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BANKING SYSTEM CREDIT AS AN INSTRUMENT OF ECONOMIC GROWTH IN NIGERIA

BY

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INTRODUCTION

Globally, banks in developing countries are expected to play very vital and effective roles in financing their economic projects and activities as their contribution in ensuring sustainable economic growth. This expectation is as a result of the fact that there is acute shortage of capital in the developing countries of the world. For many years, theoretical discussions about the importance of credit development and the role that financial intermediaries play in economic growth have occupied a key position in the literature of developmental finance. According to Shaw [1973], financial or credit development can foster economic growth by raising savings, improving efficiency of loan-able funds and promoting capital accumulation. Banking system credit in Nigeria assumed a new dimension and was transformed by the recapitalisation and consolidation of banks which restructured them for better performance. Access to bank credit or financing improved commensurately in response to competition and the healthy state of soundness the banks attained.

It would be recalled that the banking crises in Nigeria in the 1990s was associated with major macroeconomic disruptions such as sharp increases in interest rate, large currency depreciation and devaluation and lasting decline in the supply of credit. The availability of bank credit allows firms to increase production, output and efficiency and in turn increases the profitability of banks through interest earned. Theoretical and empirical studies have shown that there is a visible positive correlation between banking system credit and economic growth. Modern economy is said to be a credit economy because of its importance in the financing of commerce and industry and in helping to stimulate economic viability, ensuring growth and development.

Several types of credit facilities are available to a Banking Service Provider [BSP] for financing business projects and investments. These credit facilities are obtained by means of financial documents or credit instruments and the credit facilities commonly obtained include the following.

a. Overdraft. These are credits facilities granted for the purpose of augmenting the working capital of businesses and it remains the most common credit facility for raising funds for firms.

b. Loans. Loans are credit facilities granted for specific purposes such as investment, construction, purchase of industrial machineries, execution of government projects et cetera. Loans considered too large to be financed by a single bank may be syndicated. Loan syndication involves a situation where a consortium of financial institutions such as banks, investment companies, or insurance companies combine to provide finance for a particular project in order to spread risk.

c. Commercial Bills otherwise referred to as Bill of Exchange is another form of credit facility in which payment is made after a determinable period of time usually ninety days for commercial purposes.

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For the sake of mentioning, Advances, Promissory Notes also referred to as IOU [I owe you], Cheques and Drafts are forms of credits facilities granted to individuals and households for sundry reasons. In developed economies, Credit cards also constitute a form of credit facility. Credit card holders are granted credit facility by banks for a specific period of time.

The objective of this paper is to explore how Banking system credit can be used as an instrument of economic growth and development in Nigeria. The paper is divided into five sections. Section one deals with the introduction, section two reviews the related literatures, section three highlights banking system credit as an instrument or tool of economic growth, section four analysed banking system credit in Nigeria and section five is the summary, conclusion and recommendation.

2. REVIEW OF RELATED LITERATURE

In developed and developing economies of the world, banking system credit spurs innovation and economic growth by identifying and funding productive investments. Theoretical and empirical literatures have shown that real money balance or liquidity which credit provides could be included as a factor in the production function because of its role in facilitating transactions, exchange and specialization. The availability of credits is a source of real money balance or liquidity. According to Ho [2005], there are

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several implications of the inclusion of real money balance as a factor in the aggregate production function. First, money has its own marginal physical productivity schedule like other inputs. Second, procedures in deriving the demand function of real money balance are identical to those of other production factors. Third, changes in money stock can affect aggregate output. Finally, real money balances have explanatory power over the rate of growth of total factors of production. Thus, banking system credit play a significant role in businesses and even in financing government investments. Credits are used to facilitate commerce, manufacturing, construction, mining and for providing capital for Small and Medium Enterprises [SMEs] in an attempt to enhance growth in the economy. It is often cheaper for businesses to borrow capital from the banks than to stockpile cash through savings. Thus, banks in most developed economies like Japan and the US exist to provide liquidity or working capital for commercial transactions such as stocking inventories or for expansion of businesses, capital formation and in creation of new businesses.

