per cent with effect from 1st January 2004. Furthermore, at least 50.0 per cent of a bank's capital shall comprise a ratio of not less than one to ten (1:10) between its adjusted capital funds and total credit, net of provisions.

(v) Interest Drawback Programme (IDP)

Following the concerns over the prevailing high interest rates, especially, for borrowers in the agricultural sector, the Interest Drawback Programme (IDP) was established in 2003. The IDP moderates the effective borrowing rate to farmers by providing those who repay