

**FINANCIAL SECTOR REFORMS AND MONETARY
POLICY IN NIGERIA ***

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S. I. Ikhide **

SUMMARY

This paper reviews the impact of financial liberalisation on monetary policy in Nigeria, examining in particular the progress made in the transition from direct to indirect forms of monetary management. While recognising the inherent shortcomings of the previous direct control system, it highlights the difficulties that have been experienced in practice in moving to indirect controls. It argues that Nigeria's inability to meet certain minimum conditions could to a great extent compromise the successful implementation of indirect controls. It concludes that a range of measures are needed, including far reaching measures on restructuring insolvent banks, introduction of powers to deal with offending market participants, development of the secondary market, plus a shift to a realistic exchange rate. Even when all these have been achieved, there remains the need to substantially reduce government fiscal deficits and remove ceilings on interest rates, without which the money market cannot function adequately. The paper raises serious questions about the advisability of implementing open market operations on a large scale at this stage of the economic reform.

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** Department of Economics, Obafemi Awolowo University, Ile-Ife, Nigeria.

1 INTRODUCTION

Financial sector reform (FSR) became a major component of the structural adjustment programme in Nigeria with the deregulation of interest rates in August 1987. However, in terms of attention, research efforts in this regard have been minimal, when compared to the efforts into the other components of the programme such as trade liberalisation and exchange rate reforms. Even where research is available, emphasis has tended to be placed on the institutional aspects of the programme and here too the focus has been on the banking sub-sector (Ikhida and Alawode 1994, Ojo 1993, Soyibo and Adekanye 1992). The reasons for this are not far-fetched. Stabilisation issues tend to have more far reaching implications, given the structures of most Sub-Saharan African countries and given the nature of imbalances that necessitated the implementation of economic reforms in these countries in the seventies and early eighties. Efforts were geared towards the investigation of current account and government deficits as well as their implications for saving/investment imbalances. The financial sector in some of these countries is coterminous with the banking system and an examination of the role of the banks in the mobilisation of savings for the purpose of bridging the savings/investment gap come naturally with the aforementioned concerns.

In recent times however, more attention have started to focus on the reform of the financial sector. First, it is realised that the structure of the financial sector can affect macroeconomic performance. Gertler (1988) provides an excellent survey on the connection between the efficiency of financial markets and macroeconomic performance. For instance, the behaviour of monetary aggregates has great implications for the level of prices and the balance of payments (Fry, 1988).

Second, it is becoming increasingly clear that the ability to sustain stabilisation policies such as exchange rate reforms may hinge critically on structural changes in the financial sector. Specifically, such structural changes in the financial sector may be crucial for the efficient conduct of monetary policy. Without such structural changes, it would be difficult to make any substantial progress with macroeconomic stability (Khan and Sundararajan, 1992). Third, some recent literature has started to focus on the issue of sequencing and timing of both the overall stabilisation programme and the liberalisation of the financial sector. The speed, sequence and timing of specific components of financial sector reforms may hinder the attainment of the objectives of the goals of stabilisation policy. The reverse is also true. Fourth, and more important for our present purpose, the adoption of indirect methods of monetary control may make easier the transition from a regulated to deregulated economy. Over the years, there has been a gradual shift in the overall approach to economic management in LDCs. After several unsuccessful decades of emphasis on the role of government interventions in promoting growth, developing countries are now devoting more efforts to having market signals guide the allocation of resources. This has been accompanied by the promotion of private sector development. However, it is conceived that such efforts at promoting the private sector is better implemented through an increased role of market forces in the allocation of resources in the economy (Hinds, 1992). Thus,

direct control of monetary aggregates which places emphasis on the imposition of limits on the price or quantity of credit must yield way to indirect methods aimed at influencing financial institutions' liquidity through market forces. This has several implications for the conduct of monetary policy.

The objective of financial sector reform defined in a broad manner is to increase the size, improve the efficiency and raise the diversity of the financial system of the reforming economy. This objective is attained through financial liberalisation which is viewed as the process of moving towards market-determined interest rates as well as market-determined prices on all classes of financial products, banking system characterised by symmetric entry and exit conditions to all participants, increasing internationalisation or the opening up of domestic markets to international competition and limited barrier to the introduction of new financial products. Within the Nigerian context and within the framework of this paper, this has been operationalised through allowing market-determined interest rates to prevail for most of the reform period, eliminating direct credit, restructuring balance sheets of financial intermediaries and improving financial infrastructure.

The successful implementation of these reform policies has implications for the monetary policy framework. There is an intricate relationship between FSR and the objectives, instruments and operating procedures of monetary policy. In particular, indirect monetary management will only succeed when substantial reforms have been implemented in the financial sector. Such reforms as the restructuring of the portfolio of the domestic banking system and the reduction in the size of the deficit of the government are initial conditions for transiting to a more market-based system of monetary control. Thus relatively well developed financial systems are needed to ensure that indirect methods of monetary management work well. However, the transition away from poorly developed, repressed or thin financial markets is very difficult to achieve so long as the direct methods of control are in place. This then is a paradox (Roe and Sowa 1994).

The objective of this study is to examine how this relationship between the liberalisation of the financial sector and the monetary policy framework has worked itself out over the period of adjustment in Nigeria. From our discussion so far, three issues which this study will attempt to focus on emerge. The first is that there are important linkages between FSR in general and the monetary policy framework under indirect controls. Second, the problem of the initial conditions, especially the fiscal deficit and bank restructuring arrangement may vary in magnitude from country to country. Added to this is the fact that countries may also differ in the pre-existing depth and sophistication of their financial systems. Under these circumstances it may be out of place to impose a common formula for transition to market based system of monetary control. The implication of this for the speed, timing and sequencing for the adoption of indirect methods of control is examined in this study.

The rest of this study is organised as follows: Section II presents a brief macroeconomic background of the Nigerian economy and reviews the structure of the Nigerian financial system. Section III reviews the major policy measures in the liberalisation programme as they impinge on the financial

sector with emphasis on the progress of the reform process, section IV reviews monetary policy in Nigeria prior to the implementation of indirect controls in 1993 with a view to highlighting the major shortcomings in the pre-reform dispensation, section V focuses on the experience of Nigeria with indirect monetary management. Here the emphasis is on documenting the operating procedures of monetary management by the Central Bank of Nigeria. In section VI, we focus on the main operational issues arising from our discussions in section V and in section VII, we examine some of the policy implications of this study. Finally, in section VIII, we present our main conclusions.

2.A MACROECONOMIC BACKGROUND

Nigeria did not have a stable macroeconomic environment before and during the implementation of SAP. The terms of trade deteriorated for most of the period between 1970-1985. The CPI growth rate was on the average 17.1 per cent between 1980-85 and though this fell to about 5.0 per cent for 1986 and 1987, it again started to rise from 1988, peaking at 47.5 per cent in 1989. It has remained consistently high in the 1990's reaching an all time high of 54.7 per cent in 1994. The current account reported a surplus between 1989-93 after a fairly long period of deficit between 1981 and 1988 (there was a moderate surplus in 1984 and 1985 due to the austerity measures embarked upon by the military administration). Domestic savings as a ratio of GDP, which stood at an average of 27.7 per cent between 1970-80, started to fall in 1981. Between 1981 and 1986, it stood at 13.8 per cent. The investment ratio has followed the same pattern although reporting slightly lower figures. Fiscal deficit has been chronic and is financed by borrowing from the banking system.

The share of commercial banks in total financial assets has shown a structural shift from about 57.7 per cent in 1980 to 36.4 per cent in 1993. The major gainer has been the Central Bank whose share has increased from 33.1 to 46.4 per cent during the same period. It is doubtful if the chartering of new banks embarked upon during huge structural adjustment programme has improved competitiveness in the system as the three largest banks still account for up to a third of total deposits. One major feature of banking in the period of deregulation is the occurrence of large distress in the banking system. Close to 42 banks are severely distressed in the system with 45 per cent of loans classified as non-performing (CBN, 1994).

The performance of major monetary and financial ratios did not show any appreciable improvement during reforms. For example, total loans and advances measured as a ratio of GDP declined from 25.6 per cent in 1986 to 14.3 per cent in 1990. The aggregate domestic credit GDP ratio, which peaked at 50.3 per cent in 1986, had halved by 1993 (24.5 per cent) with credit to government commanding a larger proportion. The ratio of both narrow money M1 and broad money M2 to GDP has followed the same trend. From a high of 19.2 per cent in 1981, M1/GDP ratio plummeted to 11.5 per cent in 1993 and M2/GDP ratio from 30.6 to 20.1 per cent during the same period. The behaviour of

interest rates has followed the same pattern. Severely negative before the liberalisation exercise, the deregulation exercise in 1987 yielded interest rates that were mildly negative to positive in the period 1987-1990. But with pressure on prices thereafter, real interest rates have turned severely negative again for the period 1991-94 (Table 10). Thus, it can be observed that most macroeconomic aggregates have become severely unstable in recent times. It is in this environment that indirect monetary control was initiated in 1993.

Much of the difficulty in achieving the objectives of SAP resulted largely from the failure to achieve fiscal balance and the consequent reliance on borrowing from the Central Bank to finance the fiscal deficits. This has adversely affected both the market for foreign exchange, money and goods and negated the expected role of markets in allocating resources efficiently. The extent to which open market operations in government bills can help to successfully manage the excess liquidity in the system which is created by government borrowing from the Central Bank is one that should be of some interest given the enormity of this problem in the attainment of stabilisation goals in the economy.

2.B THE STRUCTURE OF THE NIGERIAN FINANCIAL SYSTEM

The financial sector in Nigeria is made up of a wide array of institutions and instruments. It consists of the Central Bank of Nigeria which is the apex financial institution, Commercial and Merchant Banks, Development Finance Institutions, Thrift and Insurance organisations, a Stock exchange and a Securities and Exchange Commission and a virile informal financial sector. The number of commercial and merchant banks have increased from 12 in 1960 (at independence) to about 120 at the end of 1992 with a branch network of 2391 out of which commercial banks account for 2275 (with 774 in the rural areas). At the end of 1985, (prior to the commencement of the structural adjustment programme), the ownership structure of the share capital in commercial banks indicated dominant ownership by government (Federal and State) accounting to 58.6 per cent followed by private shareholders (22.5 per cent) and foreign interests (18.9 per cent). Today with government divestiture of its ownership in major enterprises, the ownership structure has tilted in favour of private individuals with foreign interest playing only a supporting role. Commercial Banks dominate the Nigerian Banking industry; they account for 71.2 per cent of total credit outstanding to the private sector as at the end of 1993. The pattern of investment in recent times are concentrated in 'other assets' followed by loans and advances and inter bank placements¹. Whereas commercial banks concentrate on the retail end of the financial system, merchant banks are supposed to transact wholesale banking business. Recently, merchant banks have relied on short term sources of funds, which is reflected in the preponderance of short-term loans in their portfolio.

In addition to these, six development finance institutions also operate in the system. These are the Nigerian Agricultural and Cooperative Bank, the Nigerian Industrial Development Bank, the Nigerian

Bank for Commerce and Industry, the Federal Mortgage Bank, the Nigerian Export-Import Bank (NEXIM) and the recently established Urban Development Bank. As their names suggest, these are development finance institutions charged with the responsibility of providing loan and industrial finance by attracting foreign resources, mobilising domestic savings and allocating investment funds efficiently. More often than not, they are established in recognition of unfulfilled credit needs of domestic industries. As of 1992, the share of the assets of these institutions (minus NEXIM and the Urban Development Bank) in the total assets of all financial institutions in Nigeria was put at about 1.9 per cent.

Specialised banks have been established with the onset of the structural adjustment programme to meet up with the ever increasing credit needs of segments of the society who are not adequately catered for by the existing arrangement. These are the Community banks whose capital requirements are provided by the communities in which they are located and the Peoples Bank which is supposed to provide for the needs of small and medium scale entrepreneurs in the society. Both of them are designed to provide credit facilities at grassroots level and thereby promote self reliance. At the end of 1993, the Peoples Bank was operating 271 branches and 879 community banks.

Thrift institutions have also achieved some prominence in the financial system. These comprise mainly of insurance companies, pension funds and the savings banks. In 1987, 87 insurance companies operated in the system out of which 68 were wholly indigenous and 19 were jointly owned by Nigerian and foreign interests. The asset share of insurance institutions in the total for all financial institutions was put at 2.1 per cent in 1992. The main pension institution in Nigeria is the National Provident Fund (NPF) which was established in 1961 as a compulsory savings scheme with the objective of running as a social security program by providing protection to contributors in their old age, invalidity or temporary loss of employment. The enabling act establishing the National Provident Fund requires it to invest its surplus funds "only in securities in Nigeria authorised by the Trustee Investment Act 1957 and 1962 and shall be restricted to securities created or issued by or on behalf of the Government of the Federation". Both employers and employees contribute to the Fund. The NPF commenced operation in 1962 and since then has been a major participant in the Capital market. The Federal Savings Bank, FSB, was established in 1974 with the aim of providing a ready means for the deposit of savings to encourage thrift. As a way of reaching savers in the rural areas, the scheme was initially tied to the Post offices whose network of branch distribution spanned the nation. However, as a result of its poor performance, the scheme is now operated as an independent savings institution directly supervised by the Central Bank of Nigeria. The investment portfolio of FSB has found interest in such instruments as the Federal Government of Nigeria Development stocks and Treasury bills.