The availability of credit is important to the real economy. Globally, a positive change in credit availability has positive significant effect on the nation's Gross Domestic Product [GDP]. Again, modern economy is a credit economy because credits constitute a powerful source of liquidity and are considered as the oil of the wheel of commerce and industry. According to Nzotta [2004], it is generally accepted that bank credits influence positively the level of economic activities in any country. It influences what is to be produced, who produces it and what quantity is to be produced. Bank credits affect and alter the level of money supply in an economy or country. It is the most important source of bank income and it promotes the activities of banks and non-bank financial institutions and thus influences the level of growth of the financial system. It also affects aggregate output and productivity, the pattern of production, the level of entrepreneurship, and the realisation of aggregate economic performance, development and growth. It could thus be said with absolute assurance that banking system credit is of crucial importance both to the banks, the monetary authorities, business community and the economy in general

Credit may be viewed from two angles namely trade or commercial credit and banking system credit. Freear [1980] defined trade credit as transaction which involves the supplier handing over goods or performing a service without receiving immediate payment in exchange, that is, payment is expected to be made at some agreed later date. The purpose of trade credit is to facilitate sales, thus it is seldom referred to as 'consumer credit'. Basically, it involves some element of risk since cash is yet to be received and thus control is advocated to strike a balance between the desire to increase sales and the risk of increasing bad debts and subsequently liquidity shortage.

However, our focus in this study is on banking system credit which involves financing economic activities such as manufacturing, production, commerce, et cetera, by the provision of loans and overdrafts by banks and financial institutions. Japan depended greatly on banking system credit to revamp its war-torn economy in the 1950s, and that economic literatures referred to as the 'Japanese miracle'. In the Japanese experience, Small and Medium Enterprises [SMEs] that could not raise long term funds from the Capital Market were the major beneficiaries because it was realised that the SME sector constitutes the largest proportion of businesses in any economy and also provide the largest percentage of employment. SMEs' contributions to a nation's GDP cannot be undermined. According to European Central Bank, ECB, [2009] report, to put the importance of the banking sector in the Eurozone into perspective, by the end of 2007, bank loans to the Private sector made up 145per cent of Eurozone GDP, compared with 63per cent in the US. Even in Nigeria, credit has been recognised as an essential tool for promoting the economy. The Federal government have recognised that for sustainable growth and development to take place, the financial empowerment of the predominantly poor in the society and SMEs in particular is vital. If the growth strategy is enforced and the latent entrepreneurial capabilities of this large segment of the people is sufficiently stimulated and sustained, then positive multipliers will be felt throughout the economy. For this reason, various policies have been instituted over time by the Federal Government to improve production capabilities such as the People's bank, the introduction of Agricultural Credit Guarantee Scheme Fund [ACGSF], policy to positively augment the potential of SMEs in an attempt to enhance their standards as it were with such programme as Small and Medium Enterprises Equity Investment Scheme [SMEEIS] and to put the sector in the front burner of government's development strategy. All these were aimed at ensuring the growth of the economy but nothing is apparent to show for their success, not because the policies were bad per se but for hazy implementation without any concrete follow up strategies or monitoring institution charged with ensuring success.

3. BANKING SYSTEM CREDIT AS AN INSTRUMENT OF ECONOMIC GROWTH

All economic units need liquidity [liquid funds] for its operations, thus the availability of bank credit is an important source of real money balance; in other words, bank credit is a major source of liquidity for financing production and running the economy. Theoretical and empirical studies have shown that real money balance could be included as a factor in the aggregate production function. Sinai and stokes [1972], employed Cobb-Douglas [CD] production function to examine the potential significance of real money balance in the production function and explain its contribution or impact on GDP. This they demonstrated in Cobb-Douglas production function equation as follows:

$$Q = TK^{\alpha} L^{\beta} \quad m^{\gamma} u$$

Where:

Q = Output
K = Capital
L = Labour
m = Real money balances
T = Efficiency factor
α, β, γ = Elasticity of output with respect to Capital, Labour and Real money balances respectively.
U = Random disturbances.

