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Restructuring the Nigerian financial system for economic resuscitation.

S. B Falegan
Central Bank of Nigeria

RESTRUCTURING THE NIGERIAN FINANCIAL SYSTEM FOR ECONOMIC RESUSCITATION*

BY

S.B. FALEGAN, FCIB

Today's presentation was originally scheduled for 8th July 1993, under the title, "Bank Restructuring: Challenges and Opportunities." It was rescheduled for 24th November 1993 under a new title, "Restructuring the Nigerian Financial System for Economic Resuscitation".

In today's re-presentation which by divine providence could not be "wished away," I was afraid that a new topic would be given to me at short notice. What I appreciate most is the confidence reposed in me by your Executive's persistence in requesting me to speak on Restructuring the Nigerian Financial System for Economic Resuscitation.

The "velocity of circulation", with apologies to economist's language, in the art of governance in Nigeria, unpredictable and epileptic as it is, not only necessitates the changing of dates for this presentation, but more fundamentally in having far-reaching adverse economic consequence for our economy, with the financial system as the black spot and focus of attack and concern, as implied on our topic for discussion. One is not even sure that by the time the presentation is concluded, the conclusions might not have been overtaken by events, and other developments.

For a number of reasons, you will find the treatment of the banking sector as dominating the entire presentation. It is because it is the parent of the entire financial system.

Before this presentation, I have had access to the Central Bank of Nigeria's **Economic Report For The First Half of 1993**, and I have been priviledged to read this address titled, **Recent Development in the Nigerian Financial Services Industry: Problems and Challenges** presented by Mr. P.A. Ogwuma, OFR, Governor, Central Bank of Nigeria at the annual Dinner of the Chartered Institute of Bankers of Nigeria on 12th November 1993.

I have also read in the papers about a seminar on the **Crisis of Confidence in the Financial Sector** organised by Vacon Ventures and Security Limited. The 10th Anniversary Lecture of First City Merchant Bank Limited on the **Fall and Rise of the Naira** delivered by Professor Adebayo Adedeji was particularly exciting.

All of them deal with the same problems with different emphasis and perception. When I reflect on them, I concluded on a sad note at the waste of brain, intellect, knowledge, and perception by Nigerians in understanding and identifying all their problems and prescribing solutions, but all wasted on lack of sincere and honest implementation by the ruling class, resulting in our culture of development by

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destruction.

I start with Table 1 deliberately, which deals with the Federal Government Finances. From it, it is as if it was deliberate that the introduction of the Structural Adjustment Programme in 1986 was planned and destined to fail from its inception. Other than the brief period of 1987, the Federal Government deficit grew annually at an unprecedented rate ending in a deficit of ₦62 billion (actual) in 1992 and ₦27 billion in the first half of 1993, higher than estimated for the whole years. It overshot the planned expenditure of ₦83.3 billion by ₦11 billion in the nine months of 1993, while estimated revenue of ₦108 billion was down to ₦99.7 billion by the estimates for the whole year. Apart from the recurring budget deficits, extra budgetary expenditures, that is, unplanned for budgetary spending predominated with reckless abandon without visible sign that they are spent on the productive sectors of the economy. From available information, about 40,000 projects of doubtful value that would still require ₦300 billion to complete are abandoned.

The consequence of Table 1, in short, is that the inter-relationship among macroeconomic variables as tools for policy management is put to severe and unsustainable test of ineffectiveness where one of the policy compliments, as is evident in government expenditures, run foul of other policy options and objectives, resulting in action worse than inactivity.

Underlying the existing level of Federal Government deficit is the unknown amount of deficit of all the state and local governments which to me are basic to future policy decisions.

From both public pronouncements and newspaper reports, nearly all the state governments and local governments are in arrears of payment and in debt of one nature or the other to contractors, suppliers, state-owned banks and the budding community banks. None seems to have been able to pay the 45% salary increase to all workers forced on them by the Babangida Administration without regard for ability to pay.

The heaps of refuse in our streets, the unpaid salaries of teachers for months at both local and state government levels are evidence of additional financial burden that will militate against any balanced or reduced budgetary deficit in the near future. Nor must we fail to mention such outstanding commitments to workers in almost all the parastatals, including the Police and the Army.

It is painful that one can not quantify these commitments in Naira and kobo. When all of them are however taken into account, the unavoidable financial commitments will further reinforce incurring additional budgetary deficits, which will render any fiscal policy meaningless in the next couple of years and therefore continue to undermine monetary and other policies.

In a circumstance of fiscal indiscipline and profligacy, the efficacy of monetary, balance of payments, exchange rate and interest rate policies become meaningless. The consequence is self-reinforcing and lethal. There is a cumulative excessive monetary and credit expansion, which generates high powered money that results in cumulative inflation which impair and intensify pressures on interest rates which exerts severe pressure on an ever-depreciating Naira, artificially held down by fiat. The cumulative money illusion, buoyed by the cumulative inflation generates cumulative depression and fall in output, leading to cumulative unemployment, both voluntary and involuntary.

The cumulative fall in demand leads to the substitution and rising and thriving informal market at the expense of the formal market where tax-avoiding and evading underground markets now substitute for a falling tradable industry.

The rising external debt burden now estimated at $35 billion, and the deteriorating balance of payments deficit, further compounds the exchange rate depreciation which further escalate capital flight. In succession, the stock market dips, resulting in sustained downward trend in share price trading activities. Capital flight abroad is reinforced by lack of domestic investment where the whole system is awash with excess liquidity, where fund holders prefer to invest in short-dated liquid assets at high in terest rates, than tie their money down to long-term investments because they are not sure of any return.

With the financial system awash with cash in the absence of investment outlet, there is the consequence of cumulatively depressed and repressed financial system, the most felt impact and victim being the banking sector.