Apart from these major financial institutions, the financial system is also inundated by a collection of young and small institutions that play a major role in the intermediation process². These include finance companies, leasing companies, mortgage, savings and loan associations and venture capital

companies. Most of these have come into prominence in the wake of the financial innovation that pervaded the system with the onset of financial liberalisation. Although their activities are mainly restricted to the urban areas, their characteristic single unit offices and share aggressiveness in the mobilisation of savings and the creation of investment outlets mark them out as viable potentials for the fostering of enhanced intermediation given a well developed money and capital market. In 1992 alone more than 47 finance companies were granted licenses to operate. As at 1993, about 752 finance houses were in operation although only 310 were licensed. Data available on 207 of these institutions showed an aggregate capital cum reserves of 1142.2 million Naira and 5393 million Naira assets. The single largest source of their funds is loans. These amounted to 3161.2 million Naira, or 58.6% of the total (CBN, Annual Report, 1993). At a percentage of total domestic credit to the economy, this was slightly above 1.0 per cent in 1993. As a percentage of credit by commercial banks to the economy this was approximately 4.0 per cent. Thus on a comparable note, finance companies have become important purveyors of credit in the financial system. Although they are not depository institutions, finance companies are allowed to borrow a minimum of 100,000 Naira from any person or corporate organisation subject to certain statutory limitation on total outstanding borrowing. They are authorised to transact a general class of lending and leasing business to consumers, industrial, commercial and agricultural enterprises.

Discount houses are special non-bank financial institutions aimed at providing discounting/rediscounting facilities in government short term securities. In particular, it is expected that discount houses will promote the growth and efficiency of the money market, enhance the implementation of open market operations by facilitating the issue and sale of short-dated government debt instruments by tender and also accommodate bank's short term financial needs. Their main sources of funds is equity (paid-up capital and reserves), money on call, and overnight advances from the CBN. By September 1992, approval-in-principle had been granted to three discount houses. The bureaux de change were set up in 1989 to act as dealers in the spot market for foreign exchange. The need to broaden the foreign exchange market at the onset of SAP and improve the access of small transactors to foreign exchange necessitated their establishment. The National Economic Reconstruction Fund (NERFUND) was set up in 1989. It is a funding mechanism aimed at bridging the gap in the provision of local or foreign funds to small and medium-scale enterprises. It is jointly owned by the Federal government of Nigeria, the CBN and other foreign partners.

Instruments of the Money Market

The money market has been developed with two main objectives in mind: to provide the public and private sectors with means to raise short-term money and invest cash and to serve as a conduit for the management of liquidity and money by the monetary authorities. One is therefore not surprised that the money market did not come into existence until the establishment of the CBN in 1959. The major

institutions operating in the money market are the Treasury/Central Bank dealing in treasury bills, treasury certificates, government development stocks, (all Federal government borrowing instruments), the commercial banks, dealing mainly in bankers acceptances, certificates of deposits, and bankers unit funds and private companies dealing mainly in commercial papers. The interbank market has also become more prominent with the SAP. The size of the money market has increased substantially both in terms of the number and heterogeneity of instruments traded since 1987 when SAP began. Today, mutual funds, Unit Trusts, Investment companies, operate both in the money and capital market (Ikhide and Alawode 1993). It is expected that with the establishment of the discount houses, the money market will grow even faster. Because of their relevance for indirect monetary control, a brief survey of the instruments of the money market is attempted here.

1. Inter bank funds-market. These are generally unsecured interbank placements of maturity from overnight to 90 days. In 1994, 95.7 per cent of total placements was overnight. The rates charged on call money rates vary over time and across institutions. Inter bank funds market are very sensitive to changes in interest rates as witnessed by the fall in the value of transactions between 1993 to 1994 when average rates for the 30 and 90 days maturity fell from 66.2 and 63.2 in December 1993 to 18-21% in 1994 in response to the re-regulation of interest rates policy.
2. Treasury Bills (TBs). These are short term debts of the Federal Government. The Central Bank provides rediscount facility which makes the instrument highly liquid. They are reserve eligible assets. Introduced in 1960, they dominate the money market. As at end of 1993, they constituted about 71.2 per cent of total money market assets. They are now issued weekly and are held by banks and the non-bank public. Most of the outstanding treasury bills are held by the CBN who actually underwrites the issues. As at end of 1994, the CBN took up 85.6 per cent of total issues.
3. Treasury Certificates (TCs). This is a medium-term instrument of one to two years maturity designed to bridge the gap between treasury bills and other medium term instruments. Again, the CBN holds most of the outstanding issues because investors perceive its yield and maturity characteristics as unattractive relative to the risk-return profile on other short term instruments. CBN average holding in 1994 was about 89.9 per cent.
4. Certificates of Deposit (CDs) were introduced in 1975 by banks as a financial innovation in response to the excess liquidity in the system at a time when government securities were in short supply (this was during the oil boom era). The maturity structure ranges from 90 days to 3 years, and the instruments are traded among banks. Transactions in CDs started to take a plunge in 1992 after the peak performance of the late 1990's. The decline can be traced to the preference by holders for shorter-term instruments in the face of highly volatile interest rates, unstable macroeconomic environment and the distress in the banking system which has increased the risk attached to CDs. Merchant banks remained the main holder as at 1994 with a monthly average issue of 348.3 million

Naira representing 79.4 per cent of total issues.

5. Commercial Papers (CPs). Are negotiable short-term, unsecured (IOU's) promissory notes issued by firms and non-bank financial intermediaries. Issue of commercial paper constitute the main supplement to bank loans for fulfilling seasonal credit requirements of the private sector. They are popular with both commercial and merchant banks. As at 1994, average holdings by the two financial institutions stood at 68.5 and 31.4 per cent respectively.
6. Bankers Acceptances (BAs) are short-term IOU's typically issued in connection with foreign trade and guaranteed as to payment by a bank. Most holdings of BAs are by commercial and merchant banks. Investment in BAs by commercial and merchant banks which had remained at relatively modest levels up to 1993 rose significantly in 1994. A major factor for this trend could have been the relatively unattractive nature of other short term instruments due to the re-regulation of interest rates in 1994.
7. Unit Trust schemes are institutions established mainly for the mobilisation of the financial resources of small and big savers and management of such funds to achieve relatively high returns with minimum risks through efficient portfolio diversification. The first Unit Trust Scheme was launched in December 1990 and by end of 1992, ten units schemes had been launched.

The Capital Market

The capital market in Nigeria can be divided into two: the non-securities segment and the securities segment. The non-securities segment consists of Savings Banks, Mortgage Banks, Development Banks and Insurance Companies. Their instruments consist of term loans, mortgages and leases. Mention must be made here of the Development companies which complement the activities of the development banks. Their history in most cases predate the establishment of some of the development finance institutions, they supply loan and equity capital for financing new and existing enterprises. They cater for a wide range of industrial groups in both the public and private sectors. They started in most cases as regional development boards and have undergone different stages to become what they are today - public investment companies. At their inception, they were mainly established to administer and use funds made available to the marketing boards in such areas as agriculture and industry. Most popular among them today are, the Northern Nigeria Development Board, the Odua Investment Company Limited and the Central Investment Company Limited serving respectively the North, West and East. Their investment in banking, commerce and manufacturing run into millions of Naira. Data is not readily available on the activities of these finance institutions but nevertheless they constitute an important segment of the capital market (Okigbo, 1991).

The capital market proper consists of the securities segment. It is instructive to distinguish between the fixed interest securities market (debentures and bonds) and the shares market in Nigeria. The bonds market is dominated by the government whereas private enterprises dominate the shares market. Only a

few debentures are issued by the private enterprises. The conventional sources of funds for the purchase of fixed-interest securities are households, individuals and enterprises particularly financial institutions - commercial banks, savings institutions and the Central Bank.

In general, two groups of transactors place their securities in the market - the government (Federal, State and Local governments) and the incorporated enterprises. Government securities dominate the market. There were a number of legislative actions which supported the market for government securities. Among these were the Income Tax Management Act, 1961, which conferred tax free status on Pension and Provident Funds that maintain at least one third of their total investment in government securities (50 per cent for those approved after 1961); the Trustee Investment Act, 1962, which empowered trustees to invest in government stocks and industrial securities provided such securities are quoted on the stock exchange. And since very few industrial securities are quoted on the stock exchange, the Trustee Investment Act, 1962, had the ultimate effect of forcing all Trust funds to be invested in Government stocks; the Insurance (Miscellaneous Provisions) Act 1964 which requires insurance companies to invest at least two-fifths of all funds from risk premium in Nigeria securities one-quarter of which must be held in Government stocks. It is not surprising therefore that given these measures and the frequency of issues of government bonds, the demand for government loan bonds comes mainly from financial institutions such as commercial banks and savings-type institutions.

Up to the late 1970's, public issue of industrial securities were very limited. Issues of equity shares were more substantial than industrial bond issues both in terms of values and frequency of issue. Two main events, the indigenisation exercise executed through the Nigerian Enterprises Promotion Decree (NEPD), 1972, and 1977 and the privatisation program under the current structural adjustment program have served as main impetus for the growth of the equity market between 1972 and 1990. A total of 57 equity securities valued at 146.31 million Naira was traded on the new issues market between 1971 and 1977. Of this, 31 securities valued at 66.18 million Naira were new issues. The privatisation of erstwhile government concerns also gave a fillip to the growth of the market. In 1990 alone, the Technical Committee on Privatisation and Commercialisation (TCPC) on behalf of the Federal government of Nigeria offered to the public a total of 563,373 million ordinary shares worth 6533.639 million Naira in seven companies for privatisation. All the issues were oversubscribed. Thus, over the years the size of the primary market has grown in absolute terms (volume) as well as in value. The issue of government stocks has dominated total issues while in relation to transactions in the market, the situation has not changed. In terms of values, Government stocks also constitute the hub of the market. However, in terms of the number of listings and of the transactions, private (industrial securities) have been growing rapidly in importance particularly in the past decade.

In terms of institutions the capital market consists of a primary market which is dominated by the investment (merchant) banks, brokers and dealers and venture capitalists and a secondary market dominated by the Stock Exchange. While the primary markets main concern is with the primary issues,

the secondary market handles already existing issues of the Exchange.

Following from the report of the Barback committee set up in 1959 to advise on the desirability of setting up a stock market in Nigeria, the Lagos Stock Exchange now known as the Nigerian Stock Exchange (NSE) was established in 1960. The growth of the market was rather slow in its early years with only 6 equities quoted as at the end of 1966 in contrast to 3 in 1961. An average of one equity was quoted for these years except for 1964 and 1965 when no equity was quoted at all. Government stock comprises the bulk of listing with 19 such securities quoted on the Exchange in 1966 as against just 5 in 1961, an average of 3 stocks were quoted for these years. On the whole a total of 60 securities were quoted at the end of 1966 with total transaction value of 18.1 million Naira, Government and industrial securities accounting for 90.1 per cent and 9.9 per cent respectively. Many factors contributed to the low level of performance in these early years. Some of the identified factors include the lack of infrastructural facilities, the low level of awareness about the role of a stock market, and the reluctance of many companies to seek quotation on the exchange. Some of these problems still, linger in the capital market today thirty years after the establishment of the stock exchange.

For a Stock Exchange to mobilise savings effectively and channel such savings to the most deserving sectors while promoting national integration and unity, it has to develop suitable strategies for access to savers and users of funds spread across the length and breadth of the country. The decision to decentralise the exchange in 1977 clearly had this objective in view. The establishment of trading floors in Kaduna and Port Harcourt was quickly followed by decision of the council of the Exchange on certain policies aimed at dispensing relevant supporting facilities for example, the licensing of new stockbroking firms specifically for the new trading floors and the encouragement given to existing firms to appoint agents and attaches located in the hinterland. From the Securities and Exchange Commission report, there were only 20 stock-brooking firms in Nigeria as at 1985. The figure rose to 21 in 1986, and as 1992 the number had risen to 140. Similarly, from the three trading floors at Lagos, Port Harcourt and Kaduna, new trading floors were opened in Kano, 1989, Onitsha, 1990 and Ibadan in 1990. The exchange has dual listing requirements; firms listed on the second-tier market are subject to less stringent listing conditions. The dual listing facility is designed to accommodate small and medium scale enterprises. The Securities and Exchange Commission is the main regulatory agency in the capital market. It licenses stockbrokers and issuing houses, and investigates cases of abuse and 'insider' trading. Presently there exists in the capital market a network of brokers, investment bankers and brokerage firms (Table 5).