The above Cobb-Douglass Production function shows that Output [GDP] is a function of real money balances [m] and other factors of production. That means that the level of Output at any given time depends on the level of real money balances [availability of credit to boost liquidity] and other factors of production. Ho [2005], opined that the above Cobb-Douglass production function equation could be re-written in such a manner to incorporate directly credit in place of real money balances. In his opinion, the production function equation above may be written as:

$$Q = f(X_1, C)$$

Where, Q = Output [GDP]

$X_1 = (X_1 X_2 ...... X_n)$ is a set of production factors.

C = the level of Credit available.

Taylor [1983], contends that the incorporation of a Credit factor in Cobb-Douglass production function directly reflects the contributions of financial institutions to aggregate production or output level of any economy and this is done vide the granting of loans and overdrafts to the productive sector of the economy. The emphasis is that the credit incorporated in Cobb-Douglas production function that contributes to aggregate GDP includes Credit to the Productive sector of the economy because Credit to the Productive Sector of the economy constitutes a factor of Production and not that expended on consumption. Based on the above economic facts we analyse below banking system credit in Nigeria.

4. ANALYSIS OF BANKING SYSTEM CREDIT IN NIGERIA

We attempt to analyse banking system credit in Nigeria in line with data provided by Central Bank of Nigeria [CBN], Statistical Bulletin [2007] for the period 1992 to 2007 as shown on table 1.

Table 1: Banking System Credit to the Domestic Economy [N million]

	Credit to other Private Sector	Credit to Non -Fin. Public Sector	Credit to state & Local Governments	Credit to Fed. Government. [Net]	Aggregate Credit [Net]
1992	76,098.7	2,347.4	1,512.8	91,112.1	171,071.0
1993	91,239.3	2,746.8	1,543.5	185,167.9	280,697.6
1994	145,103.9	3,655.4	2,241.0	288,113.5	439,113.8
1995	204,945.1	3,479.6	2,933.9	263,002.8	474,361.4
1996	255,558.8	1,524.5	3,530.2	110,465.6	371,079.0
1997	316,577.3	1,453.0	1,481.9	46,358.4	365,870.6
1998	370,706.7	13,933.6	941.3	133,929.0	519,510.6
1999	452,411.1	692.3	2,101.8	176,804.9	632,010.1
2000	587,486.2	9,51.0	7,564.3	[123,989.8]	472,011.7
2001	827,122.9	1,080.1	26,796.4	[6006.5]	848,992.8
2002	938,271.2	164.3	17,326.6	373,639.2	1,311,910.4
2003	1,281,125.5	212.0	2,0234.9	552,569.3	1,833,694.8
2004	1,507,885.2	1,930.8	24,631.8	485,725.5	1,993,610.7
2005	1,950,379.8	2,449.4	54,526.6	306,031.9	2,256,411.7
2006	9,165,912.2	29,117.2	1,931,36.1	[2,631,650.1]	6,756,515.4
2007	15,558,801	13,249	240,506	[9,954,984]	5,857,572.0

Source: CBN Statistical Bulletin, Vol. 18; 2007; pp. 69-70

Evaluating the effect of credit growth to output raises a number of burning issues. According to CBN statistical bulletin [2007], the total aggregate credit [Net] disbursed by Banking Service Providers [BSPs] to the domestic economy in Nigeria grew astronomically from N171,071. 00 million in 1992 to an aggregate [Net] total of N5,857,572 million, that is, [Five trillion, eight hundred and fifty seven billion, five hundred and seventy two million naira only], with credit to the Federal Government standing on a negative balance of N9,954,984 million in 2007. For the same period, credit to the Private sector alone grew from N76,098.7 million in 1992 to N15,558,801.00 million in 2007, that is, over fifteen trillion naira. Going by the CBN figures, this is quite a colossal sum and to be fair to Banking System Providers [BSPs], it is a tremendous performance but the question that readily comes to mind is how has this credit affected output to spur growth in the economy? To ease our analysis, we present below in table 2, Banking system credit to the domestic economy for five selected years showing total credits and their percentages to the various sectors of the economy.