The Banking Sector

In this era when the word "Bank" is being used in a most irreverent way, it is tempting to interchange financial system with the banking system. You will forgive me if I fall into such trap. I have had the opportunity of being a Central Banker, a mortgage banker, a stockbroker and an operational banker in both commercial and merchant banking. In my secluded shell of financial management, I now watch with despair and anxiety, the mixed-grill pollution that is attendant on the whole financial system. The deregulation of the economy, however unavoidable, is now being threatened, albeit unnoticed, by a crisis of the financial system.

At the time of writing, there are about 125 banks - commercial and merchant banks. Before the 1986 deregulation, there were about 40 commercial banks and 15 merchant banks. That period can be regarded as the period of crawling or elephantine banking - drab, oligopolistic, lethargic and conceited. The banking system, indeed the whole financial system was highly regulated. Banks were subjected to severe restrictions both on their products and their activities, thus limiting the banking system's activities and abilities to adapt to changing market conditions. The characteristic excessive regulatory controls and restrictive banking legislations of the period led to the repression of the banking system. The commercial banks had a network of branches for mobilising rural savings for a pitance and taking such savings to the urban centres for lending, thus draining the rural areas of their funds for lack of investment outlets. Many of these older banks are only being forced to change by the challenges they face from the new ones. They still have a proper grip on their network branches of depositors who are still being paid interest on their deposits at heavy discount or below the market rate. It is interesting to watch deposit rates in some of these older banks hover around 12 to 18 percent while new breed commercial banks pay as high as 27 to 30 percent for similar deposit. Some of them still employ the old archaic method of banking through queuing, manual operation and referencing for customer attendance. No wonder the queue and complaints are still endless, in an ever-challenging and expanding business environment.

The deregulation era brought in its wake new breed banking promoted by private initiatives and capital. These new breed banks are run by highflyers and risk-takers who have challenged the older ones to their lethargy. For both commercial and merchant banks, they must number almost 60 or more, employing the most modern and sophisticated instruments, including computer application, electronic banking and micrographics. No wonder the older ones complain about them or unfair practices and competition in snatching their customers.

The third set of banking is the Hoi Poloi: including those set up by the Federal Government The Nigerian People's Bank which have 830 branches nationwide; those encouraged by the government - the community banks now numbering 512. They are expected to rise to 1,000 at the end of the year. The good thing about community banks is that they not only compete effectively with the old-time banks in mobilising rural savings and they pay competitive rates and attract customers and depositors away from them.

There are those who take joy in borrowed names - the mortgage bankers, largely savings and loans and building societies. They number about 145 now. Finally is the mixed grill called Finance companies most of which combine commercial, merchant and mortgage banking functions: ostensibly they don't take deposit but in reality "borrow" money to take "deposit" such that make their borrowed funds are larger than the deposits of some of the licensed deposit-taking banks. They number about 660. Of course, we must not forget nor underestimate the "wonder banks" whose unauthodoxy makes nonsense of professional and conventional banking.

The rapid and diversified growth in the money market of our financial system has also been accompanied by the growth in the securities (capital) market with both the Securities and Exchange Commission, along with the Nigerian Stock Exchange as the regulatory authorities. There are now about 140 stock broking companies, including issuing houses, fund and investment managers and registrars. In addition to the above are about 136 insurance and reinsurance companies operating as part of the financial system.

Equally important for mentioning are the development banks, including the recently established Urban Development Bank along with the Federal Mortgage Bank and its satellite mortgage houses.

The rapid growth and structural changes which have characterised the system have also been accompanied by some operational developments aimed at making the system work effectively and efficiently. They include:

(i) development of about 132 bureaux de change as supplement to official foreign exchange operations,
(ii) the short-lived transformation of the Foreign Exchange Market from an auction to an inter-bank market, where the whole banking system including the Central Bank were market makers in response to market forces,
(iii) the establishment of securities transfer facility for banks wishing to trade government securities among themselves for an active secondary market,
(iv) the establishment of the institutional structure for the operation of an inter-bank settlement system arising from over-night and other inter-bank fund placements, (The clearing house known as Nigerian Inter-bank Settlement System which replaces the existing clearing system at the Central Bank started operations in May, 1993),
(v) the establishment of three discount houses to begin discount operations to facilitate monetary policy via open market operations.

The banking system in response to business circumstances and challenges has also been responsible for promoting Unit Trusts as additional financial intermediaries and deposit-taking outlets. Also, either in response to avoiding the "common directive" requesting them to provide "subsidy funds" to the National Housing Fund or in facing the challenges posed by finance houses or both, many commercial banks and merchant banks are directly, albeit subtly, involved in setting up some mortgage institutions and finance houses.

Product Initiation, Imitation and Differentiation

In order to survive the competitive environment, the banks have embarked on aggressive differentiated products promotion into the Nigerian money market as a way of increased share of a captive market and providing improved quality services to customers to boost their deposit base. As confirmed in the Nigeria Deposit Insurance Corporation's (NDIC) 1991 Annual Report, commercial and merchant bank products stood at 37 and 35 respectively at the end of 1991, all directed at individual, business and corporate customers (see NDIC Annual Report 1991 page 45). Their tenor varies from 90 days to 180 days for commercial banks and up to 365 days for merchant banks. Virtually each bank has its brand product or brand name, while the minimum investment in a product is now ₦25,000 with upfront interest payment; some of the products are converted or re-discounted before maturity.

Apart from the similarity in all the products as to tenor, accessibility, yield (except in brand name), they are operationally not different from one another. The uncertainty and volatility in interest rates even hamper their enhancement and effectiveness as instruments of deposit mobilisation. The similarity of the products apart, their enhancement is further hampered by the near-perfect knowledge of the market where the investors have turned the deposit-hunt competition into a seller's market.

In response to the need for improved services to customers, some banks have introduced the Electronic Banking System (EBS), whereby customers have access to their bank account from any of its branches. Additional facility provided by EBS include on-line signature verification, immediate fund transfer between branches and consolidation of accounts, all of which facilitate the clearing system.

