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THE ROLE OF THE CENTRAL BANK IN THE NIGERIAN ECONOMY*

BY

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Given the unstable macro-economic environment which has prevailed in Nigeria in the last few years and the great interest and concern this has generated among professionals and the general public, I consider it appropriate to focus my presentation on *"The Role of the Central Bank in the Nigerian Economy"*, with a view to highlighting the bank's responsibilities and its contributions within the broad context of macro-economic management in the country.

BACKGROUND

2. For a start, let me provide a brief background on the general objectives of a central bank. From an international perspective, a central bank has two major objectives:

(a) It performs some traditional functions such as the issue of currency, provision of banking services to the government, control of credit, acting as a lender of last resort and supervision of banks. These functions come under its "stabilization" role; and

(b) It promotes general economic development by implementing financial policy measures aimed at achieving specific national development objectives. These come under its "developmental" role.

These two broad goals generally reinforce each other. Consequently, central banks in both developed and developing countries always endeavour to strike a balance between the two fundamental goals.

THE ROLE OF THE CENTRAL BANK OF NIGERIA (CBN)

3. Since its establishment in 1958, the objectives of the CBN have remained broadly the same, but the strategies for achieving these objectives have changed in consonance with the varying legal, institutional and macro-economic environments:

(a) The various amendments to the CBN Act of 1958 and the Banking Decree of 1969 tended to erode the authority of the CBN with regard to the execution of its primary mandate. However, the CBN Decree No. 24 of 1991 and the Banks and Other Financial Institutions Decree (BOFID) No. 25 of 1991 which replaced the previous CBN and Banking legislations made an attempt to strengthen the bank's supervisory role in response to the widened scope of its activities and financial sector reforms initiated since 1986. It is noteworthy that the CBN Decree of 1991 gave the Bank direct access to the Presidency in contrast to the practice of its reporting through the Minister of Finance;

(b) Owing to the rapid structural growth of the financial sector in the last three decades, the Bank has modified the nature and style of its surveillance. It has systematically developed policy instruments more relevant for a market-based financial sector. The Bank's size and structure have also witnessed a corresponding growth; and

(c) The Nigerian economy has recorded vast structural changes, resulting in varying approaches to economic management. Economic management moved from reliance on control mechanisms in the late 1960s and up to 1985 to a system of deregulation between 1986 and 1993 and back to the use of control in 1994. The Bank's response has influenced its operations appropriately through the establishment of the relevant bureaucratic structure and technologies.

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THE ROLE OF THE CBN IN PERSPECTIVE

Given the dynamic economic setting in which we operate, the role of the CBN has continued to evolve since its inception. The process of evolution can be summarised as follows:

(a) In several ways, the period up to 1981 could be regarded as the golden period for the Bank. It successfully took off as a virile institution and effectively carried out its traditional functions of currency issue, external reserve management and monetary control. In partnership with the Federal Government, the CBN has supported key financial institutions in the money and capital markets which have played a significant role in shaping the course of Nigerian economic growth and development. Examples of such financial institutions are the Nigerian Industrial Development Bank (NIDB), Nigerian Bank for Commerce and Industry (NBCI), Nigerian Agricultural and Co-operative Bank (NACB), Federal Mortgage Bank of Nigeria (FMBN) and the Agricultural Credit Guarantee Scheme Fund (ACGSF).

(b) Economic developments in Nigeria since 1981 have been unique. The Bank made critical inputs into the decision to modify the style of economic management in 1986 and has played an active supporting role, especially in the management of the Foreign Exchange Market (FEM), implementation of financial sector reforms, management of domestic and external debt and introduction of Open market Operations (OMO). The Bank also continued to promote financial intermediation through its support for institutions and schemes such as the Nigerian Deposit Insurance Corporation (NDIC), Nigeria Export-Import Bank (NEXIM), Refinancing and Rediscounting Facility, Export Stimulation Loan Scheme, as well as the Rural Banking Scheme, etc.

IMPACT OF CBN'S ACTIVITIES

5. In appraising the performance of the Central Bank, it should be stressed that what matters most, is the impact of the activities of the Bank on the Nigerian economy. In this regard, I wish to examine two aspects - the effects of its actions on the overall targets of economic policy and the intermediate target variables:

(a) With regard to the overall targets of policy, it is clear that macro-economic stability and sustainable growth have so far remained elusive. While inflation, GDP growth rate and developments in the balance of payments have behaved contrary to expectation in recent years, I would want to caution that the exact impact of CBN's policies on the overall targets of economic policy is generally difficult to establish, owing to the complementarity of monetary and banking policies with fiscal and other sectoral policies which are outside the control of the CBN;

(b) With the increasing incidence of distress in the financial sector, the regulatory capacity of the CBN has been called to question. While I acknowledge that more needs to be done in this regard, I wish to state that concerted actions by all parties are needed to resolve the underlying causes of distress, such as macro-economic and policy instability, unsound banking practices by operators, insider dealing and abuses and the negligence of directors and shareholders, among other factors.