Table 2: Banking System's Credit to the Domestic Economy [N million]

	1999	per cent	2001	per cent	2003	per cent	2005	per cent	2007	per cent
Aggregate Credit [Net]	632,010	100	848,992	100	1,833,694	100	2,256,411	100	5,857,572	100
Credit to FGN	176,805	27.98	[6,007]	-0.71	552,569	29.80	306,031	13.56	[9,954,984]	-169.95
Credit to State & Local Government	2,102	0 33	26,796	3.16	20,235	1.09	54,526	2.41	240,506	4 10
Credit to Non Financial Public Enterprise	692	0.11	1,080	0.13	212	0 01	2,449	0.11	13,249	0.23
Credit to other Private Sector	452,411	71.58	827, 123	97 42	1,281,125	69.10	1,950,379	86.44	15,558,801	265..62

Source: CBN Statistical Bulletin, 2007; Percentages computed by the author

4.1 Credits to the Federal Government

The role of the Federal Government in ensuring economic viability, development and sustainable growth is quite enormous. To accomplish its task, the Federal Government seldom resorts to borrowing from both international and local creditors. According to CBN statistical bulletin [2007], banking system credit [net balance] to the Federal Government stood at N91,112 million in 1992, representing 53.25 per cent of total credits to the domestic economy. Over the years, though with increase in value term, there have been a downward trend as per the percentage of credit disbursed to the FG, for instance, in 1999 and 2005, credit extended stood at N176,805 million and 306,031 million, representing 27.98 per cent and 13.36 per cent respectively. Obviously, the decline in banking system credit among other vices such as corruption, lack of proper monitoring and feedback mechanisms are responsible for the deteriorating state of Federal infrastructures and the slow pace of economic growth in general.

Credits to State and Local Governments

The State and Local governments play complementary roles to that of the Federal government in the provision of basic infrastructures and landmarks on which the economy thrives. Good governance requires proper funding, thus the importance of banking system credit to State and Local governments cannot be overemphasized.

For the period under review, banking system credit to State and Local governments in 1992 stood at N1,512 million representing 0.88 per cent; in 1999, it was N2,102 million representing 0.33 per cent, in 2003, it was 20,235 million representing 1.09 per cent and in 2007 it stood at 240,506, representing 4.10 per cent of total credits to the domestic economy. The low range of percentages indicates that banks are stringent or reluctant in disbursing credit to State and Local governments. The reason may not be far-fetched. Since there is no continuity in governance in Nigeria, the fear that loans obtained by an administration may not be repaid by the succeeding administration constitutes a basic factor. Another may be the degree of corruption and abuse of public funds by government officials.

Credits to Non-Financial Public enterprises

Non-Financial Public enterprises comprise of companies and enterprises controlled by government or government owned corporations and companies which differ from publicly quoted companies. Well managed and efficient non-financial public enterprises such as the railway corporation acts as a pivot for economic growth and development in any economy. For fast growing developing countries like Japan and India to name a few, with proper monitoring strategies put in place, bank funding is concentrated in this sector as a result of its contributions to the viability of the economy in general and its importance in the provision of employment in particular. Sadly, in Nigeria this very important productive sector of the economy appeared neglected such that corporations in this sector like the Nigeria Railway Corporation, Power Holding Company of Nigeria [PHCN] and Nigeria Airways appeared non functional or dead. The frustrating state of these corporations has been adjudged by some stakeholders as due to its poor funding. CBN Statistical Bulletin [2007] revealed that banking system credit to this sector in 1999 was N692m representing 0.11 per cent, 2001 was N1,080m representing 0.13 per cent, 2005 figure stood at N2,449m representing 0.11 per cent and of the N5,857,572m net positive balance of banking system credit made available to the domestic economy in 2007, only a paltry sum of N13,249m representing 0.23 per cent was channelled to this sector in the first quarter of 2007 and nothing in the rest quarters. This explains why the productivity capacity of this sector is low with resultant negative effect on exports and hence foreign earnings. With this level of performance, Nigeria dream of attaining economic freedom or power in 2020 as we move closer could be a mirage as was “Housing For All in 2000” in the twentieth century.