Problems and Challenges

Subsumed in these developments are the fears that sooner or later the cut-throat competition and the get-rich-mania are bound to adversely affect the banking system as already evidenced in the collapse of some finance houses, the hidden illiquidity and insolvency of some banks and the commonplace default in money market operations. Of course, the regulatory environment has never been lacking and it will be examined later. The problem with such regulations is the breath-taking rate at which the operators bit the regulators, making the latter merely reactive and not problem anticipating. The consequence of all these is that we are passing through a period in this country in which the banking community, indeed the whole financial system is increasingly being regarded with hostility, unpopularity and resentment. Some of the banks are established with small down payment and borrowed funds. Through inter-locking ownership and directorate of other institutions, they establish finance houses and mortgage institutions and direct credit to related companies, so that the owners would have the necessary funds to repay their debts.

What are the problems? Page 17 of the **African Guardian** of February 15th 1993 summarised the problems facing the banking industry in Nigeria with this heading - "Fraud, inept management and many other factors are pushing banks down the abyss."

The Nigeria Deposit Insurance Corporation established in 1988 joined the Central Bank of Nigeria as part of the regulatory framework of the banking system. The NDIC, as we all know, has the responsibility for ensuring depositors's funds and guaranteeing refunds so as to prevent insolvency, undercapitalisation, substandard, doubtful loans and negative shareholders funds. In June 1991, two Decrees - numbers 24 and 25 (Central Bank of

Nigeria Decree 1991 and Banks and other Financial Institutions Decree 1991) were issued to further strengthen the regulatory authority over the banking and the financial system. With such arsenal, the Central Bank of Nigeria issued, through its Banking Supervision Department, its November 7, 990 circular letter to all licensed Banks setting out the"Prudential Guidelines for Licensed Banks." The guidelines relate to requirements for asset classification and disclosures, provisions, interest accruals and off-balance sheet engagements.

In applying these regulatory instruments, the Central Bank was reported to have classified in September 1992, the 124 banks operating in Nigeria into two categories - **healthy** and **unhealthy** - using the following as criteria - ability to meet specified cash reserve, liquidity ratio, statutory paid-up capital adequacy ratio, sound management and adherence to prudential guidelines. The banks used the criteria to determine participation in the inter-bank foreign exchange market. Eventually, 44 banks were adjudged unhealthy, 14 of which are state-owned, 18 are merchant banks and two are commercial banks partly owned by the Federal Government. With the advent of the Dutch Auction method at the forex and the extensive use of stabilisation securities for mopping up excess liquidity, the situation deteriorated with more banks on the unhealthy list.

To reinforce the evidence of threatening imminent banking failure and collapse, the NDIC in its 1991 Annual Report showed sustained deterioration. It was reported in the 1991 Annual Report of NDIC for example that of the 119 banks existing at the time, eight were distressed, that is, technically insolvent. Of the eight, one was a privately owned commercial bank, while the rest were state government owned commercial banks.

Monetisation and Financialisation of the Financial System

The extent to which an economy is being monetized and the extent of its financial deepening are often based on a number of factors with the banking system's role as the barometer for measuring such factors:

(i) growth in money stock,
(ii) rise in the ratio of demand deposit to money supply (MI),
(iii) growth in Quasi Money, that is, in savings (M2),
(iv) rise in the ratio of demand deposit to money supply (M2),
(v) rise in financial assets, institutional markets and products including bonds, stocks and shares, etc.,
(vi) relationship between changes in GNP per capita income and some monetary aggregates, and
(vii) growth in the securities market, showing new issues ratio and share turnover ration.

Due to lack of adequate data, I am restricting myself to examining the growth and the relationship between demand deposit and money supply which I have termed the monetisation ratio. The other relationship is the growth in total commercial and merchant assets and the growth in GNP per capita income.

To reflect the financialisation ratio, the examination of the other monetary and financial aggregates (securities, bonds, shares, finance and mortgage assets etc.) in relation to other indicators especially GNP would have provided the extent of financial broadening and deepening. We are, however, constrained by lack of adequate and reliable information, and restricted to a narrow definition of financialisation ratio, which is the ratio of total commercial and merchant banks' assets to GNP.

Table II shows the monetisation process. In the 1960s, the ratio of demand deposit (DD) to M1 and M2 average 38 percent and 26 percent respectively. With some wide fluctuations DD to M1 ratio peaked at 66 in 1980 and declined to 50 in 1983. In 1984, it again picked up, reached 63 in 1985, then up to 1989 the decline was sustained. The situation fluctuated between 1990 and 1992. The same observation is true of the relationship between demand deposit and M2. The currency ratio (M1-DD), that is, the money multiplier or income velocity of money is ordinarily expected to decline to show the degree to which the economy is being monetized. What we are saying there is that the way money affects prices and output depends on how fast it circulates through the economy which is money's income velocity of circulation, that is, the annual nominal GNP divided by money stock. The increased use of demand deposit in the 1980s is thus vividly reflected in the inverse income velocity of money. The decline in the 1990s is another way of saying that the money supply has been utilised or made to operate and function more efficiently in the 1980s than in the 1990s.

The further intensification of the monetisation provided is better appreciated against a background of the changes in GNP per capita income and M1 and M2 respectively. The monetisation ratio M1 to GNP, that is, the inverse of the income velocity of money grew from 9.8 percent in 1960, 10.2 percent in 1970 to 20 percent in 1980 and 25 percent in 1983. The broad money M2 shows the monetisation ratio M2 to GNP of 12.4% in 1960, 15.9% in 1970 and 32.2% in 1980, rising to 43.3% in 1983. Table III shows the trend of those relationships up to 1992. Since then, there has been increase or broadening of financial institutions for business and economy expansion. Apart from that, there has been sustained growth in financial assets, institutions, intermediaries and market, all of which should strengthen the monetisation base, that is, M2 to GNP and the financialisation base, that is, growth in money and capital markets in forms of bonds, stocks, shares, etc.

