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## Keynote address at the 3rd CBN Executive Seminar

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## Keynote Address

by

Mr V. A. Odozi\*

Distinguished Ladies and Gentlemen,

### 1. Introduction

I should begin by expressing appreciation for the opportunity offered me to be with you today as the Special Guest of Honour and to deliver the keynote address on the occasion of the third in the series of annual Central Bank of Nigeria in-house Executive Seminars organised by the Research Department in collaboration with the Personnel Department. The first seminar, held in 1993, dealt with the nexus of policies pursued under the auspices of the Structural Adjustment Programme. The second seminar, held in 1994, was on the theme: "The Nigerian Banking System: Policies, Issues, Problems and Prospects".

At this juncture, I wish to note that a major objective of the Executive Policy Seminar is to update our Executive staff's knowledge and understanding of economic and financial policy issues and thereby enhance their contribution to policy design and implementation. Feedbacks received indicate that this objective is already being realised.

The objective of the Executive Policy Seminar should, however, go beyond an understanding of economic and financial policy issues. An occasional exercise in critical self-appraisal is highly desirable. That is why the theme of this year's Seminar, namely: **Central Banking - A Case Study of The Central Bank of Nigeria**, is unique and breaks new grounds. Furthermore, the theme of this Seminar is highly relevant for the following reasons:

**First**, Central Banking is our business and devoting some time to discussing it, away from the pressures of daily routine which tends to overwhelm most Executives these days, is likely to offer rather interesting insights on how we stand.

**Second**, the CBN has for sometime now, especially in the last one year, received a rather bad press and, whether deserved or not, this is not a desirable state of affairs. It is, therefore, necessary to find out at a seminar such as this, what had gone wrong and how we could put things right in order to redeem our dented corporate image. Of priority importance is the need to evolve an effective information management strategy to explain developments in the economy and CBN's role and measures.

**Third**, this seminar offers an opportunity for an informed discussion on the highly topical issue of CBN autonomy.

Distinguished Ladies and Gentlemen, I have perused the Seminar's programme and noted that there are 14 technical sessions devoted to the main theme and sub-themes on some

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critical aspects of the Bank's operations. It is, therefore, a very rich agenda of relevant issues and I am indeed delighted to be involved in raising some of the leading issues even if I would not address them in detail.

## **2. The Challenges Facing the CBN**

In setting the ball rolling, as it were, I intend to share with you my thoughts and concerns on some of the challenges currently facing the Central Bank in its major areas of operation.

**First**, the Central Bank is called upon to do far more than is practicable at a given point. For instance, the commercial banks have been complaining that we are competing with them in retail banking. I am also aware that quite a number of informed impartial observers are critical about the CBN being saddled with retail banking functions through the maintenance of chequing accounts for public sector institutions of various descriptions. It is, of course, recognised that a Central Bank in a developing country would have to undertake a number of non-traditional central banking functions, especially where there are no other institutions that could provide such services in a safe and efficient manner. However, where such institutions exist or have emerged, maintaining the non-traditional functions involves high opportunity costs i.e. it is detrimental to the performance of the more traditional functions such as monetary policy management and banking supervision, there is a strong case for rationalisation of the functions of the Central Bank, to give increased focus and channel resources to the achievement of its major goals, namely, price stability, currency issue and the safety, soundness and efficiency of the banking system.

**Second**, the challenges that face the Central Bank of Nigeria are legion and I cannot, given the constraints of time, begin to articulate them here. I intend to highlight them in the expectation that, at the appropriate times during the technical sessions, you would explore the issues in some depth. The challenges include the achievement of price stability; effective banking regulation and supervision, including the designing of an effective framework for resolving banking sector failure/distress; the restoration of confidence in the system; checking the increased incidence of fraud; payment system reform; and in-house capacity building and management succession. The issues subsumed under the above list of challenges are far-reaching and would perhaps require another seminar to do justice to them. However, I hope that some attention would be given to them on this occasion.

## **3. The Issue of Central Bank Autonomy**

Distinguished Ladies and Gentlemen, on an occasion such as this, where the theme is Central Banking, it would be appropriate for me to make some observations on the issue of greater autonomy for the Central Bank of Nigeria. Whether we call it independence or autonomy, there is need from the start to state what it does not mean!

Autonomy does not mean that the CBN is absolutely independent of Government. It does not mean that the CBN is above the laws of the land or unaccountable to nobody. It also does not mean that the CBN has absolute freedom to spend and award contracts irrespective of the value. Finally, it does not mean that the CBN is free to choose its goal or mandate.