6. While there has been a tendency to focus on the short-term adverse trends in the economy, I should like to argue that the ultimate effects of many of the bank's actions in recent years would have their potential benefits materialize in the future. For example, the liberalised financial sector which the bank has assiduously fashioned out since 1986 is bound to have positive influence on the long-term growth and development of the economy. Equally, maximum benefits will in future be derived from the bank's contributions to research, man-power training and efforts to harmonize supervisory activities in the financial sector, through rigorous enforcement of the prudential guidelines.

CONSTRAINTS ON CBN'S PERFORMANCE

7. The Bank has needlessly operated under some serious constraints which should be minimized so as to enhance its performance. Let us briefly highlight some of these constraints.

(a) The mandatory financing of the huge fiscal deficits of the government has made monetary control, price, exchange and interest rates stability difficult to achieve;

(b) The prevalence of policy inconsistency and instability has made monetary policy outcomes to diverge from targets;

(c) The lapses in policy co-ordination and implementation have impacted negatively on the productive sectors;

(d) The pervasive intervention by governments in the financial sector has often sent conflicting signals to the public, especially when there was no co-ordinating arrangement to guide the actions of the regulatory authorities;

(e) While the Bank has operated more freely in its present relationship with the government, it is constrained by certain legal provisions which require it to seek approval on issues, such as the liquidation of banks, that require prompt responses;

(f) The Bank has been largely overwhelmed by the large-scale mismanagement in financial institutions, as well as dishonesty and lack of transparency by both financial industry operators and directors which are symptomatic of the general indiscipline in the society as a whole; and

(g) There are general limitations imposed by inadequate statistics and infrastructure.

LOOKING TOWARDS THE FUTURE

8. Distinguished Ladies and Gentlemen, I feel convinced that the CBN's contributions to the Nigerian economy can be enhanced if these constraints are eliminated or reduced to the barest minimum. Immediate actions are, therefore, needed to:

(a) effect appropriate amendments to its enabling laws to permit the Bank to act more independently on critical issues;

(b) get bank operators and directors to act more honestly and professionally in managing their institutions;

(c) enact a new law to deal with dishonesty, mismanagement and insider - abuse by bank operators, especially those whose actions brought adversity to their various institutions. It is noteworthy that, in this regard, the Federal Government has co-operated fully with the CBN and NDIC to enact the necessary legislation which is expected to be in the statute books soon.

(d) strengthen the implementation of monetary policy through greater policy co-ordination; and

(e) restructure the Bank towards greater focus on its fundamental policy concerns. One important aspect of these actions is a clearer definition of the relationship between the Bank and the government. The trend world-wide is to grant greater autonomy for the central bank to ensure sustained macro-economic stability and growth. What the CBN needs, in addition to its present administrative autonomy, is instrument independence. This implies that after the government has set the broad objectives of economic policy, the CBN should be given the discretion to choose the appropriate instrument(s) and when to apply them to achieve the desired objectives. Such instruments which the CBN should be allowed to manipulate appopriately include the monetary aggregates as well as exchange and interest rates, backed up by adequate consultation and co-operation with the government, such an independent status would produce a salutary effect on the economy. Given such autonomy, the tenure of the CBN Governor should be tied to the achievement of the policy objectives and targets.

CONCLUDING REMARKS

9. Mr. President, Distinguished Ladies and Gentlemen, in conclusion, I wish to assert that although the challenges which lie ahead of the CBN are enormous, if not daunting, the Bank will respond adequately if given the support to carry out its functions. Its contributions to the economy will be enhanced and its role in creating a robust financial sector will increase. Lifting my gaze and making some prognosis regarding the character of the CBN by the year 2,000, I see a smaller outfit both structurally and functionally. Shed of some of its developmental activities which can effectively be taken over by other agencies, it should focus on its stabilization functions which can sustain price stability and restore full confidence to the financial sector. If given the automony that I have discussed earlier, it should become a more effective, efficient and responsive institution, gaining greater confidence of the general public.