Credits to Other Private Sector

Private sector, void of government control consists mainly of private companies, Small and Medium Enterprises [SMEs], individuals and households. A very large proportion of this sector consists of households and the peculiar characteristic of households in every economy is consumption. Consumption is their basic reason for the demand for credit. In explaining the circular flow of product and income in an economy, Iyoha [2004], posits that 'households exchange money for goods and services provided by the business firms'. For reasons that most SMEs do not posses necessary collateral to meet lending requirements in Nigeria, we may conclude that a very large proportion of credit to this sector was granted to households who are mainly salary earners and whose primary reason for demand for credit facility is consumption purposes. Judging from the discouraged state of SMEs in the country, this assessment is absolutely considered true.

According to CBN statistical Bulletin [2007], while a paltry of N13,249 million representing 0.23 per cent of total credit to the domestic economy was channelled to Non-financial public enterprises for productive investments, a whooping sum of N15,558,801m representing 265.62 per cent was channelled to the Private sector basically for consumption purposes in 2007 alone. Credit to the Federal government for same year stood on a negative balance of [N995,984m] representing -169.96 per cent. In 2006, first year after the recapitalization exercise the gains of recapitalization or improved bank balance sheets was felt only by the Private sector as credit demanded basically for consumption rose from N1,950,379.8 million in 2005 to N9,165,912.2 million in 2006, and to N15,558,801 million in 2007. The implication of this is that Nigeria consumes far greater than we produce and the consequences of that are dreaded anywhere.

Discussion on Findings

In this paper, we attempt to show how banking system credit can be used as an instrument of economic growth in Nigeria. Our analysis is carried out from the viewpoint that economy grows when the productive sector is funded thus making credit or bank lending a factor of production, that the concentration of banking system credit on private sector largely made up of households whose primary reason for the demand for credit is consumption negates economic reality for growth as we have in the Nigerian economy.

From available records, Nigerian banks presently find solace in lending to private salary earners rather than lend to companies and SMEs which operate under stress of inadequate infrastructure, poor roads, epileptic power supply, inadequate water supply, etc. As a result, majority of bank credit products these days are aimed at individuals. These come in the form of Personal loans, Utility loans, Auto loans, Asset acquisition loans, LPO finance, Cash Overdraft Against Salary treasure [COAST] etc. Consumption centred economy negates the principles of Cobb-Douglass production function and cannot influence economic growth. This is because consumption impacts negatively on our foreign reserve with dire consequences on the rate of exchange and the power of our domestic currency- the naira. The near hyper-inflation rate prevalent in our economy emanates from this level of consumption. High level demand for credit for consumption coupled with inflation weakens the capacity of banks to finance large scale investment projects that contribute to output. As a result, the contribution of Banking System Credit to the domestic economy, though looks enormous, its impact on output or GDP is estimated too weak or near zero. To reverse this trend, deliberate efforts must be made by government, monetary authorities and policy makers to channel adequate funds from the banks to the productive sector of the economy.