As shown earlier, not only have the banks multiplied, other financial intermediaries have also doubled or non-existing ones developed.

Ideally, the aggregation of the ratio of commercial and merchant bank assets to GNP plus the ratio of total securities to GNP will provide an accurate measure of the economy's financialisation ratio. All that is regretably available is shown in Table IV.

As shown in Tables II to IV, the financial system in nominal terms has grown rapidly. However, using the GNP deflator, money stock measured by both M1 and M2 fell sharply and grew at a drastically reduced rate. Two other measures, the Bank Assets/GNP ratio (Table IV) and M1/GNP or M2/GNP ratios show sharp contrast, with phenomenal growth rate in nominal terms. When measured in real terms, as shown in Table III, the ratio fell sharply and growth rate fluctuated downwards drastically. In effect, monetary signals have gone wild and wrong. Money's income velocity of circulation both in nominal and real terms fell significantly in all the economic sectors.

Based on a declining per capita income particularly in the last five years, these developments betray the extent to which inflation has bloated the actual growth and performance of our banking and financial system.

The period January 1993 to June 1993 would have presented an accurate picture of the point being made here that there has been intensification of cash in preference to the use of bank deposit and the use of cheques. That is, there is the preference for use of cash than for use of banks; that within a few days that a cheque is paid in, the bulk of it is withdrawn in cash. I understand that the situation was aggravated during the political campaigns when "cash and carry" operations replaced banking operations, that is, the intensified use of money multiplier through increase in velocity of circulation of currencies at the expense of bank deposits, that is, a demonetisation of the economy. The banking system must admit responsibility for the loss of confidence and faith by customers preferring "cash and carry" operations to banking operations.

First, there is the impression that the benefit in the upsurge in the number of banks to the economy has been minimal, merely servicing and not productive of the economy. Second, some banks only thrive in esoteric and over-the-counter services without contribution to real output and production. They, instead, contribute to financial repression so evident in government-led fiscal profligacy that has characterised the Nigerian economy. There is no evidence of increased output of goods and services commensurate with the growth and quantity of money supply. Hence, run-away inflation typical of the German post-war economy; and a depressed economy characterised by profound underemployment, reminiscent of the typical stagflation. Third, given the rate of inflation in the economy and the daily depreciation of the Naira, it is obvious that the banking system is now characterised by capital inadequacy and in real terms, the minimum paid-up capital of each class of bank of ₦50 million for commercial banks and ₦40 million for merchant banks has become negative and grossly inadequate. Let me emphasize the consequence for all finance houses, mortgage institutions and non-bank financial institutions of our financial system.

Like the banks they are equally characterised by capital inadequacy, illiquidity and in most cases insolvency, managed and operated by non-professional and inexperienced raiders of the financial system. Infact, I will not be surprised if some or many of the community banks are not already smartering under the same problems. Just like the Federal Government and State governments rely on excessive borrowing from banks owned by them (however small their share ownership), community banks must have become victims of local governments where some local government chairmen make themselves chairmen of such community banks.

Apart from Government proffligacy and some non-oil export proceeds that exporters prefer to change in the black market and the like, the bulk of the money is from proceeds of laundered cocaine money and political funds. Yet, the little that is left is squeezed from the banking system in form of stabilisation securities. Meanwhile, the banks' competitors - finance and mortgage houses which are depositories for these floating funds smile home with usury rates they charge the banks and other borrowers. The fierce and almost uncontrollable cut-throat competition within the banking industry does not help matters. If it is not under-cutting in deposit hunts, it is out-bidding in the foreign exchange market. The increasing level of default in the inter-bank money market further dents the image of the system.

When these funds find their way to the foreign exchange market, chasing the limited foreign exchange available, the Central Bank is blamed for underfunding FOREX. The cumulative effect is the unending depreciation of the Naira, the end of which is not in sight.

From another angle, the banking system has become a victim of its operations. Bureaux de Change that are set up as buffer between bid time users of foreign exchange and small users have become a major instrument of foreign exchange manipulations, dictating in conjuction with the parallel market, the rate of exchange. It is amazing that no sooner did the Central Bank clamp down on transactions with bills for collection and open accounts than the Bureaux de Change become not only fertile market for forex but a patronising market for some of the less-than-candid banks that care less of the effects of their professional misconduct in further depreciating the naira. Meanwhile, the finance companies and mortgage houses engage actively in "banking" without "deposits", to outwit the licensed banks and in collusion with parallel market and Bureaux de Change in the absence of prudential guidelines for them. It is confusion reinforcing confusion in a vicious circle!

Fourth, the quality of management and staffing of banks have been called into question. The NDIC observed that "some banks are characterised by inept management and instability in the tenure of office of key management staff. Negative culture of interpersonal wranglings among some bank's top management hamper operations as this often leads to polarisation of rank and file of staff. Board members and top management staff in some banks embarked on empire building quarrels on access to priviledges and perquisites of office rather than charting profitable plans for their banks." Meanwhile, poor attendance to customers, long queues at counters, bureaucratic delays, indifferent and clumsy services drive customers to non-bank finance houses. It is clear from the above that a considerable number of banks lacked professional experience and economic or moral solvency.

The issue of uncertainty and instability in tenure of office of key management staff especially in government-owned banks continues to give concern about government interference. Privatisation of these banks notwithstanding, the recent restructuring of the board of directors of the banks where the Federal Government is now a minority shareholder has caused some ripples and misgivings to the extent that it was reported that stockbrokers have shunned shares of banks on the Nigerian Stock Exchange. Meanwhile, it is no exaggeration that the banking, finance houses and mortgage institutions sector of the Nigerian economy is regarded as an avaricious blood-sucker that has the best conditions of services in the country and within the service sector of the Nigerian economy in particular. Yet, like Oliver Twist that have become part of the ever-demanding and strike-inducing aspect of our national life that negate increased output and productivity.