Mr. President, Distinguished Colleagues, Ladies and Gentlemen, in concluding this Address on a note of optimism, I want to remind all of us that it is our actions that create the institutions we have. It is a challenge to all of us - the government, the CBN, financial operators and the general public - to create a Central Bank, within a suitable environment, that is sufficiently responsive to the needs of the economy.

I Thank you all for your kind attention.

"I wish to assert that although the challenges which lie ahead of the CBN are enormous, if not daunting, the Bank will respond adequately if given the support to carry out its functions. Its contributions to the economy will be enhanced and its role in creating a robust financial sector will increase. Lifting my gaze and making some prognosis regarding the character of the CBN by the year 2,000, I see a smaller outfit both structurally and functionally. Shed of some of its developmental activities which can effectively be taken over by other agencies, it should focus on its stabilization functions which can sustain price stability and restore full confidence to the financial sector."

SOURCES AND MANAGEMENT OF EXTERNAL RESERVES IN NIGERIA

BY

Newman C. Oputa

Abstract

Reserves are all those foreign assets of a country held by the monetary authorities which can be mobilized at periods of external imbalances with ease and certainty. External reserves are held either in the form of "earning assets" notably government's foreign securities or in the form of "non-earning" liquid assets like gold bars in the vault of Central Banks. In Nigeria, the composition of the external reserve consists of gold, IMF reserve tranche, Special Drawing Rights (SDRs) and convertible currencies. The major sources of external reserves are derivable from the components of foreign exchange inflows which include: receipts from petroleum, service incomes, other invisible items, capital importation, interest payments on foreign securities, external borrowing/ foreign aids and grants, non-oil export proceeds among others. Over the years, the external reserve management policy measures put in place had been trade and exchange control, foreign exchange budgeting, foreign currency diversification and exchange rate. A review of the attained levels of reserve for the period 1970 through 1993 using the reserve/import ratio revealed that the levels of external reserve were considered inadequate in 1970-1973, 1978, 1981-1985, 1987-1988, 1992 and 1993 while adequate levels were sustained in 1974-1977, 1979-1980, 1986 and 1989-1991. The periods of reserve adequacy corresponded with years of improved receipts from the oil sector while periods of inadequacy were characterized by huge outpayments. An analogy drawn from the analysis was that regulations were tightened during periods of declining reserves while the value of imports surged immediately after periods of reserve build-up. Also, in the 1970s exchange control measures applied were meant to conserve the level of reserve while in the SAP period, deliberate policy measures were directed at shoring up the value of the reserve through the exchange rate policy measures. A critique of policy measures in the pre-SAP period showed inconsistency in the set objectives pursued while in the SAP years, the exchange rate policy measures proved unsuccessful with the sustained rates not generally accepted as being realistic. Suggestions proferred were the urgent need for a medium to long-term external reserve management policy guidelines for the country, a revisit of the option for the establishment of investment offices in few commercial centres abroad to handle the management of the country's foreign securities and engage in rigorous portfolio forecasting and management, the full implementation of the government's export policies to increase inflow, the effective enforcement of the reserve/current liabilities criterion to allow for a sustained reserve build-up and the determination of a more realistic exchange rate that would shore-up the value of the external reserves.

1. INTRODUCTION

Reserves are external assets of a country which are made readily available to and controlled by monetary authorities for direct financing of payments imbalances, for indirectly regulating the magnitude of such imbalances through intervention in exchange markets and/or for other external commitments[1]. The level of reserve in a country is influenced by external sector developments such as international trade transactions, exchange rate, external debt and other related external obligations. However, when reserves are used for financing domestic foreign exchange needs, they could exert pressures on the internal monetary environment. Thus, if a country's trade volume increases, banks and other financial intermediaries may exert increasing pressure on her international reserves. This scenario calls for a continuous effort by a country at effectively managing her reserve to an optimum level that would sustain her numerous external commitments.

The concept of reserves should encompass those assets over which the monetary authority of a country exercises direct and effective control and this conditions must be applied "very strictly." A country's external assets may be erroneously confused as its external reserves. Nigeria's external assets comprise mainly of the foreign holdings of the Federal Government, semi-official institutions, state governments, commercial and merchant banks and that of the Central Bank. The monetary authority's component of the external assets constitutes the external reserve of the country. External reserve may be interpreted in terms of its gross or net position. The gross reserve comprises the monetary gold, the reserve position in the Fund, convertible foreign currencies referred to as the foreign exchange reserve and SDRs with the Fund. The net reserve is a residual component derived from subtracting the current foreign liabilities of the monetary authorities from the gross reserve (Gross reserve minus current foreign liabilities). However, the gross

[1] IMF (1993), "Balance of Payments Manual" Fifth Edition, Page 97.