Regulatory Agencies

The main regulatory agencies of the Nigerian Financial system are the Central Bank of Nigeria (CBN), the Nigeria Deposit Insurance Corporation, the Securities and Exchange Commission, the Federal

Mortgage Bank and the Federal Ministry of Finance. The CBN regulates investment intermediaries and all depository institutions except mortgage firms. It performs banking supervision and examination through examining books of accounts, and statutory returns submitted by regulated institutions. It also grants licenses, imposes reserve requirements, prudential guidelines and monetary policy guidelines; because of its mandate for overall economic management, the Central Bank has pervasive oversight responsibility over the entire Nigerian financial system. The rapid growth of new banks and other financial institutions in recent years has overstretched the capacity of the Central Bank to supervise financial institution.

The Nigerian Deposit Insurance Corporation was set up in 1989 to provide limited insurance coverage on the deposit liabilities of all licensed banks (including mortgage institutions) to a maximum of 50,000 Naira per depositor. It also conducts periodic checks of the books of insured institutions. The Federal Mortgage Bank of Nigeria is the principal regulatory and licensing agency for mortgage institutions while the Securities and Exchange Commission (SEC) regulates operations in the capital market. It licenses stockbrokers and issuing houses. The National Board of Community Banks processes applications for the establishment of Community Banks. The regulation of the activities of Bureaux de Change and Insurance Companies come under the ambit of the Federal Ministry of Finance. The activities of the Nigerian Industrial Development Bank and the Nigerian Agricultural and Cooperative Bank come under the supervision of the Federal Ministry of Industries and the Agricultural Ministry respectively. Concerns have been expressed in recent times about the implications of this preponderance of regulatory institutions for effectiveness. Areas of overlap have been identified particularly between the CBN and NDIC.

Informal Financial Sector

This survey of major financial institutions will not be complete without a reference to the informal financial sector in Nigeria. Informal financial arrangements are very pervasive in the rural areas where formal rural credit still accounts for a very low proportion of the credit needs of the rural dwellers. The situation can be better appreciated when it is realised that well over 65 per cent of the population of Nigeria dwell in the rural areas and as of 1977, prior to the commencement of the rural banking program, most of these people did not have access to formal banking system. Most of these institutions concentrate on deposit mobilisation and safekeeping services. In spite of several attempts to extend credit to the rural areas through the formal banking system. Most of these institutions concentrate on deposit mobilisation and safekeeping service. In spite of several attempts to extend credit to the rural areas through the establishment of such rural financial institutions like the Community banks and the People's bank, these institutions still thrive vigorously in the rural areas and enjoy more patronage than the formal financial institutions. In the Nigerian context, it is pretty difficult to separate the act of

deposit mobilisation and safe keeping of assets from the provision of credit. Rural financial institutions are engaged in both although emphasis tend to be more on the former. Most prominent among them are the Rotating Credit and Savings Associations (ROSCAS). Others go by different names such as Esusu, money lenders and money collectors, and pawnbrokers. Their characteristic low information and transaction costs coupled with the easy access that they provide to low income groups who may not have access to formal finance are some of the factors that have continued to ensure their survival even in a very competitive environment. Their tenacity is a testimony to the often canvassed fact that for the rural dweller, the availability of financial services is of prime importance and that availability of credit is more important than its price (Popiel, 1994).

3 FINANCIAL SECTOR REFORMS IN NIGERIA

Attempts at reforming the financial sector in Nigeria have fallen under five main headings - reform of the financial structure, monetary policy reforms, foreign exchange reforms, liberalisation of capital movement and capital market reforms.

- (a) Reform of the financial structure: generally, measures undertaken here are designed to increase competition, strengthen the supervisory role of the regulatory authorities and strengthen public sector relationship with the financial sector. In this direction, some measures undertaken include:
- Enhancing bank efficiency through increased competition and management by granting licenses to more banks to operate. Conditions for the licensing of new banks were relaxed. In response, the number of banks increased dramatically from 40 in 1986 to 120 in 1992. A comparable increase in the number of non-bank financial institutions occurred.
 - Strengthening banks supervision and increasing their viability through adequate regulations regarding minimum capital requirements, specifying the range of assets and liabilities they can acquire, introduction of uniform accounting standards for banks to ensure accuracy, reliability and comparability. Two banking laws were promulgated with effect from June 1991, the CBN Decree No. 24 of 1991 and the banks and other financial institutions Decree (BOFID), No. 25, 1991. In addition, the Nigerian Deposit Insurance Corporation (NDIC) charged with the responsibility of insuring banks deposit against bank failures and ensuring safe and sound banking practices through effective monitoring and supervision of banks in collaboration with the CBN was established whereby banks granted domestic loans on the security of foreign exchange deposits held abroad or on domiciliary accounts. There was also the introduction of an auction-based system for the issuance of treasury certificates aimed at promoting a greater reliance on market forces in the determination of yields on government debts instrument through market determined interest rates and the decision by the Federal government to sell its

share-holdings in some commercial and market banks thereby reverting such banks to private ownership.

- (b) Monetary policy reforms: designed mainly to stabilise the economy in the short run and to induce the emergence of a market-oriented financial sector. Such included:
- Rationalisation of credit controls: although credit ceilings on banks were not completely removed, the sector specific credit distributions target were compressed from 18 in 1985 to 2 in 1987 - priority (agriculture and manufacturing) and non-priority (others). Other credit measures enacted were the elimination of exceptions within the ceiling on bank credit expansion, giving similar treatment to commercial and merchant banks in relation to required liquidity ratios and credit ceiling, the modification of cash reserve requirements which is now based on the total deposit (demand, savings, and time deposits), rather than on time deposits only, and the re-introduction of stabilisation securities. These are non-negotiable and non-transferable debt instruments of the Central Bank which banks are mandated to purchase at intervals in order to control their excess reserves. It was designed to mop-up the excess liquidity of the banking system.
 - Deregulation of interest rates: in January 1987, a partial deregulation of interest rates was attempted, but by August, all rates became market determined. The CBN adopted the system of fixing only its minimum rediscount rate to indicate the desired direction of interest rates changes. Interest rate liberalisation was aimed at enhancing the ability of banks to charge market-based loans rates and also guarantee the efficient allocation of scarce resources. In 1989, banks were encouraged to pay interest on current account deposits. The rate to be paid was to be negotiated between banks and their customers.
 - The shift from direct to indirect system of monetary control: in June 1993, open-market operations (OMO) was introduced. Under the scheme, OMO was to be conducted exclusively through licensed discount houses, which are supposed to constitute the open market for government securities. The introduction of OMO was meant to replace the use of direct controls for managing liquidity in the economy.
- (c) Foreign exchange market reforms: transactions in foreign exchange constitute an important aspect of financial sector activities. A second-tier foreign exchange market was established in 1986 as an auction forum for the sale and purchase of foreign exchange. Previously, the sale and purchase of foreign exchange was rigidly controlled through the use of import licenses and the exchange rate was fixed by fiat. This resulted in an overvaluation of the Naira with its attendant consequences. In order to restore appropriate exchange rates, the authorities began the auction sales of foreign exchange to licensed dealers. A first-tier market was retained to take care of transactions related to government debt-servicing, contributions to international organisations and transfers to Nigerian missions abroad. In 1988, the government permitted the establishment

of private foreign exchange and to accord recognition to small dealers in foreign exchange.

- (d) Liberalisation of capital movement: with the deregulation of the foreign exchange, all existing restrictions on capital transfers were abolished. All that was needed was for evidence of importation and exportation to be provided to the Federal Ministry of Finance. In addition, all applications for capital transfer abroad were to be backed by appropriate documents and settled at the appropriate exchange rate.
- (e) Capital market reforms: capital market reforms are in two parts. First, we have measures undertaken as part of the structural adjustment program which had some impacts on the capital market. Among such measures are:
- interest rate deregulation
 - privatisation: the privatisation of erstwhile public institutions which started under the reform program
 - debt conversion program: debt swaps were first developed as part of the restructuring program of Nigeria's external debt which reached a crisis proportion with the structural adjustment program. Debt to equity swaps have had some impact on the capital market since they are a form of securitisation.

Second, there are reform measures aimed principally at the capital market. These include:

- deregulation of the capital market: an inter-ministerial committee was set up in 1991 to examine ways of carrying out the proposed deregulation. The main focus is the on-going deregulation of securities pricing with the intention of stimulating competition and enhancing investment in the market
- the reconstitution of the Securities and Exchange Commission
- tax policies: the reduction of the withholding tax on dividend, and the reduction of the fiscal burden with respect to the proceeds and yields from debt and equity, although much still needs to be done with regards to the latter
- regulatory measures: these include measures aimed specifically at alleviating the difficulties involved in listing, disclosures and checking insider trading. Since the concern of this work is mainly with monetary policy, we now devote the following section to the examination of monetary policy in Nigeria before the reform programme.

4 A REVIEW OF MONETARY POLICY IN NIGERIA (1960–1992)

Prior to the commencement of the economic liberalisation programme in Nigeria, direct control of monetary management was adopted by the Central Bank of Nigeria. Like in many other LDCs, the motives for this are not far-fetched. Most of them are rooted in the market failure paradigm. There was the need to channel cheap credit towards the sectors in the economy that are believed to be at the

forefront of development. At independence, it was felt that the existing financial institutions could not adequately support the process of industrialisation and agricultural modernisation that was needed to move the country into the forefront of development. Existing financial institutions were foreign owned and local farmers and entrepreneurs had difficulties borrowing from them. The informal financial sector provided the little loans they were capable of at high interest rates. There were few sources of equity and long term finance for long term borrowers. On their part, creditors actually demonstrated a reluctance to provide long-term funds for a number of reasons. Investment was considered risky - production was in new sectors and used technologies unfamiliar to the work force. Both entrepreneurs and managers were relatively inexperienced. Agricultural lending was particularly suspect as natural calamities and fluctuating commodity prices could affect the incomes of farmers and hence their ability to repay loans. Add to this the uncertainty in government policies, volatile inflation, government borrowing which crowded firms out of the financial markets, uncertainty about borrowers prospects and it is obvious why creditors will not be willing to provide long-term funds under such circumstances.

However, the socio-economic milieu was characterised by an impatient and often impoverished population yearning expectantly for government to perform. Thus the government wanted faster results. These was thus the tendency to want to use the financial system for such purposes as allocating resources to projects with high social returns and redistributing incomes. With independence, economic development became a cardinal objective of government. There was the compelling desire to use the banking system to direct financing to the investment projects highlighted by their development plans. Commercial banks were either nationalised or indigenised. Following the promulgation of the indigenisation decree in 1972, the Federal government took controlling shares in all of the foreign owned banks and went ahead in the 1977 follow up decree to limit foreign participation in banks to a maximum 40 per cent equity. By 1980, the federal or state government had majority shareholding in all but a few of the 20 commercial and 6 merchant banks in operation. Thus prior to the commencement of structural adjustment programme in 1986, government intervention in credit allocation targeting industry, small and medium-scale enterprises, agriculture, state-owned enterprises, exports and even regional balances was perverse and remained the main form of monetary management.

Two main inter-related factors have shaped monetary management in Nigeria. First is the events in the international oil market and the other is the perverse nature of the public sector with regards to its borrowing requirements. As the former has to a great extent influenced the latter, we can tentatively delineate four regimes of monetary policy in Nigeria. The first is the period 1960-1969, prior to the large scale exploitation of oil. The second is the period 1970-79, which coincided with the first oil boom as well as the onset of the second oil boom in 1979. The third period is made up of two sub-periods, 1980-1986 and 1987-1992. The first sub-period coincided with the first major downturn in the oil market and the ensuing economic austerity and the second sub-period coincided with the commencement of the structural adjustment programme, a major component of which is financial liberalisation. It is also

worthy of note that this sub-period (1987-92) coincided with a period of gradual recovery in the oil market.