The bankers did not help matters when they dragged themselves before the Securities and Exchange Commission and two of them had to be suspended from the capital market for what one can call for want of one word, financial rascality.

In any part of the world, the financial system, the hub of which indeed is the banking sector, is often regarded as the engine and catalyst for growth and development by providing finance and building up the industrial and agricultural sectors, which in turn make service sector prosperous. The time was when in the 1960s before the civil war interregnum and up to 1974, this country witnessed **economic growth and development**. Between the mid-70s to mid-80s, there was **growth without development**. Painfully, since then up to date, Nigeria has had **neither growth nor development in the midst of vast and limitless material and human resources**, except money illusion, with the consequential financial repression. Real growth is negative. Lack of growth and development are evident in the structure of financing, all of which are at the short-term end of the market as reflected in our banking sector. Inter-bank lending and foreign exchange trading have become dominant in the market. The prohibitive lending rates discourage investment in agriculture and industry. The banking system exhibits a lifestyle of extreme opulence that exposes the sector to envy and ridicule. Yet, strikes for better conditions of service are called by that sector as a routine culture of banking in a squalid country, decaying with lack of job opportunity, lack of money to provide jobs, lack of adequate transportation, lack of housing infrastructure and dying industry reinforced by a culture of development by destruction. All these sum up a sad though unfair image such that rather than our banking system responding to solve these problems, they operate as mere servicing and consuming outfits, set out not merely to discourage the real sector growth but to liquidate them; forgetting that when the real sector assets on which money supply depends fails to function, the banks themselves sooner or later face the threat of collapse.

Put in another way, do we feel comfortable about the long-term implication for the economy when it is safer, more profitable, riskless and rewarding to earn not less than ₦20,000 a month by merely depositing ₦1 million with a bank as against an investor in the same bank with same ₦1 million whose annual return on capital is not more than ₦25,000. We can all imagine the disincentive to a manufacturer or an industrialist or a farmer whose gestation period for investing and producing lies between not less than 18 months and twenty-four months before he can be sure of sales, in addition to structural barriers such as lack of water supply, electricity instability in monetary and fiscal changes. In the area of under-provision for bad and doubtful debts which affect the inadequate capital base of some banks classified as problem banks, I wonder whether these banks ever consider the serious implication for their self-defeating operations.

This is done by merely turning their valued customers into debtors and making marginal debtors chronic and big-time debtors of irredeemable proportions. A bank lends ₦1 million to a customer at 25% interest rate per annum; suddenly hikes the rate 30, 40, 45% per annum within a pace of six months; it becomes a problem loan for the customer, a non-performing loan for the bank for which provisions have to be made.

The provision for such problem loan including accrued interest rises correspondingly for the bank which turns the bank into a problem bank severely leading to further under-capitalisation, credit risk, declining profitability and damage to balance sheet from over-exposure. By charging customers such prohibitive usury rates, the banks are unconsciously inflicting financial distress on themselves since their provision is the function of the size of their non-performing loans. The amusing thing now is to find the banks in the same stupor and straight-jacket that they find their defaulting customers. The chasing is intensified among themselves through inter-bank default, while the Central Bank is chasing them all.

Whether we like it or not, it is the banking system that will be blamed for all of these, even where the banking sector is a victim of circumstances. That reminds me of a treatise I read many years ago, the title of which is "Why Banks are Unpopular." It was reported by the author, Mr. Guide Carli that one Mr. Schopenhauser on visiting the gallery where the portraits of the Fugger (a German word for a banker) were hung and observing their images, exclaimed: "when I look at your faces, I have to admit that God is not with you."

That is the challenge our banking system, indeed, the whole financial system faces today. It is perhaps in these challenges that solutions can be volunteered for resuciating the financial system.

The Regulatory Arsenal

Of course, it is clear to all of us that there is no want or lack of regulation of our financial system. What seems to be wrong or worrisome from time to time is that the regulatory environment is very hostile and unproductive of the system. There is the culture of how to break and not how to conform with the rules. Mention has been made of the Decrees No. 24 and 25 (Central Bank of Nigeria Decree 1991 and Bank and other Financial Institutions Decree 1991 respectively) which repealed and replaced the Banking Act of 1969 plus its four other amendments with the sole purpose of effective control, regulation and supervision of the system.

The creation of the Nigerian Deposit Insurance Corporation under Decree No. 22 of 1988 is to further insulate the banking system from financial crises of illiquidity and insolvency. These are well stated in Section 5 (a-e) of the Decree.

Before detailed discussion of restructuring and opportunities, Section 15(a) of the Decree establishing NDIC has become worrisome to me and I am sure it must be a source of concern for the authorities at NDIC. The section stated that **all licensed banks and such other financial institutions in Nigeria engaged in the business of receiving deposit shall be required to insure their deposit liabilities with the Corporation.**

With the fast-changing kaleidoscope of terminologies in Nigeria, the word **Bank** is no more limited to licensed banks. Most, if not all mortgage institutions in Nigeria use the word bank and they are all licensed by the Federal Mortgage Bank (FMB). The FMB itself is a deposit taker. I am not sure whether its deposits are expected to be insured with NDIC, not to talk of the deposits of the secondary mortgage banks. The finance houses are or qualify as **other financial institutions in Nigeria**. Although, they deny being deposit takers, everyone knows that the euphemism for their deposits is "loan funds" which amounted to ₦1.3billion for the 84 out of 618 finance companies operating at the end of 1992. Deposit or no deposit, such large size of "loan funds" that end up fueling inflation and disputing both money market and foreign exchange market has serious implications for monetary policy and control. The relevant question here is: should their deposits (funds) be insured? And by whom?