On the other hand, banks appear reluctant to lend to SMEs for several reasons, The dwindling operations of SMEs, resulting in low profits and hence the inability to repay credits and the spending spree or 'the deliberate refusal to pay attitude' of entrepreneurs who hardly realise that bank funds are for investment purposes only may be possible reasons. SMEs too dread to demand for credit as a result of lack of necessary collateral security and the high cost of credit, that is, the interest rate and other associated charges coupled with the harsh macro and micro economic factors militating against their operations. Presently, the lending interest rate prevalent in most banks ranges from 18 per cent to 2 3per cent and that is considered too high for the survival of SMEs. As a result of these factors, demand for credit for production or by the productive sector is consistently on the decline overtime.

Though the Federal Government, Monetary and Regulatory authorities have been striving to overcome the adverse factors inhibiting economic growth and development, more efforts and direct policy have to be channelled towards ensuring that SMEs are well funded and if well funded, utilization of such funds must be well monitored with appropriate sanctions melted to defaulting bankers and customers alike by government. Under the Abacha administration, bank executives were incarcerated on ground of faulty credits and in the immediate past administration of President Yar'Adua, bank executives were sacked for same reason which was claimed to be responsible for the poor performance of concerned banks. Though not impossible, it is very rare for a prudent banker cum bank to deliberately package or grant faulty credits knowing the consequences of what that means to the bank. For each faulty credit, the law has been brutal on bank executives. In practice, it takes the integrity of the customer for the best packaged credit to succeed but the Nigerian context of being a 'big man' is to nonchalantly and deliberately flout rules, whether national or organizational and this jinx must be controlled in our national life. In this dispensation of democracy and the 'Rule of law' policymakers must enact rules to hunt bank credit defaulters and policies aimed at the private sector compelling deliberate reduction on consumption by placing very high monthly or yearly taxes actively enforced and collected on some grades of automobiles to curtail the drain on our foreign reserve. CBN directive on mandatory use of credit bureaux by banks before granting credit facility to their customers is a welcome development and this will help in reducing the incident of nonperforming loans in the country.

For most fast developing nations, bank consumer credit, that is, credits granted to finance the purchase of non-productive goods should not be allocated the greatest percentage of total credit to the domestic economy as it appears to be the case in Nigeria. According to Mckinnon complementary hypothesis, such development is less efficient in the process of economic growth and hence might lessen the contribution of banks credit to growth [Mckinnon, 1973]. From the analysis, the contribution of banking system credit has been less significant in the economic growth process in Nigeria as SMEs appeared neglected and large scale investment projects are not given the needed attention and are largely financed by foreign funds.

5. Summary, Conclusion and Recommendation.

In this paper, attempt was made to address how banking system credit can be used as an instrument of economic growth in Nigeria. The specific objectives that banking system credit were expected to achieve were also stated. It was revealed that though credits have increased tremendously in recent times, the expected effect on domestic economy and output or GDP in particular is not significant. While credits to Non-Financial Public Enterprise and other productive sectors declined consistently, credit to the Private sector comprising mainly of households whose demand for credit facility is basically for consumption increased astronomically. The implication of this lopsided distribution of banking system credit is that the Nigerian economy is consumption based and that negates the principle of Cobb-Douglass production function because credits channelled for consumption do not impact or influence output or GDP growth as other factors of production do, rather it drains the foreign reserve thus weakening the domestic currency with its concomitant influence on inflation.

In conclusion, it was clear that

banking system credits have no significant impact on the economic growth in Nigeria. This is expected to be a pointer to the Federal Government, monetary and regulatory authorities for them to put in place policies aimed at reversing the trend of a consumption-based economy to a productive-based economy, so that the Vision 2020:20 could become a reality.

Based on the above, we recommend that appropriate policies be formulated to ensure that the productive sector of the economy particularly SMEs are funded. Credit bureaux should be empowered as the 'NAFDAC' to arrest and prosecute erring bankers and customer's alike rather than approving loans which is the exclusive rights of professional bankers. This means that Credit bureaux has no business with loan applications but should be concerned with the monitoring and scrutinising of monthly credit returns to detect slow and potential bad and doubtful loans, advances and overdrafts of certain magnitude for immediate legal action.

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