The major objective of monetary policy after the establishment of the Central Bank of Nigeria (CBN) in 1959 was the creation of the necessary monetary and financial infrastructures given that at independence, the nation had inherited a nascent monetary system with a narrow financial sector. Financial instruments such as treasury bills, treasury certificates and development stocks which were largely the borrowing instruments of government were all introduced during this period. These provided necessary channels for mobilising liquid money balances from the banking institutions. The exigencies of monetary management in a war ridden economy (the Nigerian civil war 1966-70) dictated the enactment of a spate of decrees between 1967 and 1969 to give a bite to the power of the CBN to control the economy. The Central Bank (amendment) Decrees, 1967-69 and the Banking (Amendment) Decrees 1969 gave legal backing to the monetary control mechanism of the Central Bank. This decree led to an increase in the instruments available in the arsenal of the CBN to include currency changes, compositional variations of liquid asset ratios of banks through discriminatory cash ratios and variations in the Central Bank Minimum Rediscount Rate (MRR). This rate has remained the 'core' interest in Nigeria's organised interest rate structure (Ndekwa, 1995). The overriding objective of monetary policy during the war years centred on the mobilisation of resources for government to meet up with its war requirements. The annual growth rate of government sector credit was 57.0 per cent between 1967 and 1990 compared with an annual average growth rate of 36.9 per cent for the whole period 1960-1969. This desire to satisfy a burgeoning government borrowing requirement constituted a fiscal resource constraint and informed the policy measure to introduce reserve eligible asset requirement in that period. For the first time, all financial institutions that do banking business were brought under the control of the CBN through the instrumentality of reserve asset requirement. The goal of internalising the operational procedures of the banking and financial institutions though emphasised was only of secondary importance. Consequently, the supply and allocation of credit to the private sector declined and an annual rate of increase of the consumer price index from 3.7 per cent in 1966 to 13.1 per cent in 1969 was recorded (Ndekwa, 1995).

The second period in our analysis (1970-1979) confronted the monetary authorities in Nigeria with the need for an active monetary management policy with the large expansion in government expenditure and an increasing dependence on the external sector occasioned by burgeoning petroleum revenue. The financial sector experienced rapid monetary expansion in the 1970's as these expenditures had to be met through a monetisation of oil revenue. Bank credit constituted another major stimulus to monetary growth during the period. Aggregate demand expanded by more than the increase in output, and inflationary pressures intensified. With large scale internal and external imbalances, (external stability was eroded), monetary management came under severe pressure. Thus the twin objectives of monetary policy in the 1970's were the maintenance of relative price stability and a healthy balance of payments

position. Direct monetary instruments such as selective credit controls and credit ceilings, interest rate controls, prescription of cash reserve requirements, exchange rate control and imposition of special deposits featured. Credit rationing guidelines featured more prominently than the other control techniques. Up to March 1972 and from April 1976-1979, the credit control guidelines took the form of individual and aggregate loan ceilings. Between April 1972 and March 1976, the use of aggregate credit ceiling was dropped while the specification of a sectoral distribution of credit was in vogue. The aim of sectoral distribution of credit was to channel credit into identified productive sectors. At the same time, interest rates were kept low with the intention of promoting investment. The end result of both goals was to increase the level of output and thus stem the tide of inflationary pressure. In addition, supplementary reserve requirements were imposed on the banks to reduce their free reserves and ability to create credit. Discriminatory cash ratios of banks in the range of 2-5 per cent and discriminatory credit allocation were aimed at controlling sectoral allocation of credit between the public and the private sectors and secondly within the private sub-sectoral economic activities³. Given that interest rates were fixed at low levels by fiat, it is to be expected that administrative allocation of credit became the next best alternative. With a larger share of credit going to government, the excess liquidity in the banking system remained, even in the face of a minimum liquidity ratio of 25 per cent. The cash ratios turned out to be ineffective as they were lower than those voluntarily maintained by the banks. Stabilisation securities were first issued during this period. To tackle the problem of external imbalance, a multiple exchange rate system was maintained first against the US dollar and the UK pound sterling and later against a basket of seven international currencies. In addition, a freezing order on importers' advance deposits in the banks against letters of credit was put in place.

Breaking the period into the 1970-74 and 1975-79 sub-periods enables us to gauge the effectiveness of policy measures during this period. We have summarised these results in Table 6. Obviously, it became more difficult to attain policy objectives in the second period. The perverse movement in monetary aggregates, fiscal deficit, inflation rate and balance of payments are all reflective of the deviation of targeted variables from actual observations. Narrow and broad money grew by an average of 41.4 and 36.9 per cent respectively, in the second sub-period as against 24.5 and 24.3 per cent in the first sub-period. Growth in the net domestic credit, especially to the government sector became the major cause of rapid monetary expansion taking over from the growth in net foreign assets of previous period. The fiscal operations of the government moved from a surplus in the previous period to a deficit of about 6 per cent of GDP during the second period. Inflation rate increased from 10.4 per cent to about 20.3 per cent. The overall balance of payments position moved from a buoyant surplus to deficit within the period under review (Ojo, 1992). Because of their relevance for our analysis in the future, we briefly highlight three policy issues which we believe rendered ineffective the policy measures embarked upon during the 1970's. Those are, the failure of the monetary control framework which relied heavily on selective credit controls and credit ceilings, a low interest rate policy which rendered government debt

instruments unattractive to the private sector and Federal government fiscal operations which resulted in the injection of large amounts of high powered money into the economy.

The period 1980-86 further put more pressure on the ability of the Central Bank to effectively harness its arsenal of instruments for the purpose of managing the economy in a depression. If the performance of the Central Bank in the 1970's is a test of the use of monetary policy in 'good times' the 1980's definitely tested the use to which monetary policy can be put in 'bad times' (Harvey, 1985). Although one must quickly mention here that due to the absence of concomitant factors, the age old aphorism about the effectiveness of using monetary policy to slow down an economy did not quite work out in the Nigerian context and the reason is not far-fetched both fiscal and incomes policy worked in the opposite direction and the overall result was a failed attempt at restoring balance in the economy.

As has been pointed out elsewhere, the oil market collapsed in the early 1980's leading to a significant decline in foreign exchange earnings. The objectives of monetary policy remained as in the earlier period-price stability and balance of payments equilibrium. The direct instruments of monetary policy control were retained. To restrain the growth of liquidity demand pressures on the economy, credit expansion ceiling on banks was reduced from 30 per cent in 1980-82 to 7 per cent in 1985. Selective credit controls were used on a massive scale. Sectoral allocation of credit to preferred sectors saw to it that these sectors took close to 75-79 per cent of banks' loans and advances. The guidelines also altered the distribution of merchant banks assets portfolio with a view to inducing them to lend long term. In 1980, the merchant banks were to ensure that a minimum of 40 per cent of their loans and advances was of medium and long-term nature with a maturity of not less than three years, while a maximum of 20 per cent of such loans and advances could be for short term projects maturing within one year. This ratio of medium to long-term loans and advances was raised to 50 per cent in 1985. The stipulated minimum proportion of loans and advances that commercial banks were required to grant to indigenous entrepreneurs increased from 70 per cent in 1980 to 90 per cent in 1984. Out of these proportions, the small scale indigenous enterprises were to be allocated proportions fixed at an average of 16 percentage points during the review period. In 1982, it became mandatory for banks to lend not less than 30 per cent of the total deposits collected by their rural branches to customers in the rural areas though this was raised to 40 per cent in 1985 (Ojo, 1992).

During the same period, reserve requirements remained unchanged from their 1970-79 levels. The ceiling on interest rates remained with only some marginal adjustments in the later part of the period. Within the limits set on lending rates for banks, various sectors and activities enjoyed preferential treatment. Development finance institutions were supposed to do so at controlled rates. Interest rates on government debt instruments and bank deposits were also rigidly controlled.

The outcomes of these policy measures are briefly summarised in Table 7. Suffice it to say that the trend observed in the 1970-79 period continued during this period. Both broad and narrow money continued their upward climb. In 1980 alone, broad money increased by 40.06 per cent and for the

remaining part of the review period, it grew by an annual average rate of 10.6 per cent. Narrow money grew by 50.1 per cent in 1980 alone, and for the remaining part of the period maintained a growth rate of about 7.6 per cent per year. Although it is fairly difficult to link performance in macroeconomic aggregates directly to changes in monetary management, the unsatisfactory performance in GDP, inflation, balance of payment and external debt tended to have trended with the performance of the monetary aggregates. Declines in output were recorded between 1981 and 1984. Average inflation rate for the period stood at 17.8 per cent. Modest surpluses were recorded in the balance of payments account for the period 1980-1983; this became negative in 1984 and 1985. A new dimension was introduced as the debt service ratio increased from only 5 per cent in 1981 to 33.2 per cent in 1985.

One important observation from our discussions on monetary policy during the review period 1960-85 is the fact that although the monetary authorities tended to have relied extensively on the use of direct methods of monetary control, these measures seem not to have been very effective in attaining the objectives of monetary policy during this period.

It is on record that the compliance with credit guidelines were generally unsatisfactory during the period under review. Banks only acquiesced to ceilings on aggregated credit extension when for instance, there is inadequate demand for loans by the private sector as experienced during the slump between 1982 and 1985. Even though the ceiling was only 7 per cent during these years, banks, kept within these limit. When the economic situation was still buoyant, it was not unusual for banks to burst credit ceilings. In 1980 and 1981, banks exceeded the permissible growth rate of 30 per cent by 3.3 and 5.2 percentage points respectively. The sectoral credit controls were also not effective as it was difficult to keep banks within the stipulated targets. Although 75 per cent of credit was supposed to go to the preferred sectors, the commercial banks achieved a target of 69.1 per cent while the merchant banks only achieved 62.8 per cent out of the 79 per cent limit for them. Thus both commercial and non-merchant banks would seem to have extended more credit to the non-preferred sectors during the period, with the merchant banks being the worse culprits.

One major shortcoming of direct controls is the preponderance of concessions and exemptions that come with most directives and the tendency for this to breed corruption and other sharp practices. For instance, in Nigeria the small banks were usually given some concessions to extend more credit either in the form of a slightly higher credit ceiling or as a proportion of their total deposit liabilities. This became destabilising with the increase in the number of small banks in 1986. In 1980, for instance, a small bank was defined as one whose loans and advances fell below 100 million Naira as at March 31 of that year. Such banks were allowed to maintain a credit ceiling of 40 per cent. Alternatively, such a bank could expand credit up to the level of 70 per cent of its total deposit liabilities, excluding government deposits of not more than six months maturity. Also, over the years, certain categories of loans and deposits were excluded from credit ceilings. These included money at call with other banks, loans granted for the purchase of shares by Nigerians under the indigenisation performance, loans for buying

motor cars by eligible workers and loans for agricultural and residential building construction above the prescribed minimum (Ojo, op cit.). The jostle to benefit from some of these concessions often led banks to devise short cut methods for circumventing monetary policy guidelines and bred frauds and malfeasance with attendant effects on the effectiveness of policy measures. More importantly, some of these exceptions could be sources of excessive credit expansion by banks.

The problems facing the Nigerian economy worsened during the period 1980-85 and led to the embracing of a structural adjustment programme in 1986. Policy strategies under SAP were meant to be different from what had existed hitherto. However, the country did not move immediately from direct into indirect controls as will be the norm under liberalisation. A short review of monetary policy between the period 1986-1992 prior to the commencement of indirect controls in 1993 is in order here. The objectives of monetary policy remained the same-output and employment growth, price stability and maintenance of external equilibrium. But more importantly, given the need for monetary policy to become a more active tool for the realisation of the goals of SAP, the pursuance of the goal of establishing a market-oriented financial system for effective mobilisation of financial savings and efficient resource allocation was given a greater attention. Towards this end, the CBN adopted a phased approach to transiting from a direct to an indirect method of monetary control. This transition called for a prior reform and liberalisation of the financial sector in order to create a conducive atmosphere for the introduction of indirect monetary control.

Monetary policy measures were directed at dampening the inflationary pressures in the economy and relieving the domestic pressures on the available foreign exchange reserves. Thus, in 1986, the CBN required the banks to deposit in a non-interest bearing deposit account at the CBN, the domestic currency equivalent of all outstanding external payments arrears. The policy on restraining bank credit expansion was confused. The 10 per cent ceiling imposed on the rate of credit expansion by banks fixed in January 1986 was reduced to 8 per cent in July and maintained till August 1987 when it was further reduced to 7.4 per cent. However, in 1988, the ceiling on credit expansion by commercial banks was raised to 25 per cent only to be reduced again in 1988 and later in 1989 to 10 per cent. To reduce the excess liquidity in the banking system, public sector accounts were transferred from banks to the CBN and the banks were prohibited thereafter from accepting foreign guarantees/currency deposits as collaterals for domestic loans denominated in Naira. The implication of this is that banks are no longer to grant domestic loans denominated in Naira on the securities of foreign guarantees or deposits held abroad and in domiciliary accounts with the banks. The transfer of public sector accounts to the CBN impacted significantly on the liquidity of the banking system as close to 8.3 billion Naira went into the coffers of the CBN three months after the directive.