The second observation I wish to make is that in the last decade or so there has been a global trend towards increased central bank independence. This development followed the world-wide



acceleration of inflation especially in the 1970's. In this connection, with the failure of fiscal policy in most countries, as embattled governments and vote-seeking politicians sought to achieve their aims by resorting to money-printing, it was recognised that only central banks, insulated from executive/political pressures and given an anti-inflation mandate, could ensure the achievement of price stability.

Third, in the realm of economic theory, two developments have served the cause of central bank independence: the first was the death of the so-called Phillips Curve i.e. the recognition that, after all, there was no long-term trade-off between inflation and employment. The second was the failure of the monetarist experiment in America and, ipso facto, the Friedman's solution of "rules rather than discretion" - the so-called 'K' per cent rule.

To complete the theoretical foundation, I wish to mention the theory of public choice which is often introduced into the discussion of central bank independence to justify the proposition that central bank officers do not serve the public interest but their own and, therefore, should not be entrusted with much discretion. This allegation has been effectively countered by the argument that the self esteem of central bank officers is enhanced by the achievement of their major mandate, - namely, price stability, which enhances the public good.

My fourth observation is that if there is any doubt that the case for central bank independence has a sound theoretical foundation, there is no doubt about the empirical evidence which is overwhelming. The finding is that "the higher the degree of independence of a central bank, the lower, as a rule, the average rate of inflation, and the smaller are the fluctuations in a country's price movements" (O.Issing, 1993). Furthermore, there is some positive correlation between the independence of a central bank and economic performance. This is amply demonstrated by the fact that the more independent central banks are those of the more developed economies. It is, therefore, not surprising that Germany whose central bank, the Bundesbank, is ranked as the most independent also has the most stable currency in the world and consistently good economic performance.

Fifth Observation: I have tried to state what central bank autonomy, in the Nigerian context, is not! I have even made a case for it without defining what it is. Now, I would like to expatiate on what central bank autonomy should be. First of all, we need to distinguish between goal/mandate independence and instrument independence. Goal independence implies that the central bank is free to choose its goal or mandate. Instrument independence, on the other hand, means that after the goal or mandate had been determined by the appropriate political authority e.g. Government or the National Assembly, the Central Bank should be free to select the appropriate instruments for the achievement of that mandate. Specifically, the concept of central bank independence, envisaged in the Nigeria context, embraces the determination of the goal of the Central Bank by the Executive/Legislative authorities; the granting of powers under the law to the Bank to select and use suitable instruments to fulfil that mandate; and accountability by the Bank for its performance through periodic reporting to and reviews by the relevant Executive/Legislative authorities. Additionally, it implies freedom from Executive and political pressures on the Bank to act against its better judgement or in a manner inconsistent with the achievement of its mandate. Finally, it implies the endowment of the Bank with enhanced powers to act more promptly and decisively in dealing with distressed institutions and erring officers of banks.

In my view, the above model of central bank independence not only addresses the need for an effective vehicle for dealing with the problem of entrenched inflation but also takes care of the concerns about central bank independence, such as alleged "democratic deficit" or the theory of public choice. With respect to the problem of policy co-ordination, which might arise with the advent of an independent central bank, there are a number of possible solutions. However, the one



I find most relevant is the establishment of a Committee on Fiscal and Monetary Policies with a clearly defined mandate. Such a committee would provide a forum for policy consultation, clarification, harmonisation and review.

Before concluding this contribution to the discussion on the subject of central bank independence, I would like to clear some myths or wrong notions often encountered in debates on the subject. One is that prior to Decrees 24 and 25 of 1991, the CBN was under or subservient to the Federal Ministry of Finance. The true position, however, is that the relationship was one of co-ordinate powers. For while the day-to-day management of the Bank was under the direction of the Governor, the Board of Directors whose Chairman was and still is the Governor, had defined powers with respect to the formulation of monetary policy and the administration of the Bank. Furthermore, the relationship between the Minister of Finance and the CBN Board was clearly defined. For instance, the CBN was required by the CBN Act of 1969 to submit its monetary policy proposals to the Minister of Finance for presentation before the Council of Ministers. In the event that the Minister disagreed with the CBN proposals he was required to submit his own proposals side-by-side with those of the CBN unabridged to Government. What greater concept of coordinate powers could there have been than what was manifested by the above statutory arrangement!