I want to make bold to say that NDIC within its short-life span has proved to be a very efficient voice for rescuing failing banks. Practical experience must have shown, however, that some of its laws need to be revised or changed. Sections 22, 23, and 24 of its Decree seem to lay more emphasis on penalities and not on solutions while there are some ambivalence in the practical application of Section 22. It seems to be difficult for a bank that has been closed down for insolvency to easily develop public confidence to such an extent as to reapply to function again. The case of the Farmers Bank of the early 50s must be a pointer as to why no new bank has sprung up under that name. Where, from practical experience, the NDIC has the final authority in providing solutions, factors of social, political, sectional and psychological dimensions must have constrained it.

The question I often ask myself on reading some of these reports is: what next? Is it sufficient to merely cry and identity these problems every year and in occasional reports without taking concrete steps and firm decisions on implementation? This is the crux of the matter, and why is it so? There are many vested and conflicting interests from the negative to the indifferent, from the mundane to the sublime, from the self-seeking to the self-centred, political and non-political, all operating behind the scene and stalling all solutions that give the impression that those in charge are shirking their responsibilities, which is not necessarily so.

Those were the questions agitating my mind when the Central Bank of Nigeria announced the boldest, most courageous measures of taking over major state-owned banks - New Nigeria Bank Plc, Mercantile Bank of Nigeria Plc., African Continental Bank Plc., Pan African Bank Limited and Cooperative and Commerce Bank Plc. According to the Deputy Governor of the Central Bank of Nigeria, the measures were necessitated "by the alarming deterioration in the financial position of the banks which has not abated inspite of series of corrective measures taken by the regulatory authorities to resolve their problems." Besides, owners of the banks had defied the persistent calls on them by the CBN and the NDIC to "recapitalise their banks largely because the capital deficiencies of the banks are far beyond what the owners can afford ... the action was in the interest of their depositors and other creditors and the compelling need to maintain stability in the banking system."

(A) Further Strengthening the Arsenal of Regulations

By this singular action, what looked like a dormant or passive role of the regulatory and supervisory authorities is now made to bear on the system:

(i) What appears as too much emphasis on the automatic role of NDIC, of its deposit insurance function has been supplemented by other functions and active instruments made to intervene, sell or refloat a solvent bank in order to minimise damage to the banking system.

(ii) The *modus operandi* of the technical supervision of banks are now clear such that control and management are substantially tightened. Its mandate to take over the administration and where desirable, the ownership of such banks experiencing solvency problems are now uninhibited, and it must remain so.

(iii) The NDIC can now exercise its mandate to sell a problem bank, if the shareholders fail within a period to recapitalise or sell off its controlling interest. This it can do by making efforts to find potential buyers such that other than losses suffered by shareholders, loss of depositors and other creditors can be minimised.

(iv) To find interested buyers, NDIC must be able to give different funds with favourable guarantees to potential buyers at minimum cost.

(v) The need to further streamline the role of the NDIC on Deposit Insurance was apparent in the dispute that has arisen between NICON and two or more mortgage banks that have deliberately or otherwise confused **Bank Deposit Insurance Scheme with Fidelity Guarantee Insurance.**

(B) Should NDIC Insure Non-Licensed Banks' Deposit?

There is the school of thought that holds that NDIC should go beyond its existing operations and cover deposits of the People's Bank, the Community Banks, the Mortgage Banks and even the Finance Houses. This is at a time when there is crisis of confidence in the new outfits and evidence of the incipient stages of a pending financial crisis. Such a suggestion gives the impression that the NDIC itself can not run out of funds. The NDIC operations are limited to banks that have more capital base, a much more earning solid base and considerable management and it is already overwhelmed by problems from that sector. To super-impose on it an additional burden of insuring deposit of uncertain bubonic institutions is to court disaster for the system. At a time when all "deposit takers" depend on brokered deposits - an expensive and uncertain source of funds, gathered together by middlemen and shunted off to whoever pays the highest yield, and at a time when the investor-fund holder is dictating terms and creating a seller's market, the velocity of casualties of failed houses that will knock at the door of the NDIC will crash the financial system totally.

The solution to the above is as follows:

(a) Let the mortgage institutions and the finance houses respectively develop independent Deposit Insurance Schemes for their operations.

(b) Raise deposit insurance premium as a way of maintaining investor confidence, especially in this period of hyper inflation.

(c) Also, raise the limit/insured to ₦500,000.00. Both deposits and banks can share the cost of higher premium involved through higher fees for services or reduction in interest rates on deposits.

Finally, while the NDIC under Section 34 of its Decree has authority to enforce mergers and consolidations, it will be to the credit of the banking system's health growth and credibility to evolve mergers and acquisitions without prompting from regulatory bodies, where such actions will instill confidence of both the investing and patronising public.

(C) Limit to Limitless Funding by CBN

At the time the Central Bank took over the five banks, there were indications that two additional banks were in distress and about twenty-five other banks were illiquid, though not yet insolvent. This development raises other questions as to the source of funds with which the CBN and NDIC rescue these distressed banks. It also raises the issue whether both CBN and NDIC have limitless resources with which they can bail out every bank and all banks in distress. If the resources are from their operational surpluses, well and good. If, however, they have to resort to borrowing, printing notes just for the sake of salvaging banks, the implication for monetary management and policy as it is inflation-induced should be clear and unambiguous. That is why the two institutions must not hesitate to sell off the banks to willing buyers and customers as soon as possible. That is why, as an alternative, they must be ready to liquidate such banks where the situation warrants it. In addition to the above and for an effective open market operations being innovated in the system, the CBN has to be selective in the number of viable and healthy banks that can participate in the scheme in order to make it function efficiently.

Since the finance houses have been under the regulatory umbrella of the CBN effective 1991, the Central Bank must revise and prescribe their minimum capital requirement, provide prudential guidelines and institute a supervision technique over them to streamline many of their conflicting roles.