In January 1988, the liquidity ratio of merchant banks was reduced from 30 per cent of demand deposits and call money to 20 per cent of total deposits although this was again raised to 30 per cent in 1990. In 1991, the base for calculating cash reserves requirement was extended beyond demand deposit

to include time and savings deposits. Beginning from October 1990, efforts to stabilise the economy through a mopping up of banks excess liquidity were intensified through the issuance of stabilisation securities. These are non-negotiable and non-transferable debt instruments of the Central Bank which banks are mandated to purchase at intervals in order to control their excess reserves. As part of the liberalisation efforts, the sectoral credit guidelines were reformed to give banks some leeway in their credit operations. The sector-specific credit distribution targets were further compressed into four sectors from 8 in 1986 and two sectors in 1987. Under this two-sector grouping, agriculture and manufacturing enterprises were regarded as priority sub-sectors while all other sub-sectors were grouped as others. Effective, first week in September 1992, the CBN on a selective basis lifted credit ceiling on individual banks which observed CBN guidelines in respect of statutory minimum paid-up capital, capital adequacy ratio, cash reserve, liquidity ratio requirements, prudential guidelines on sectoral credit allocation and sound management (Oduyemi, 1993).

By far the most radical change was in interest rate management. The immediate objective in removing the lid on interest rate ceilings in 1987 was the need to improve the efficiency of the financial system in the mobilisation of savings and the allocation of resources. Initially, the interest rate structure within the deregulated regime was to obtain signals from the minimum rediscount rate (MRR) which has since its introduction in the financial sector in 1962, been the minimum rate at which the Central Bank was willing to rediscount bills for the banks. The MRR acted as market signal for other rates in the economy. However, in 1989, the link originally provided with the Treasury Bill (TBS) rate was broken as part of the liberalisation of the money market. Banks and other financial institutions were then free to bid for TBS with no pre-determined rate, as before.

Having thus been made redundant, the financial sector ceased to obtain the signal for interest rates from the rediscount rate. Lending institutions take their cost of funds (deposit rates) with some mark-up as the basis for their lending rates (Ndekwa, op. cit.). Market interest rates have risen significantly since 1987. The average savings deposit rate rose from 9.5 per cent in 1985 and 1986 to 12.2 per cent in 1987 and stood at 19.5 per cent in 1993. Time deposits rates went from about 13.8 per cent in 1987 to 29.7 per cent in 1993 for commercial banks and from 14.5 per cent to 41.1 per cent for merchant banks. The lending rates rose more steeply. By June 1993, the maximum lending rates averaged 39.9 per cent for commercial banks and 57.7 per cent for merchant banks up from their respective levels of 17.3 and 17.6 in 1988. The interbank rate moved from an average of 23.6 per cent in 1990 to 86.0 per cent in 1993. Given high inflation rates, real interest rates have remained predominantly negative.

Monetary and credit developments showed mixed results for the period 1986 and 1992. M1 and M2 grew after a moderate increase in 1986. The record growth of about 44.2 per cent in 1988 is paralleled only by the 1981 benchmark growth of 50.1 per cent. The increase in these aggregates were again due to an increase in aggregate bank credit to the economy. In 1988, M1 was targeted by the monetary authorities to rise by 15 per cent, but instead expanded by 43.6 per cent. In 1992, again, M1

grew by about 66.4 per cent. The variations in M2 followed the same trend (Table 6). Banks in general failed to comply with the credit ceilings, neither did they adhere to the sectoral allocation guidelines. Unlike in the previous periods, merchant banks performed better than commercial banks this time around. The years 1986, 1987 and 1989 showed impressive results. Again, we observe a wide disparity between policy intentions and actual performance in almost all our macro variables. Unlike in the previous period, however, bank credit to the private sector constituted a major expansionary factor. The dominance of government through its monetisation of oil receipts and borrowing from the Central Bank remained an underlining factor in the expansion of M1.

Surprisingly, the implementation of the adjustment policies yielded mixed results. GDP growth showed an impressive turn around especially after the low levels (1.6 per cent) recorded in 1985. GDP grew by 9.9 per cent in 1988, 7.3 per cent in 1989 and 8.3 per cent in 1990. This growth pattern however is mostly attributable to the improved levels of oil export. The current account balance has shown some strong results during this period. After some marginal deficits in 1987 and 1988 (0.3, 0.7 per cent of GDP respectively), a surplus of about 16.9 per cent of GDP was recorded in 1990. This dipped to about 3.9 per cent in 1991 but rose to 8.7 per cent again in 1992. The overall balance of payments position which we think is a better reflection of the external position of the country has shown very volatile fluctuations and has remained in deficit consistently. From 10.1 per cent of GDP in 1984, it climbed to 21.8 per cent in 1992, after dipping to under 2 per cent in 1990. By far the most worrisome macroeconomic variable has been the changes in the CPI. Inflation has remained defiant throughout the period. It averaged 7.8 per cent a year between 1986 and 1987, 30.8 per cent from 1988 to 1992 and 54.3 per cent in July 1993. No doubt, there have been other contributory factors but the rate of growth of money supply has been a major element in the inflationary spiral. This unsatisfactory state of affairs facilitated the movement from direct to indirect monetary control in 1993. Specifically, open market operations was expected to provide a veritable alternative to the inadequacies of credit ceilings and selective credit controls.

5 FROM DIRECT TO INDIRECT MONETARY CONTROL

(i) Issues in the Transition to Indirect Control

The evolving economic environment of the 1980's more than the often emphasised inadequacies of direct monetary control is the immediate cause of the change in monetary policy stance from direct to indirect controls in Nigeria, in the early 1990's. This is not to underplay the seriousness of the identified inadequacies in the last section. To reiterate, ceilings on interest rates, even with the best of intentions particularly, the desire to provide low cost funds to encourage investments for priority sectors often hinder financial deepening and prevent financial resources from being directed into their most efficient uses; financial dis-intermediation occurs with the imposition of ceilings on interest rates as savers and

investors look for alternative outlets outside the formal financial system to conduct their business⁴. Credit ceilings were completely ineffective in the control of domestic credit. The Nigerian case revealed problems relating to the varying composition of the credit, the enforcement of the ceilings and the efficiency of the control system; problems which in the long run rendered the programme ineffective. It is also feared that given the mechanism for allocating credits to banks, the framework may have discouraged competition. In setting credit ceilings, the monetary authorities usually allocated the scope for future lending largely on the basis of banks' past share in total lending. This may have the tendency to inhibit growth and competition, which may be deleterious for monetary control as markets outside the control of the monetary authorities spring up. Selective credit controls are often costly in terms of allocative efficiency. This ensues when credit regimes give birth to low return investments and saddle banks with large non-performing loans. It has also been questioned whether such loans actually get to those who are targeted - the so-called priority sectors because of the fungibility of loans. High reserve requirements in the form of cash and liquidity ratios formed a significant part of the monetary control framework. Since interest is not paid on reserves, they could constitute a tax on commercial banks and increase the cost of financial intermediation and thus erode monetary control. These and other shortcomings of direct controls render them suspect in a system that is focused on enhancing the efficiency of the financial system and using same as a vehicle for development.

However, it must be emphasised that more than any of the aforementioned, the changing economic environment in the 1980's which emphasised liberalisation of financial markets, relaxation of capital markets, a move towards more flexible exchange rate systems articulated a format whose broad thrust was to allow market forces to play a greater role in the financial system. Pre-reform financial system with their emphasis on direct controls such as credit ceilings and sectoral allocation would not accord with the domestic and international environment of the 1980's with a predilection towards a more defined role for the private sector and by implication, less of direct government involvement. For the financial sector, this yielding of way to market forces would also result in an alteration of the instruments and channels of monetary policy and therefore prompt a reassessment of the appropriate measures of monetary policy.

The transition from direct to indirect control and the reliance on market instruments would dictate that the existing financial structure be made to undergo some changes. In operational terms, this would require that controlled interest rates should give way to liberalised interest rates, that direct controls be reduced, and that efforts be made to promote and deepen the rudimentary money and capital market. In other words, financial sector reforms will involve an alteration of the pre-reform financial structure to make the financial system more responsive to market forces so as to promote saving and improve the efficiency of resource allocation. The measures needed to bring this about can be divided into two broad categories. The first consists of changes in supervision and regulation of the financial sector. Measures in this category include among others, the deregulation of entry barriers, the restriction on the scope of

bank activities, the privatisation of state owned commercial banks, raising capital requirements, limiting loan concentration, loan classification and provisioning, re-capitalisation and restructuring of weak financial institutions, and reform of the supervisory system. The second category is the reform of monetary control instruments and procedures which is the core of monetary management. This stage will involve the establishment of open market operations, the development of secondary and repurchase markets, unifying and lowering of reserve requirements, reform of discount and refinancing facilities in favour of generalised rather than selective rediscounts from the Central Bank, liberalising interest rates and the removal of quantitative credit controls (Wong, 1991). While the order for the implementation of measures in the second category may not be as enumerated, there is a fair consensus in the literature on sequencing for the need for the first category of activities to be completed before the second stage, that is the reform of monetary management procedure is embarked upon (Khan and Sundararajan, 1991; Wong, 1991; Turtleboom, 1991). To what extent were these conditions met in Nigeria prior to the introduction of open market operations in 1992?

(ii) Fulfillment of Pre-conditions for Transition to Indirect Monetary Management in Nigeria

The Central Bank of Nigeria made attempts at restructuring the financial system prior to the introduction of open market operations in 1993. The steps taken are briefly itemised below:

(a) Deregulation of interest rates

Bank deposit and lending rates were deregulated at the commencement of the structural adjustment programme in August 1987. In 1991, the CBN in a reaction to rising nominal lending rates in the market for loans, prescribed a maximum margin between the bank's average cost of funds and their maximum lending rates as well as a minimum level for their savings deposit rates. Interest rate determination was still supposed to be market-related through its link to the cost of funds. The deregulation of interest rates at this early stage has remained one of the most controversial steps taken in the liberalisation efforts in Nigeria. It has been argued that this premature liberalisation of interest rates is a major factor in the incidence of non-performing loans in the banking system in the 1990's (Ikhide & Alawode, 1994). This issue will be revisited later in this work.

(b) Deregulation of entry barriers

In order to promote competition in the money market, the procedure for licensing new banks was rationalised and liberalised. Consequently, the number of banking institutions increased from 50 in 1987 to 120 in 1993. This created serious problems of supervision for monetary authorities.

(c) Issue of treasury instruments by auction

An auction-based system for issuing treasury bills and certificates (both government debt instruments) and the issue of these instruments as bearer bills to enhance transferability was introduced. This

delinking of the treasury bill rate from the MRR (which was the 'core' interest rate) was aimed at improving the efficiency of public debt management and the conduct of monetary policy, enhancement of investor interest and participation in the holding of government debt instruments, promoting greater reliance on market forces in the determination of yields on the instruments and encouraging the development of the secondary market for government short-term debt instruments.

(d) Reform of the regulatory and supervisory framework

In 1991, the CBN Decree No. 24 of 1991 and the banks and other financial institutions Decree (BOFID) No. 25 of 1991 were promulgated to replace the CBN Act of 1958 and the Banking Decree, 1969 respectively. The Decree gave the CBN a high degree of autonomy in the conduct of monetary management, increased the bank's regulatory and supervisory power over commercial and merchant banks and extended its licensing and supervisory powers to cover financial intermediaries other than banks such as Discount Houses and finance houses which were previously excluded from the banks surveillance. The non-inclusion of these institutions created some loopholes in monetary management and weakened monetary policy. The Decree gave powers to the CBN in consultation with the presidency to apply monetary policy instruments such as open market operations (OMO), reserve requirements, stabilisation securities and special deposits to achieve the objectives of monetary policy.

(e) Prudential reform

Prudential guidelines regarding adequate provisions for bad and doubtful debts and loan classification, interest capitalisation, capital adequacy and limits on loan concentration were put in place in 1990. Financial liberalisation is often accompanied by excessive credit growth which may put some stress on the credit approval process and force banks to make risky loans. This in turn may lead to bank insolvency and financial crisis which will hamper effective monetary control. In order to mitigate the adverse effects of the implementation of the guidelines on banks' balance sheets, the CBN subsequently allowed banks to write off accumulated bad and doubtful debts over a phased period of four years. Steps were also taken to strengthen the capital bases of banks. The minimum paid-up capital of banks was increased from 20 to 50 million Naira in the case of commercial banks and 12 to 40 million Naira in the case of merchant banks with effect from June 1992. It is doubtful if these measures had any significant impact on mitigating the spate of bank failures post-reforms.

(f) Licensing of discount house

As a means of developing a secondary market for government debt instruments with a view to reducing government dependence on the CBN financing of its deficit, three discount houses were licensed in 1992. In addition to intermediating funds among financial institutions, the discount houses will also promote primary and secondary markets for government securities.