The second myth relates to powers of the CBN under the limited autonomy granted in 1989 and confirmed by the CBN Decree No. 24 of 1991. In this connection, opponents of CBN autonomy have alleged that this was the period when the Ways and Means Advances got out of hand and the CBN became unduly powerful and unsupervised! This is a long story, but I shall abridge it by stating that the allegation is unfounded and that, in any case, the antidote to undue reliance on the CBN to finance ever-increasing fiscal deficits is to have a central bank that is sufficiently autonomous and insulated from Executive and political pressures. I should also make the point that although there is an operating clause in the CBN Decree No. 24 of 1991, which appears to confer some element of instrument independence on the CBN by specifying that the total outstanding amount of temporary advances granted to Government should not exceed 12.5% of the estimated Budget revenue, the preamble in Section 8, which gives the President residual powers, has undermined that independence. Further constraints on CBN autonomy were imposed by some sections of the BOFI Decree No 25 of 1991 which provide for prior Presidential approval and thus limit CBN's discretion to act in dealing with terminally distressed banks and errant bank directors and staff.

## CONCLUSION

I would like to conclude this address by stating that the Bank has enormous responsibilities and faces serious challenges. The anguish of central banking in Nigeria over the last decade or so has been the undue and mandatory financing of the entrenched fiscal deficit by the CBN against the Bank's better judgement! It has led to the reintroduction of stabilisation securities for which the CBN has persistently been condemned by all and sundry. While recognising the high opportunity cost of using stabilisation securities, we are left with no viable option to deal with the persistent excess liquidity in the banking system and severely constrained by the lack of a flexible interest rate anchor to make Open Market Operations viable. It must, however, be stated for the records that this Administration has demonstrated both the political will and the discipline to achieve fiscal viability - for instance, the fiscal deficit for the first half of 1995 was the lowest in several years. There are indications that this dawn of fiscal restraint would continue.

Moreover, we also face the daunting task of resolving the deep-seated banking industry distress and restoring confidence to that sector. Here again, this Administration has been consistently supportive if not proactive by putting in place a most robust and comprehensive supervisory intervention framework as evidenced by the liquidation of terminally distressed banks and the stringent law against insider abuses and financial malpractices in banks. This record is unparalleled in the history of banking regulation in Nigeria. I am inclined to believe that we are now on the threshold of a major breakthrough in distress resolution in this country.

In spite of the recent achievements, there is a missing link, namely: a CBN with greater autonomy. Our hope and vision is for a CBN that has instrument independence; freedom to select appropriate instruments for the achievement of its mandate; and which is free from executive or political pressure to act against its better judgement and at the same time is responsive, responsible and accountable. I, of course, recognise that although formal independence is a major condition for better macroeconomic performance, it is not a sufficient condition. The bank must win greater freedom, acceptance, prestige and authority through its track record of credible performance. Above all, it must demonstrate sound technical competence, professionalism and integrity in its actions. This is a challenge that must be met if any meaning is going to be made of independence - formal, operational or *de facto*! I would also stress that the Research Department has a major role to play in determining the amount of influence and respect we enjoy as a Central Bank. At this juncture, I wish to reinforce the case for Central Bank autonomy by quoting Dr. Otmar Issing of the German Bundesbank.

".... in principle, resistance to making the central bank independent always reflects the intention of reserving access to money creation to policy makers. This has never been good for the value of money anywhere. In view of the temptations inherent in the political process, a society can signal its determination to safeguard the stability of money only by choosing the appropriate institutional arrangement. In this context, the independence of the central bank comes top of the list."

On both pragmatic and utilitarian grounds, there is a compelling case for greater CBN autonomy and certainly not less. It is, therefore, our hope that the new epoch of economic liberalism and institutional innovation now prevailing in Nigeria would induce a radical rethinking on the status of the Bank and bring about the desired change for greater autonomy.

Distinguished Ladies and Gentlemen, I commend the vision of the Research and Personnel Departments in initiating this annual series of policy-oriented seminars. This year's edition promises to be particularly stimulating and value-adding given the very topical theme and sub-themes and the array of high profile resource persons being mobilised to handle the various technical sessions. I wish to confirm Management's continued support for this worthwhile initiative in capacity building.

It is now my pleasure and privilege to declare the 3rd CBN Executive Seminar open.

I urge all participants to be actively involved in all aspects of the proceedings of the Seminar to maximise its benefits both to staff and the Bank. As usual, we expect the Seminar Proceedings to be published by the Research Department in good time. I wish all of you a successful and fulfilling occasion.