A Review of Firebrigade Sector Mode of Administration

As you can see from my treatment of the subject so far, it appears problems are being treated *ad hoc* and as they occur in each sector, without proper coordination, and the attendant implication of their inter-relationships. One or two examples will suffice:

(i) There is the call by the Finance Houses Association of Nigeria that the Central Bank of Nigeria should regulate the activities of Finance Houses and other financial institutions. While I share the view of the need for regulation of these finance houses to take account of their recapitalisation and management structure, I am often puzzled about the number of responsibilities the Central Bank of Nigeria is expected to shoulder, given its own limited human and management resources. The other time, I read in one of the papers that the Banking Supervision Department of the Central Bank carried out less than twenty five percent of its inspection and supervision functions during 1992. In the face of such inadequacies, the voluntary coming together of financial operators in forming associations to bring order, sanity, professionalism and ethics into the system should be encouraged instead of what looks like open confrontation which hightens loss of confidence in the system. The sadness attendant on the financial system is to see both the regulated and the regulator trading words and disputes and shifting responsibility. To read of Money Market Association of Nigeria denying Central Bank of Nigeria's allegation of usurping its powers and vice versa reflects lack of control going hay-wire. For example, both the operators and the regulators know the crushing effect of the rising interest rate on the economy generated by unhealthy competition for funds. Apart from "upfront interest payments" denying the government of tax revenue and increasing the cost of borrowing, the removal of such upfront interest payments should therefore be part of a package of understanding among operators for monitoring by the regulators.

Either for want of action or suffocation of duties from official quarters, a novel idea of compromise arrangement is being developed between corporate creditors and corporate debtors to solve their problems outside the orthodoxy. Unfortunately, this has been received with a great deal of hassle. Rather than for the regulatory authorities to openly castigate such scheme as function-usurpation, the working of mind and cooperation will be a way forward out of the financial quagmire.

(ii) In the case of the mortgage institutions, I was intrigued if not amused by the blunt and brutally frank castigation of mortgage institutions by Mr. John Akinloye and Dr. Salihu Karshi, Director of the FMBN and Chairman of Housing Policy Council respectively, about the obvious ambivalence in operational mismatch of their short-term borrowing in form of deposits and long-term lending for housing on the faulty expectation of "sharing" the National Housing Fund. On two occasions during the course of this year when I was asked to present papers on the future of mortgage operations in Nigeria, I drew their attention to three important issues which today are big challenges to all of them:

(a) their expectation on the National Housing Fund, where commercial and merchant banks and insurance companies will be compelled to lend to them at 4% the money which they are now competing for with the same institutions from the depositors; and/or which many of them place with the same banks or finance houses at market rate. Does it make sense? They disagreed.

(b) their operations so far are not for any mortgage lending; instead, they engage in LPO financing, other short-term banking and finance companies' operations without regard for any financial or prudential ratios. They deny.

(c) giving the present level of interest rates, it will be interesting to know how many mortgages they have financed, who are their customers and how they are coping with repayment. They say everything is fine.

Now that the new bosses at the helm of affairs at the regulatory apex of the housing finance sector see the need for the overhaul of the regulatory arsenal of that sector, maybe some sanity will be made to bear on the sector.

Review of the Financial System

Finally, the recent announcement by the Federal Military Government to set up an inter-ministerial-cum-departmental body to study the Naira exchange rate is to me again adhoc and half-measure, merely tackling one aspect of our financial system as a tool of monetary policy and leaving the rest blowing in the wind.

Any drastic improvement in our economic performance which will lead to productive and efficient revitalisation of our whole financial system is a function of financial discipline by all arms of government. For example, while it is true that devaluation breeds inflation, reduces the standard of living and kills industries, who is losing if the naira is artificially held down at ₦22 to the US dollar officially, when nearly all industries, if only to survive, are buying "under the counter" or "behind the scene" at ₦35 to the US dollar, not to talk of the bureaux de change and the parallel market rates of above ₦45 to the US dollar. How do we service our external debt of $35 billion at such terribly depreciated rate of exchange? The Federal Government embarked on weird spending that has nothing concrete and productive to show for it and committed the country to external debt it can not service. In effect, don't blame naira exchange rate depreciation; don't blame rising interest rate; don't blame negative reserves position; don't blame sustained balance of payments deficit; don't blame other adverse macroeconomic developments. Blame the underlying causes for what they are worth, which is the financial indiscipline at all levels of government, and provide a cure. That is why I share the view of Mr. Philip Ikhile, who realised that full blown explosion in the growth of our financial system can not but be accompanied by some realities of adverse and unintended developments and consequences; yet fail to acknowledge the problems when indeed they are real. The realities must be faced as fundamental and dismal; and solutions to them must be found and faced professionally and realistically - bearing short-term pains in order to be able to enjoy long-term gains.

For the rapid changes that have taken place in our financial system in the last fifteen years and the accompanying problems which are now proving intractable and insoluble, a full-blown Review of Nigeria's Financial System is now overdue, after the review of the system that was undertaken by Dr. Pius Okigbo in 1977.

That I have not stated the terms of reference will be a surprise. It is deliberate. The problems we have identified are themselves sufficient terms of reference. What I need to add is the compromised position of the Central Bank of Nigeria as an independent monetary authority for the successful implementation of macroeconomic policies. Some of us who fought or worked hard to see the Central Bank free from the dictates of the Federal Ministry of Finance wanted the Bank to be independent **not** of the Government, but to exercise its statutory functions, unfettered **within** the Government. When the good news came that the Central Bank was no more under the purview of the Federal Ministry of Finance, we did not think of exchanging for it the Presidency from where it receives marching orders that it can not resist. The consequence has been a shattering blow for the image of the Bank as revealed by the World Bank's Confidential Report on Nigeria for the period 1985 to 1991. The relevant part as it affects the Central Bank is quoted below:

> However, Bank staff attempts to account for the proceeds from oil production in 1990 produced a shortfall of foreign exchange inflows reflected in the official Central Bank cashflow of around $2.1 billion, of which only $0.6 billion can be explained by the two continuing dedication accounts.