(g) Bank restructuring

The CBN in conjunction with the NDIC began a process of bank restructuring in 1990. Initially, 6 insolvent banks were identified and were allowed self-restructuring under the close supervision of the CBN and NDIC. However, since then, there has been an increase in the number of insolvent banks in the system (see section VI). Since late 1992, a joint committee of the CBN and NDIC involving a sector of the BOFID has assumed greater control over distressed banks. Banks thus taken over by the CBN have their board of directors dissolved and an interim management board appointed to exercise powers normally vested in a board of directors of a bank and some turn-around measures, including the down-sizing of operations through rationalisation of staff and branch-network. The Boards are also empowered to appoint independent firms of auditors to ascertain the true financial condition of each of the banks. Thereafter, appropriate restructuring or liquidation options would be adopted.

(h) Selective lifting of credit ceilings on individual banks

With effect from September 1992, the lifting of credit ceilings on banks that are adjudged healthy by the CBN has been in place. A bank is adjudged healthy if it meets CBN guidelines on certain specified criteria in the previous three months. These include specified cash reserve requirements, liquidity ratio requirements, prudential guidelines, statutory minimum paid-up capital requirement, capital adequacy rates, and sound management. Following the application of these criteria, about 80 banks have been certified as healthy and exempted from credit ceilings. These same criteria have been adopted for determining which banks qualify to participate in the official foreign exchange market.

(i) Mopping-up of banks' excess liquidity with stabilisation securities

This has been going on since 1990.

(j) Institution building

Efforts here include the development of a database, training and retraining of CBN staff and the creation of a Bank Examination Department.

(iii) Nigeria's Experience with Indirect Monetary Control

Open market operations in preserving bills started effectively in June 1993. The operating target of the CBN is the level of bank reserves since it is fairly more accessible through its policy instruments. Formal Open Market Operations in treasury bills commenced on 30th June 1993. The 30th June to 24th September transactions are shown on Table 12. 1993 witnessed a lot of political disturbances in Nigeria which made it impossible to conduct weekly sessions. Thus between July and September, only ten sessions were conducted. Total sales of bills conducted during these sessions amounted to 11.2 billion Naira. From a face value of 250 million Naira at the maiden auction on 30th June, sales rose to a weekly average of 1.9 billion Naira in September. The weighted average discount rate which emerged at the

OMO ranged between 23.0 and 24.5 per cent while the equivalent yields ranged between 23.37 and 25.27 per cent. All the weekly offers were oversubscribed by wide margins ranging from 34.1 to 154.4 per cent. By contrast, responses to offers at the primary auction did not show any significant response. The CBN has thus remained the main subscriber to these issues. Of the total issues of 5,600.00 million and 92,126.5 million Naira in August and September, the CBN re-absorbed 4,334.6 (77.4 per cent) and 87,199.9 million Naira (94.7 per cent) respectively in its portfolio. This was partly attributed to the short tenor of the securities offered at the OMO, where the average tenor dropped sharply from 52 days in June and July to 32 days in August and September.

The yield curve on treasury bills was upward sloping during the period of observation. However, it would appear like this was not sufficient to induce most dealers to want to lock-in their funds for 91 days at the prevailing interest rates on commercial bank deposits of comparative tenor. While the weighted average discount rate ranged between 23.0 per cent and 24.5 per cent for tenors of between 25 and 47 days at the OMO, the discount rates on 91-day, primary issues rose from 25.0 in June through August to 26.0 per cent in September. The corresponding average yield ranged from 23.37 (on the 25-day, 700 million Naira offer of August 6) to 25.27 per cent (on the 45-day, 700 million Naira offer on September 24). By comparison, the average yields on the primary issues in August and September were 26.67 and 27.81 per cent respectively. These rates were 1½ - 2 percentage points below the average rates on 3 months deposits at commercial banks during the same period (Oke, 1993).

A more illuminating picture is illustrated with the performance of transactions in OMO in 1994. The Central Bank conducted 51 weekly sessions of OMO during the year. In accordance with the fixed or re-regulated policy on interest rates in 1994, the issue rate was fixed at 12.50 per cent, one per cent above the minimum re-discount rate of the CBN. The treasury bills rate fell from 27.2 per cent in December 1993 to 12.50 per cent in April 1994. The average monthly offer between January and September was 13,444 million Naira, while average monthly bids posted 19,024.4 million Naira. The average amount sold was put at 13,165 million Naira. Average tenor ranged between 29 days in April to 57 days in February. From Table 12, it will be observed that there was a sharp drop in the level of open market transactions in June following the announcement of the budget in April. Activities in the secondary market once again peaked albeit slowly as from September. Between September and December, over 30 billion Naira open market sales were effected⁵.

The CBN remained the principal subscriber to the new issues in the primary market although there was a slight shifting of ground. The average subscription for the year fell from 90.5 per cent in 1993 to 85.6 per cent in 1994. Commercial banks and surprisingly the non-bank public both marginally increased their share of new issues.

Largely through the open market sales of Treasury bills, the CBN was able to reduce its holding of Treasury bills and consequently offset the large injection of Base money in 1994. CBN holding of TBS fell from 43,948.5 million Naira at the end of 1993 to 30,632.2 million Naira in 1994, a fall of about

30.3 per cent. This contraction in the CBN's treasury bill portfolio exerted a moderating influence on the growth of base money. Base money increased during the year by 39.8 per cent compared with 51.1 per cent in the previous year, although this was well above the desired rate (CBN, 1994). The CBN has argued that "the decrease in CBN's holdings of treasury bills resulted from the OMO transactions which succeeded in transferring a significant proportion of treasury bills to the private sector" (CBN op cit., p. 155).

One way of evaluating the performance of OMO within its short period of operation is to find out by how much it has impacted on its immediate target-bank reserves and subsequently bank credit. The impact has been limited. The reported sharp reduction in the growth in bank reserves in the last three quarters of 1994 has been adduced to the 223,770 million Naira OMO bills of varying maturities sold by the CBN at an average stop rate of 12.4 per cent for the period (CBN, op cit., p. 33). Compared with the total bids of 289,016 million Naira, this translate into a sales/bids ratio of 77.4 per cent. It is not surprising therefore that the open market sales fell short of exerting any substantial impact on the supply of reserve balances consistent with curtailing of the growth of base money and money supply. The observed decline in base money may not be unconnected with the policy measure undertaken during the period which required banks to deposit at the CBN the local currency counterpart of the foreign exchange they demanded at the Foreign Exchange Market (FEM). This practically had nothing to do with the OMO transactions.

Therefore, although one could tentatively conclude that OMO has contributed to a growth of the secondary market in government securities as well as substantial rise in the holding of treasury bills by banks and non-bank financial institutions, it is doubtful whether it has impacted significantly on money and credit growth. The reason for this is the continuous injection of primary money through the Central Bank's financing of the deficit of the government. A second reason may be the government's return of ceilings on interest rates.

(iv) Issues in the Implementation of Indirect Control in Nigeria

(a) Establishing a clear and durable transmission mechanism

The channel of affectation under indirect control runs from changes in commercial banks reserves (either as a result of intervention in the open market or imbalance between the demand for and supply of commercial bank reserves) to money market rates including the inter-bank funds rate. Where there is little or no access to CBN discount window or refinancing facilities, inter-bank and short-term securities markets are crucial for commercial banks to adjust their reserve positions. The interest rate thus established governs the marginal costs of funds and exerts a strong influence on the rates paid on deposits and charged on loans (Duesenberry and McPherson 1991(a)). Thus, a tightening of credit conditions resulting from an OMO intervention may lead to some deposit mobilisation through the banks as well as some reduction in the volume of loans. The evidence from Nigeria on this line of flow

is tenuous. Suffice it to say here that the response of interbank rates to CBN liquidity mop-ups during the period of interest rate deregulation was quite appreciable. The contraction in the market following the re-regulation of interest rates in 1994 is also indicative. In 1994, the reported average rate on overnight funds which is the dominant maturity (95.7 per cent of the total value of transactions in 1994 was in overnight funds) fell sharply from 57.5 per cent as at the end of December 1993 to about 14.2 per cent in line with the new directive on interest rates. It is also on record that during the period of deregulation, commercial banks adjusted their loan and deposit rates in line with this movement in the inter-bank rate resulting from contraction in their level of reserves⁶. It should therefore be expected that the use of indirect controls operating through OMO for Treasury bills should increase the role of interest rates in the credit allocation process.

Interest rates are likely to vary more widely than under credit rationing. Two sources of such variations have been identified. First, the non-monetary factors causing a growth in nominal expenditures may vary even when the growth path of money supply does not. If the income velocity of money is stable, interest rates will have to rise to offset the effects of increased government spending, stronger investment demand, increased export earnings and such other factors that raise nominal expenditure. Alternatively, changes in the demand for money relative to GDP will cause variations in interest rates even when the non-monetary factors in the system are stable (Duesenberry and McPherson, 1991a). Because of the disaffection that such interest rate increases may cause, particularly to borrowers and financial institutions, it is often suggested that as much as possible, the identified factors in the volatility of interest rates during movements to indirect control should be kept under control. One factor that is easily identified here is a rising government deficit.

In recognition of the identified transmission process, the CBN decided to free treasury bills rate in the early part of the financial liberalisation exercise as a component of the general interest rate liberalisation programme. In addition to this, certain steps were taken to develop the market in which treasury bills are sold and inter-bank transactions take place. This include the introduction of weekly auctions when trading started and the establishment of discount houses. Although the method of sales has been by free auctions with pre-announced targets, the shooting of interest rates on TBS that have been observed elsewhere (eg Kenya) did not take place in Nigeria. TB rates have not been out of line with other money market rates and especially with the deposit rates on similar instruments in commercial banks.

Two issues have been of particular interest with reference to the transmission process. The first is the reluctance of banks to allow the increase in inter-bank rates to be transmitted to the deposit rates they are willing to pay even when they have always been very willing to hike loan rates. It is not surprising that banks did not offer to pay higher rates on their deposits given that the system was awash with excess liquidity and as such were not obliged to compete for funds. The transmission process outlined above relies on an initial impulse in the treasury bill and inter-bank funds market feeding

through a broader spectrum of bank deposit and lending rates and possibly other interest rates as well. This lack of integration of interest rates has led to the CBN intervening to re-impose ceilings on interest rates particularly when lending rates were going over the roof in 1991 and later in 1993. The other issue has to do with the seeming inability to attract on an appreciable scale the non-bank public particularly households to subscribe to TBS due to the slow pace of development of the secondary market. This can be explained by the tendency to want to hold money mainly for transactions purposes and the large denominations in which TBS are issued which renders them inaccessible to small savers. More importantly, even though the yield on TBS did rise, compared to the rate of inflation, they remained largely negative and were not enough to attract savers out of holding physical assets in preference for investment in TBS.

Also, the rate on TBS remained predominantly lower than that on savings deposits of similar duration in commercial banks due to government manipulation. It is likely that, the CBN concerned with the size of its domestic debt and the implications of a rising TB rate for its budgetary operations has been manipulating the interest rate on TBS. This concern may impede the effectiveness of indirect controls through OMO. When market yields on TBS are below market clearing rates, it may hamper the growth of a secondary market for TBS, a phenomenon that has become worrying in the Nigerian situation.

Much as we would love to recommend that such government manipulations be removed to allow TB rates to attain their market clearing equilibrium levels, and thus enhance indirect monetary control, there are a few considerations that may hinder such an action. Uncontrolled interest rates during a period of financial reform whose major component is a restructuring of distressed banks may further damage the portfolio of these banks by increasing the size of their non-performing loans and thus impairing the quality of their assets. Second, high interest rates in the face of huge fiscal deficits will only lead to further instability, create confidence problems and cause dis-intermediation, the very ailments that indirect controls are supposed to remove. Uncontrolled interest rates with a large budget deficit would also result in rapidly increasing interest payments as a proportion of the government budget. This has happened in Zambia and Zimbabwe. None of the above calls for a policy reversal, the type of which was witnessed in 1994.

(b) Dealing with 'autonomous' factors

On the balance sheet of the CBN, there are autonomous or non-discretionary factors - those that are beyond the short term control of the Central Bank - and policy or discretionary elements. The main items on the non-discretionary list include Net foreign assets of the Central Bank (NFACB), Net domestic credit to the government (NDCGB), changes in currency in circulation outside banks (Cp), purchases or sales of forex against local currency and changes in commercial banks reserves (required or excess) (Cb) due to changes in bank deposits. NFACB is outside the control of the CBN. NDCGB

depends on the Ministry of Finance. Currency in circulation outside banks (Cp) cannot be directly controlled at least in the short term. Given the nature of the elements that affect the components of the non-discretionary elements, it is doubtful if the CBN can claim any success at accurately forecasting the levels of those variables. The best that any Central Bank can do is to monitor and forecast the effects of these on its own position and the associated reserve positions of commercial banks possibly on a daily basis. The results of the OMO sessions between 1993 and 1994 clearly point to the fact that the operations though weekly, have not been able to offset the forecast movements in these non-discretionary elements. This is not surprising given the nature of government spending in particular.

The policy or discretionary elements are those over which the CBN is expected to exert some degree of independent role in charting the course of monetary policy. The elements here include foreign exchange swaps, policy regarding reserve requirements and penalties for non-compliance, the availability and interest rate terms on Central Bank lending to government, sale of Treasury bills at auction and policy towards 'tap' sales of government bills and securities, short-term money market interventions, CBN rediscounts (mainly for commercial banks) and the interest rate terms on these.

The item that has created by far the most problems for the CBN is the availability and interest terms on CBN lending to government. The Central Bank claims on government exerts a significant impact on the movements in reserve money (see Table 9).

The issue of the interest terms on CBN lending to the government has received some coverage in this work. As a matter of fact, it is a major factor in interest rate control by government. Low interest rates provide the government with fairly easier accessibility to cheaper loans than obtained through other conventional borrowing opportunities.

More worrisome in recent times has been the substantial increase in the 'other assets' items in the balance sheet of the Central Bank. This may be a significant influence in aggravating the monetary effects of the direct government borrowing on the economy in recent times. Other assets contribution to M1 growth varied between 50.6 to 73.7 per cent between 1991 and 1993. In Nigeria, this is directly traceable to the extra budgetary activities of government in particular expenditures from the Stabilisation Fund and the proceeds of dedicated priority projects which most of the time did not constitute part of the total expenditure being analysed⁷. One other source of the 'other assets' component is the substantial increase in CBN provision of liquidity to banks that are faced with insolvency in recent times. The issues here are two fold. The first has to do with the terms of provision of such liquidity. At the moment, credit facilities from the CBN to the banking system are not fully backed by collaterals (securities). If the commercial banks are going to be induced to finance government deficits rather than a reliance on the Central Bank, their accommodation by the CBN should be based on the commercial banks being made to hold treasury securities as collaterals. This will reduce direct CBN financing of government deficits and the attendant impact on money supply and prices. Second, provision of liquidity for banks may be a short-term solution to bail them out of insolvency or difficult times. But, the

provision of such liquidity may become a dominant factor in which case, the potential for the use of OMO is compromised (Wong, 1991). This underlines the need for the establishment of appropriate prudential and regulatory guidelines prior to the liberalisation exercise rather than wait for banks to go under and instituting restructuring measures that will complicate the transition to a more market determined monetary control system. In concluding, it would appear that the three main items that have influenced movement in reserve money during the implementation of OMO are Net claims on government and other items net (which also contains significant claims on government (-), net foreign assets and claims on financial institutions.

(c) Reserve requirements accounts with the Central Bank

One major factor that has been identified in the high incidence of commercial banks overdrawn accounts with the CBN is the sterilisation of the required reserves accounts in the Bank. Presently, the reserve requirements of the banks are kept in a separate account in the CBN. Such reserves do not attract any interest and banks do not have access to it.

It is possible that if idle reserves in the sterilised accounts of the CBN is allowed to flow freely to banks to cushion temporary liquidity shortfalls, the incidence of overdrawn accounts by banks in the CBN could be minimised. Sterilising the reserves of banks in this manner, in addition to the fairly high cash reserve requirements could in themselves constitute a tax on the banking system and provide them with little room to manoeuvre and actively (voluntarily) participate in OMO transactions. Where the CBN is not willing to pay interest on reserves, it could reconsider allowing banks to draw on the reserve accounts provided the average level during the maintenance period does not fall below the agreed minimum.

(d) Consistency of targets and process of monetary control

The ultimate targets of monetary control particularly during the period of reforms are price stability, balance of payments equilibrium and real output growth. The intermediate targets under indirect monetary control have been on Base money. The control process has focused on bringing about changes in the intermediate targets by acting on commercial banks reserves. The control of M1 through the base assumes a stable money multiplier. Where this exists, the process also assumes a stable demand for money functions for the effects of changes in the monetary aggregates to be transmitted to the ultimate targets of monetary policy. Where the multiplier is not stable, it is expected that monetary policy could be conducted to offset changes in the multiplier in the desired direction. Estimates of the demand for money function in Nigeria are inconclusive with reference to the issue of the stability of the demand for money function⁸. Where these assumptions do not hold, the ability of the monetary policy process to achieve the desired objectives may become suspect.

More important for the issue of consistency, however, is the tendency for the CBN to pursue

multiple and often conflicting objectives. Monetary contraction that results from OMO sales may impact on money market rates and translate into higher lending rates. In a bank oriented financial system, this may have contracting effects on bank loans and hence investment and level of output; thus making the objective of rapid economic growth difficult to achieve. When this is complicated by adverse selection by banking firms of bad creditors that are likely to be the beneficiaries of loans at high interest rates during economic reforms, due to asymmetric information, this may compound the problem of deposit institutions as they access non-performing loans and compromise the goals of indirect monetary control (add to this, persistent government deficits, that is financed by the Central Bank, what the system ends up with is excessive monetary growth which may run counter to the initial objective of the policy stance). In order to achieve the goal of economic growth, the CBN may be forced to reintroduce interest rate controls and destroy the very basis of indirect monetary management under the illusion that low interest rates are indispensable for investment growth. Even if they are not, excessive high interest rates are a symbol of instability. The other perspective is the possibility of capital inflow as a result of the high interest rates. This may lead to an appreciation of the exchange rate and hence reverse whatever gains has been made with external balance. Given these perverse occurrences, it might be necessary to monitor the outcome of the control measure redefining a single objective policy and following this through even when monetary developments indicate otherwise. What may be needed in such circumstances is the requirement for additional policy measures to strengthen indirect control so as to counteract the unwanted effects and more importantly, the insistence of an independent central bank to see its policies work themselves out completely. This takes time.

6 POLICY CONSIDERATIONS

(i) Fiscal Deficits and Indirect Monetary Control

This section briefly reviews some of the impediments to the implementation of the new approach to monetary management in Nigeria. Two of such factors are prominent. The first has to do with the persistence of high fiscal deficits by government and the implication of this for indirect monetary control. In Table 1 we summarise the trends in government fiscal operations between 1985 and 1994. Our earlier review of macroeconomic and monetary policy operations in Nigeria point to the expansive role of government spending in the economy. To reiterate, between 1981 and 1985, the fiscal operations of the Federal government recorded an average deficit/GDP ratio of 5.7 per cent with heavy reliance on credits from CBN for its finance. On the introduction of Structural Adjustment, a major policy thrust was to reduce the ratio to 3.0 per cent in the short-run and thereafter achieve fiscal balance in order to attain macroeconomic stability. This was not to be. During the period 1986-93, the deficit/GDP ratio stood at an average of 9.2 per cent. The fall in the earnings from oil which led to a short fall in revenue is often held accountable for this budgetary shortfall. However, the growth of the retained revenue of the

Federal government from 1989 did not capture all the receipts which were utilised in meeting extra-budgetary expenditures. The occurrence and misuse of stabilisation funds and dedicated accounts is a pointer in this direction (Okorounmu, 1994). Thus, by far a major factor in this expansion of the deficit has been government fiscal indiscipline.

The success of open market operations hinge critically on the ability of the central bank to forecast and monitor the discretionary and policy instruments in its balance sheet. From our analysis, it is established that the sheer size and volatility of balance sheet items like net domestic credit to government, net domestic credit to the private sector, net domestic credit to financial institutions which together constitute net domestic assets (NDA), net foreign assets (NFA) and 'other assets' which in itself is strongly linked to net domestic credit to government have constituted major contributors to changes in bank reserves during the review period with net domestic credit to government being a critical element. There is a causal nexus running from net domestic credit to government which is the means of satisfying the public sector borrowing requirement and successful monetary management relying on open market operations and this underlines the need for the close co-ordination of fiscal and monetary policy so that the public sector's deficit financing requirements are consistent with the objectives of monetary policy. OMO can be conducted in the primary market or in the secondary market. By varying the timing and the volume of primary issues and by issuing them at market rates, it is possible to influence bank reserves and interest rates in the short-run. Before the establishment of a secondary market, this could be an alternative approach to influencing short-run interest rates and monetary management (Leite and Sundararajin, 1990). Successful monetary management, however, requires the separation of central banking functions from treasury functions. This is all the more compelling when government debt instruments constitute the instrument of monetary management. Under such arrangement, the Central Bank acts as fiscal agent for the treasury but does not lend directly to government. The main involvement with government debt is thorough discretionary purchases and sales of treasury debt instruments in carrying out OMO. The use of government debt instruments in OMO, therefore, presupposes the existence of a community of dealers who buy new issues of debt instruments and trade in them in the secondary market in which the CBN intervenes to conduct OMO (Oduyemi, 1993).

The objective of the CBN is to supply to, or withdraw from the banking system enough cash to offset daily flows between it and the rest of the financial system. In their daily operations, the banks individually can meet shortages of funds by drawing down their deposits with discount houses, by borrowing from discount houses, or by selling money market instruments to discount houses. Where they have surplus funds, banks can individually use such funds to increase their deposits with discount houses or to buy additional money market instruments from discount houses. Discount houses are thus expected to intermediate between those banks which are short of funds and those which have surplus funds. This underlines the requirement for competitive interbank market rates for the efficient

functioning of the system. Discount houses in turn, can raise funds by selling certain money market instruments to the Central Bank, or borrowing from the CBN against approved collaterals up to a maximum of 20 per cent of their total assets. Thus, a secondary market facilitates the separation of central banking function from fiscal functions and thus helps to isolate the central bank from the fiscal overruns of the government. However, when budget deficits are large, requiring massive financing, the primary sales of government securities tend to be a dominant influence in the financial markets creating a number of problems. First, it limits the use of OMO as an effective short-run policy instrument. Second, it stultifies the growth of a secondary market for securities thus discouraging the active participation of both sellers and buyers. Third, it distorts the level and structure of interest rates. The large volume of bills to be sold particularly in periods of economic instability which is characteristic of economic reforms may result in market clearing rates of bills that are too high. As interest rates go higher, the ability of government to redeem such bills at the higher rates become very doubtful and the credibility problem further helps to distort interest rates. This will further inhibit banks and other financial institutions from willingly coming out to establish secondary markets since there will be genuine fears that the high risks of establishing such markets will not be compensated adequately by the small trading margins which are likely to emerge. This is the more so in the characteristic excess liquidity situation in the economy resulting in high sales/bid ratios (Roe and Sowa, 1994).

Where TB rates are not allowed to rise as a result of the ensuing instability due may be to government manipulation, the interest rate structure is further distorted. Fourth, since the Central Bank is the institution accommodating the deficits, there is likely to be a redistribution of purchasing power in favour of the government that results in the crowding out of the private sector particularly during rising prices. Thus, the persistence of high fiscal deficits is to say the least inimical to the achievement of indirect control. The vices identified have been prominent in the Nigerian experience.

In financing the overall deficit of the Federal government, there has been a massive reliance on accommodation by the CBN. Between 1986 and 1992, internal borrowing accounted for an average of 95.1 per cent used in meeting the fiscal deficit of the Federal Government with the CBN, through its ways and means advances, providing the credit. The statutory limitations on such loans were flouted as this became politically infeasible. Thus as fiscal deficits translated into increasing aggregate domestic credits, macroeconomic instability increased making the objectives of monetary policy unattainable.

The inevitable line of action is for government to reduce its deficits. Two problems are involved here. First, the growing size of debt to non-debt expenditures is making it increasingly impossible for government to fulfil its ordinary obligations of providing goods and services for the citizenry. Non-debt expenditures increased by 46.6 per cent between 1986 and 1992. During the first nine months of 1993, non-debt expenditures accounted for 50.7 per cent of total expenditure. The share of debt expenditure in total expenditure rose from 57.8 per cent in 1986 to 61.1 per cent in 1992. The increased debt service payments are a result of the growing debt obligations both external and domestic of the Federal

government. Domestic debt outstanding share of total expenditure increased from 28.5 billion Naira in 1986 to 262.3 billion Naira in 1993 (Okoroumu, 1994). This introduces another dimension to the problem of indirect monetary management. In 1993 when interest rates were de-regulated in consonance with the introduction of OMO, the minimum re-discount rate rose to 26.0 per cent. The tightening of monetary policy through the use of OMO, cash reserve requirements and liquidity ratios contributed to this increase in interest rates and has enhanced the growth of domestic debt service especially in the first 3 quarters of 1993. The re-introduction of interest rates control in 1994 did not come as a surprise. No doubt the reduction of government fiscal deficits and the encouragement of competitive interest rates will enhance monetary management through indirect control. But given the scenario we have attempted to sketch so far, it is going to be difficult to attain the fiscal balance that is so crucial for the attainment of this goal in the immediate future given present projections from oil receipts and Federal government expenditures profile.