In addition, the Report goes on :

> there is evidence to suggest that some N5.6 billion counterpart of around $0.5 billion of foreign exchange oil receipts reported by the Central Bank did not pass to the Federation Account Committee for distribution.

In this kind of situation, it will be hard put for the regulated to respect the regulator. And that is the big challenge for reforming the entire financial system.

TABLE 1
FEDERAL GOVERNMENT FISCAL OPERATIONS
(₦ Million)

Year	Current Revenue	Current Expenditure	Current Surplus (+) Deficit (-)	Capital Expenditure	Overall Surplus (+) Deficit (-)
1972	1,404.8	1,012.4	392.4	451.3	-58.9
1973	1,695.3	963.5	731.8	565.7	296.7
1974	4,537.0	1,517.1	3,019.9	1,223.5	1,796.4
1975	5,514.7	2,734.9	2,779.8	3,207.7	-427.9
1976	3,608.1	2,802.8	805.3	1,688.1	-882.8
1977	3.748.8	2,186.8	1,562.0	2,805.5	--1,243.5
1978	3.904.8	2,668.6	1,236.2	3,503	2,266.8
1979/80	8.311.1	4,017.0	4,353.5	7,739.0	-2,266.8
1981	7,511.6	4,846.7	2,664.9	6,567.0	-3,902.1
1982	5,819.1	5,506.0	313	6,417.2	-6,104.1
1983	6,572.0	4,956.2	1,315.8	4,680.3	-3,364.5
1984	6.938.5	6,275.7	662.8	3,277.9	-2,615.1
1985	9,640.3	7,215.3	2,425.0	6,005.2	-3,580.2
1986	7,969.4	7,696.9	272.5	8,526.8	-8,254.3
1987	16,129.0	15,646.2	482.8	6,372.5	-5,889.7
1988	15,525.0	19,409.4	-3,884.4	8,340.1	-12,224.5
1989	25,893.6	25,994.2	- 100.6	15,033.7	15,134.3
1990	39,033.0	36,219.6	2,813.4	24,929.1	-22,116.1
1991	31,774.5	38,243.5	-6,469.0	29,286.9	-35,755.9
1992	63.564.8	69,270.3	-5,705.5	38,453.0	-44,158.5
June '93	35,079.6	62,130.6	-19,600.0	745.1	-27,051.0

Source: (i) Professor S. Tomori's Lecture on the 2nd Adekanye Annual Leacture Table 1 28th October 1993.

(ii) Central Bank of Nigeria: Economic Report for the First Half of 1993.

TABLE II
MONEY SUPPLY COMPONENTS

	M1 Million	DEMAND Deposit (DD)	M1-DD Million	RATIO OF DD to M1	CURRENCY Ratio	M2 Million
1,984	12,204	7,321	4,884	60	40	21,600
1,985	13,268	8,358	4,910	63	37	23,819
1,986	13,105	7,927	5,178	60.5	39.5	24,592
1,987	14,906	8,607	6,299	57.7	42.3	29,995
1,988	21,149	11,736	9,412	55.5	44.5	42,780
1,989	25,698	14,009	11,688	54.5	45.5	46,223
1,990	37,234	22,293	14,941	59.9	40.1	64,903
1,991	49,365	26,256	23,108	53.2	46.8	86,153
1,992	82,165	45,399	36,765	55.3	44.9	135,280
June '93	82,634	38,017	44,617	46.1	53.9	150,496

M1 - DD = Currently ratio or money multiplier.

Source: Central Bank of Nigeria. Statiscal Bulletin Vol. 2. No. 2 1991 and Annual Report, 1992.

TABLE III

MONETISATION RATIO*

Year	GNP (N) Million	M1 (N) Million	M2 (N) Million	M1 to GNP	GNP DEFLATOR	M2 to GNP	GNP DEFLATOR
1984	63.006	12.204	21,600	19.4	0.04	34.3	0.06
1985	68.916	13,268	23,819	19.3	0.04	34.6	0.06
1986	71.076	13,105	24,592	18.4	0.04	34.6	0.07
1987	72,000	14,906	29,995	20.7	0.05	44.6	0.08
1988	77,000	21,149	42,780	27.5	15.6	55.6	30.7
1989	81,000	25,698	46,223	31.6	11.6	56.8	20.9
1990	88,500	37,234	64,903	42.1	14.4	73.3	25.1
1991	92,900	49,365	86,153	53.1	16.1	92.7	28.0
1992	96,800	82,165	135,280	84.5	17.8	137.8	29.2
June '93	N.A.	82,634	150,496	N.A.	N.A.	N.A.	N.A.

Source: Ratio of money supply to Gross National Product. Central Bank of Nigeria Annual Reports. Various Years.

Note: GNP Deflator = Real M1 or M2 at 1985 prices, i.e. $\frac{M1}{p=n}$ or $\frac{M2}{p=n}$

TABLE IV

FINANCIALISATION RATIO*

Year	GNP (N) Million	Merchant and Commercial Bank Assets (N million)	Ratio of Bank Assets to GNP
1984	63,006	34,563	54.9
1985	68,916	36,999	53.7
1986	71,076	48,124	67.8
1987	72,000	62,108	86.3
1988	77,000	76,430	99.9
1989	81,400	87,641	108.0
1990	88,500	111,551	126.0
1991	92,900	155,457	167.0
1992	96,800	232,279	240.0
June '93	NA	NA	NA

• Ratio of merchant and commercial bank assets to Gross National Product.

Source: Central Bank of Nigeria Annual Report. Various issues.