(ii) Banking Insolvency and Indirect Monetary Control

The enormity of banking insolvency in the Nigerian economy has called for massive government intervention in recent times, although economy watchers perceive this intervention as belated. From 8 in 1990, the number of banks adjudged technically insolvent rose steadily to 42 in 1994 (about 38 per cent of total banks). The banks in financial distress during the year 1994 accounted for close to 10.3 per cent of the deposit liabilities of the banking system and about 15.0 per cent of the system's outstanding loans and advances. About 66 per cent of the aggregate loans and advances of such banks were non-performing. The issue of distress has gradually spread from the 8 state banks identified in 1990 to privately owned banks. A twist was introduced in 1993 with the spread of insolvency to a wider circle of banks and non-bank institutions including community banks, primary mortgage institutions and finance companies (CBN, 1994).

The consequences for indirect monetary control and the economy as a whole is perverse. Insolvency generates a confidence crisis in the economy and where it does not lead to obvious deposit runs, it contributes to capital flight. For Nigeria, Duesenberry and McPherson (1991c) did a crude measure of the state of confidence in the Nigerian financial system using the growth of off-shore deposits. Although these are only a fraction of capital flight, their figures showed an increase in off-shore deposits from 10 per cent of official reserves in 1981 to 50.2 in 1989. Bank insolvency leads to loan concentration and crowding out. The tendency is to concentrate loans on large borrowers, the same group of people who are already severely indebted to the banks, with a view to not precipitating their failure to repay by stopping lending to or foreclosing on them. Bank insolvency tends to aid interest rates increase particularly when they become widespread. Insolvent banks are likely to be prepared to pay any interest rates in a competitive atmosphere in order to attract more depositors, who will ask for high remuneration to offset risks (wholesale depositors). When deregulation occurs during widespread

insolvencies, mobilised deposits are not all used for sound lending as a considerable part is allocated to cover operational costs so that the banks can remain liquid. As a result, the bank will not be able to compete for creditworthy borrowers through low lending rates. The cost of deposits and operating costs are high and the new resources to allocate, scarce (Aristobulo, 1991). This results in high lending rates, which may occasion credit rationing with attendant effects on the quality of the portfolio of banks. Deteriorating asset quality was hastened by the high interest rate regime which greeted the premature liberalisation of interest rates in 1987. Distress borrowing at high interest rates, the roll over of maturing debts as well as the capitalisation of interest payments by banks all compromised banks portfolio quality. The implication of such high interest rates for the development of the secondary market for bills and the stability of the macro environment for the operation of indirect control has been discussed.

When bank insolvencies are not resolved, they result in serious implications for effective fiscal and monetary control. In many cases, government absorbs losses from failing banks. Subsidies, liquidity support through rediscount facilities, special advances by central banks or special deposits by the treasury or other government institutions such as the deposit insurance corporation are common. The losses that are incurred by government under such liquidity supports at most times remain undisclosed as part of their annual budgets. Since they are in most cases financed through the accommodation of the Central Bank, (most of the time they masquerade as 'other assets' in the CBN balance sheet), they create problems with monetary management using open market operations.

The chronic lack of confidence in the banking system that ensues when insolvencies become rampant can amplify the other economic shocks that are not uncommon with adjustment programmes. For instance, loss of confidence which leads to capital flight and a shift of resources out of the banking system might make realistic exchange rate and price levels difficult to achieve. This will force banks to restrict credit. Under indirect controls, bank lending will be reduced by acting on bank reserves through open market sales of bills. Money market rates rise, interest rate on loans also rise to curtail credit demands. More often than not, in order to achieve the desired target, loan rates may rise by substantial amounts. This scenario was clearly observable in Nigeria in 1993 at the inception of OMO. When all these are also occurring in a moment of political instability, the risk will be too high for any government, to ignore. What often happens then is that the Central Bank is forced to re-impose controls even after committing itself to indirect control and serious questions are asked about credibility. The re-imposition of interest controls in Nigeria in 1994 was an aftermath of the serious instabilities caused by high interest rates and large fiscal deficits that greeted the economy in 1993, a situation that gave birth to high inflation and worsened exchange rate depreciation. This again underlines the need for cooperation between the treasury and the Central Bank in any meaningful monetary transition from direct to indirect controls. Prior to any meaningful monetary management, there is a need to restructure and rehabilitate the banking system.

(iii) Timing, Sequencing and Speed of Reform Measures

There are a few other issues to raise in connection with the switch from direct to indirect controls in Nigeria. For instance, the phenomenal rise in the number of banking institutions and other non-bank intermediaries will definitely pose serious problems for the supervisory capacity of the CBN. Also, OMO requires timely data, possibly on a daily and weekly basis to permit relevant intervention by the CBN. There is a general lag in information flow (as much as 6 - 12 weeks in some cases) which may not be conducive to the successful operation of OMO. These are issues that can be resolved with time.

Our discussion on the implementation of OMO in Nigeria so far draws attention to the issue of timing, sequencing and speed of financial sector reforms in LDCs. No doubt, the success of financial liberalisation is to a great extent affected by these three factors. Financial liberalisation is normally undertaken as part of a general programme of reforms embracing stabilisation and liberalisation. Timing has to do with where to place financial liberalisation within the general framework of reforms. There is now a fair convergence in the belief that stabilisation efforts which will include sizeable reduction in deficits, stability in the exchange rate and reduction in the rate of monetary growth and hence a deceleration of inflation should be accomplished before embarking on FSR. To embark on liberalisation in the face of high inflation which often accompanies stabilisation measures is to invite chaos as both deposit and loan rates are likely to increase uncontrollably (McKinnon, 1991). The increase in loan rates is more often than not more pronounced, impairing the credit worthiness of corporate borrowers and swelling the rank of loan defaulters; compromising the portfolio of commercial banks and the stability of the financial system (Villanueva and Mirakhor, 1990). It is also argued that the reform of the domestic real sector should precede financial liberalisation. This is to prevent credit from a freed banking sector, from flowing to industries that are profitable only because they enjoy some form of protection. Yet another reason why financial sector reforms should wait until budget deficits and inflation have been reduced is the fact that high nominal rates may impose very high costs on borrowers even if real interest rates are not high (Harvey and Jenkins 1994).

With trade liberalisation and the removal of protection, such firms may find it difficult to maintain profitability and meet debt obligations. Thus overall, financial liberalisation should come after achieving macro-stability.

Sequencing in this framework will refer to the chronological order in which individual financial reform policies are implemented (Turtleboom, 1991). Emphasis is often placed on a sequence that begins with strengthening the (prudential) regulatory and supervisory framework with attention focused on issues like specifying and enforcing rules and guidelines on loan classification, provisioning for bad debts, capital adequacy standards and limits on loan concentration. This is indispensable particularly when macroeconomic stability proves difficult to attain. The literature on macroeconomic instability, weak bank supervision and moral hazard provide enough theoretical and empirical evidence in this regard (Stiglitz and Weiss, 1991, McKinnon, 1991). Next to this is the need to restructure and liquidate

distressed financial systems. What this calls for is action on the part of the monetary authorities since banks with substantial non-performing loans ought to be liquidated without delay. It is only after this that market-based weapons of monetary control using money market instruments such as TBS could be introduced. To make them appeal to the public, their yields must be attractive. Even at that, it may be premature to dismantle direct credit controls, before market agents become familiar with these instruments. When credit controls are removed before indirect monetary techniques are established, a loss of monetary control is bound to occur with adverse consequences for macroeconomic stability (Alawode and Ikhide, 1996).

While these measures enumerated above are being put in place, bank chartering could be undertaken to allow for competition in the system. Since this has been preceded by appropriate regulatory and supervisory mechanisms, banks thus established are not likely to take unnecessary risks as they grapple with a deregulated system. In some countries, competition in banking has been increased by the licensing of new banks before the writing of new financial legislation and before the establishing of adequate bank supervision. The ensuing bank failure has in most cases reinforced the oligopoly position of other banks. It is only after all these that the final step in financial liberalisation, that is, the abolition of direct controls on interest rates and credit ceilings is undertaken. This presupposes that indirect monetary instruments have attained the desired levels of effectiveness.

The issue of speed is crucial depending on the state of disrepair in the economy prior to the liberalisation. For the banking system, banks that previously operated under government ownership and credit guidelines are not likely to be adept at things like credit analysis, risk evaluation and proper loan documentation. Plunging them overnight into a liberalised and competitive market could be risky. In this wise, it is often advised that the removal of the ceilings on interest rates should be gradual and credit controls should be eased over an extended period of time. Although it is difficult to fix a timetable for this programme, the emphasis here should be on a gradual and not a pull-mell removal of all controls.

7 CONCLUSIONS

This work has attempted to review the impact of financial liberalisation on monetary policy in Nigeria. In particular, the work has examined the progress so far made in the transition from direct to indirect forms of monetary management with a view to documenting the strengths and weaknesses of the policy shift. The study recognises the inherent shortcomings in the direct control system that was dominant prior to financial liberalisation. Also, economic reforms that have financial liberalisation as a key component often emphasise market oriented systems of monetary management as a way of enhancing the efficiency of the financial system and the general workings of the economy. However, the transition to indirect control often assumes the fulfilment of certain minimum conditions without which the system cannot work efficiently. Some of these include substantial reduction if not a total elimination of fiscal

deficits, a competitive/market oriented financial system, a proper co-ordination of the activities of the treasury and the Central Bank, and a healthy banking system.

The experience in Nigeria has demonstrated that the inability to meet these minimum conditions could to a great extent compromise the successful implementation of indirect controls. The CBN cannot claim any significant success in affecting or effectively monitoring the factors that influence reserve money growth in the economy due mainly to the domineering influence of government spending. In terms of institutions, a virile secondary market that will engender massive and active participation has not emerged once again due mainly to the dominance of the primary market where the government borrows, unstable interest and exchange rates and a proliferation of insolvent and illiquid banks.

What the latter calls for is far reaching decisions at restructuring insolvent banks. The recent steps taken by the Federal government in enacting punitive measures against bank directors who have been found guilty of fraudulent practices which may have compromised the portfolio of banks is a right step in this direction. Regulations as contained in BOFID (1991) and efforts at training and re-training bank supervisors are enough preparatory steps already undertaken for the transition. What the Central Bank now needs is enforcement powers to deal with offending market participants. Other measures include the development of the secondary market, a realistic exchange rate, data and human resources management and policies aimed at inducing competition. Even when all these have been achieved, there remains the need to substantially reduce government fiscal deficits and remove ceilings on interest rates without which the money market cannot function adequately. The above considerations pose serious questions about the advisability of implementing open market operations on a large scale at this stage of the economic reform. More research will be needed in this area. The question has been asked if it will not be more proper to deal with these problems and achieve some measure of success before implementing indirect control. While this may be the case, efforts could be intensified at developing the bills market and enhancing the capability of the central bank operators at managing reserves at the same time that steps are being taken to ensure macroeconomic stability. What may not be practicable is the call for an abandonment of all forms of direct controls even at this stage of the transition when the financial system and as a matter of fact the whole economy is completely unstable.

NOTES

1. Other assets' consist mainly of non-traditional investments. They are innovative investments that offer rapid portfolio adjustment, a major feature of the current volatile macroeconomic environment.
2. These are often referred to as investment intermediaries.
3. Cash ratios (cash as a ratio of demand deposits) were imposed on the basis of a four group classification based on the size of total deposit liabilities of the banks.
4. Financial savings here measured as the ratio of the quasi-money to total deposits initially rose from 59.1 to 64.8 percent between 1987 and 1988 when interest rates were liberalised in Nigeria.
5. It has been suggested that the political disturbances between June and August and not the interest rate cuts accounted for the lull in TBS dealing during this period. As from October 1994, the Federal Government stopped the announcement of amounts to be offered for sale.
6. In the wake of the liquidity squeeze which accompanied the transfer of public sector deposits to the Central Bank from the commercial banks in 1989, money supply decelerated sharply. The increases in bank lending rates that accompanied it led to the CBN re-introducing interest rate regulation. The CBN prescribed a maximum margin between the bank's average cost of funds and their maximum lending rates as well as a minimum level for savings deposits.
7. A Stabilisation Fund was instituted in late 1989 to sterilise receipts forming in excess of budget production. 40 percent of crude oil liftings in late 1991 due to the Gulf oil crisis was supposed to be earmarked for dedicated priority projects. Neither the Stabilisation Fund nor the dedicated priority projects could be accounted for as they were spent outside normal budgetary provisions.
8. For a comprehensive review see Teriba (1995).

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